First Trust
Monday Morning OUTLOOK

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No More Kid Gloves

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Dep. Chief Economist*
Strider Elass – *Senior Economist*

What do the internet and China have in common? For better or for worse, policymakers are no longer treating them with kid gloves. This past week, the Supreme Court reversed a decision made before the dawn of the internet that prevented states from taxing sales to their residents unless the business had a "physical presence" in the state. Now, each state gets to decide whether those sales get taxed.

Some internet retailers took advantage of the old limits on sales taxes to grow huge. In a way, perhaps the limits on sales taxes were one way of helping an "infant industry" get off the ground. But that industry is no longer an infant. Right or wrong, the new rules will re-shuffle the deck on retail sales models. Small "brick-and mortar" businesses that sell goods in their own state will benefit, while those that sell much of their product out-of-state will suffer from the costs of keeping track of tax rates across the country.

In a similar way, we are also seeing the end of "kid glove" treatment with China. As China developed, the US looked the other way as it pirated intellectual property, subsidized its own export-focused industries, and maintained higher tariffs than the US. America even led the charge for China to get into the World Trade Organization.

Until recently, Chinese tariffs on global imports averaged about 9.9%, according to the WTO, while the US average is 3.5%. US tariffs affected only about two-fifths of US imports from China, and those averaged about 6.5%, while China imposed higher tariffs on items imported from the US. In the past year, the US has imported about $540 billion in goods and services from China while China imported just $192 billion in goods and services from the US.

The Trump Administration is signaling an end to the "infant industry" treatment and has proposed tariffs of 25% on $50 billion in imports from China, in addition to recent tariffs on steel and aluminum. The Chinese have retaliated in kind. Now, the Administration is considering an expansion of the tariffs and stricter limits on China's ability to invest in US companies. One key (and justifiable) concern is that China has used various methods to steal hundreds of billions worth of trade secrets and intellectual property, via espionage, counterfeiting, forced disclosures for market entry, and reverse-engineering of products, to name just a few.

One gets the sense the Administration is thinking that, at some point, China ***can't*** retaliate because it'll run out of items to tariff well before the US does. That's the downside of China's massive trade surplus.

One thing to keep in mind is that an extra 25% tariff on all imports from China would cost consumers $135 billion, assuming no change in behavior. That's 0.7% of GDP. Not a trivial sum – and not good for the US economy - but unlikely, on its own, to cause a recession. Of greater concern is that a true trade war could harm the global supply chain and disrupt the efficient allocation of corporate capital around the world. This could put some companies that depend on Chinese affiliation in financial danger, possibly enough to strain the financial institutions that support them.

Some worry that fewer Chinese exports to America would reduce dollar flows to China, reducing their ability to buy bonds, or force a large reduction in China's $1.2 trillion of Treasury holdings. But China has increased its stock of Treasuries by about $90 billion in the past year, and bond yields have fallen recently as trade tensions have grown. The bond market doesn't seem worried.

We'd much rather live in a world where China already had lower tariffs on the US, similar to our historical tariffs on China (before the current spat). And please know we are against higher tariffs on principle. Unfortunately, other strategies haven't worked, and now the kid gloves are off. Let's give it a little while and see if it works.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-25 / 9:00 am	New Home Sales – May	0.667 Mil	**0.664 Mil**	0.689	0.646 Mil
6-27 / 7:30 am	Durable Goods – May	-1.0%	**-2.0%**		-1.6%
7:30 am	Durable Goods (Ex-Trans) – May	+0.5%	**+0.2%**		+0.9%
6-28 / 7:30 am	Initial Claims - Jun 23	220K	**220K**		218K
7:30 am	Q1 GDP Final Report	2.2%	**2.2%**		2.2%
7:30 am	Q1 GDP Chain Price Index	1.9%	**1.9%**		1.9%
6-29 / 7:30 am	Personal Income – May	+0.4%	**+0.4%**		+0.3%
7:30 am	Personal Spending – May	+0.4%	**+0.4%**		+0.6%
8:45 am	Chicago PMI - Jun	60.0	**60.8**		62.7
9:00 am	U. Mich Consumer Sentiment- Jun	99.1	**99.3**		99.3