TRADE WARS: PRICE OPTIMISM AHEAD FOR METALS?

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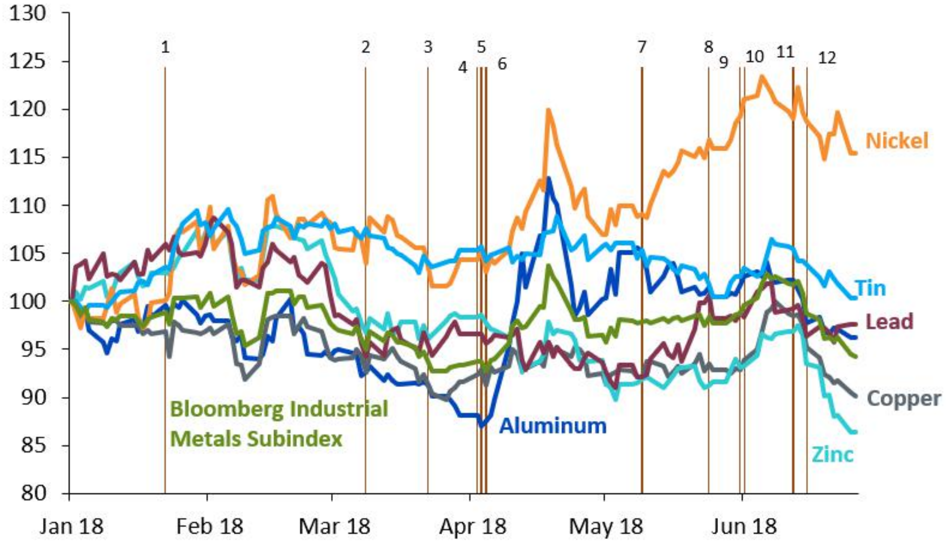
The US appears to want to wage a trade war with the rest of the world. Although some countries are retaliating, we don't expect most countries to drag themselves down the protectionist route. While global trade maybe damaged, the knock-on impact on global economic growth is likely to be small. Thus, aggregate global demand for commodities is unlikely to fall because of the protectionist policies from the US. Rather, supply chains are likely to be severely disrupted and prices of the commodities are likely to rise as a result of their increasing scarcity in destination markets.

US issues bilateral tariffs

In March 2018 the US announced it will place tariffs on US$50bn of Chinese imports, and shortly afterwards declared a world-wide tariff on steel and aluminium imports under the guise of national security concerns. The US has launched a national security investigation into car and truck imports that could lead to the application of similar tariffs on autos. The initial knee-jerk reaction from commodity markets were for prices to decline. But upon assessment, the likely disruption to supply chains drove prices higher.

Figure 1: Base metal price year-to-date (Index = 100 01/01/2018)



Key

1. US tariffs on solar panels and washing machines
2. Aluminium and steel tariffs announced
3. Temporary suspension of steel and aluminium tariffs on Canada, Mexico, EU

4. China announced tariffs on US goods including pork
5. US published list of Chinese goods that will have tariffs
6. China announced tariffs on additional US goods including soy beans
7. China cancels all soybean orders
8. US launches investigation into car imports
9. Temporary suspension of steel and aluminium tariffs on Canada, Mexico, EU expires
10. Canada announces list of retaliatory tariffs against US
11. EU announces list of retaliatory tariffs against US
12. US releases list of Chinese goods that will face a tariff starting July 6th

Note: above list is not exhaustive, just illustrative of key tariff-related announcements.

Source: Bloomberg, WisdomTree, data available as of close 27 June 2018.

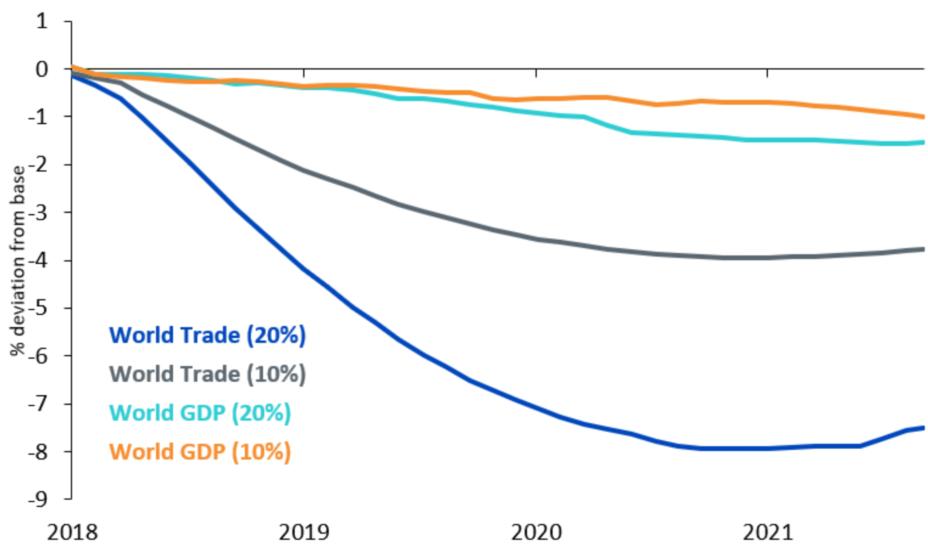
You cannot invest directly in an index. Historical performance is not an indication of future performance and any investments may go down in value.

When the tariffs on China were confirmed in June (it took some time to detail which goods would be affected), prices fell again. We believe that commodity prices are going through the same motions they did in March. Sentiment is driving price rather than the fundamentals. For a fairly contained economic growth impact, the disruption to supply chains is far greater. Just as we experienced in April, a bounce-back in prices is potentially due.

Economic impact

For the purpose of illustration, we looked at some scenarios generated by Bloomberg. In these scenarios, rather than detailing specific micro bilateral tariffs, it is assumed that the US applies a 10% tariff on all imports across all countries and other countries retaliate with reciprocal tariffs. While the cumulative decline in global trade by 2021 would be more than 7% from a base case scenario (of no tariffs), the cumulative decline in world GDP would be less than 1% over that period. To be clear, the policies announced so far do not come close to a 10% across-the-board tariff. The impact of policies announced so far comes close to zero.

Figure 2: Bilateral tariffs simulation: cost to world GDP and trade

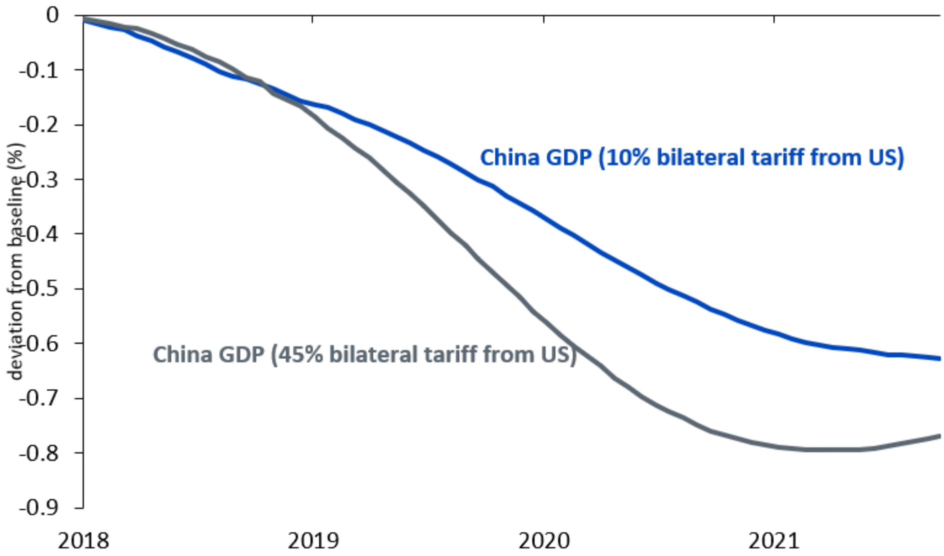


Source: Bloomberg Economics, WisdomTree, data available as of close 20 June 2018.

Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.

Even the impact on China's GDP, which is the target for a large part of US's policy, is likely to be less than a cumulative 1% by 2021 even with a more punitive tariff of 45%.

Figure 3: China GDP simulation relative to baseline with 10% and 45% tariffs



Source: Bloomberg Economics, WisdomTree, data available as of close 20 June 2018.

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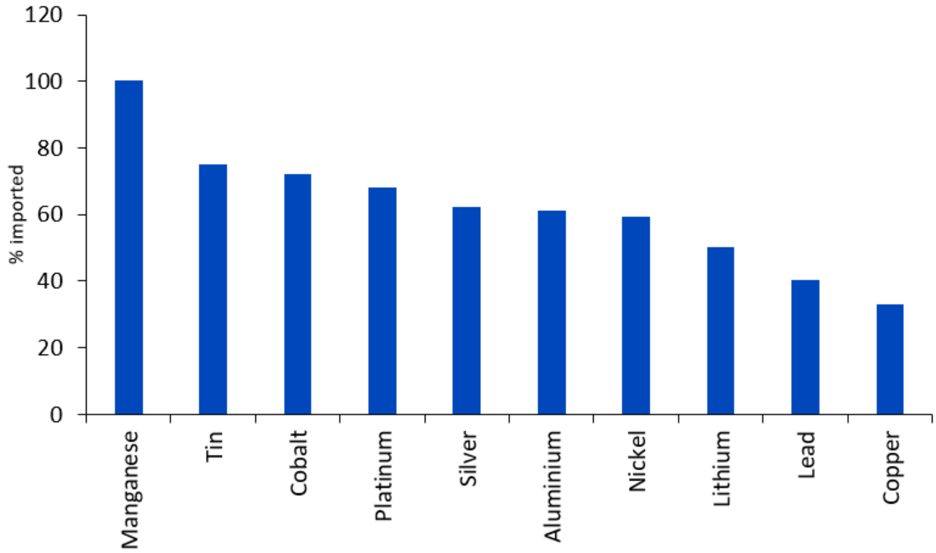
Supply chains

Bearing in mind that the damage to global economic output is likely to be small, let's turn to supply chains. The US is highly reliant on imports of many base metals. Manufacturing companies in the US will either have to pay more for imports or find domestic sources of the metals. Take aluminium for example: while the headline figures look like US only utilises 37% of its aluminium production capacity (so theoretically it could ramp up production), the country does not have any bauxite mines (the key ingredient for aluminium manufacturing) and imports almost all of it. Countries who want to retaliate can easily identify this Achilles heel.

While it is beyond the scope of this blog to analyse all supply chains, we believe there will be many traded commodities that are likely to face supply disruptions. Hence, we believe that most metal prices are likely to rise.

Figure 4: US import reliance



Source: USGS 2018 Mineral Commodity Summaries, WisdomTree, data available as of close 25 June 2018.

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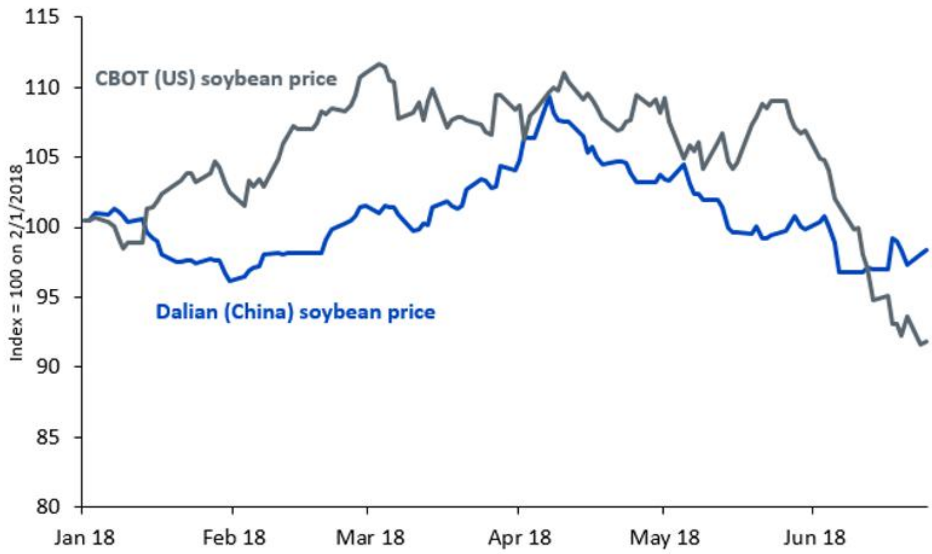
Agricultural commodities

While we are price optimistic on metals, we are pessimistic on many agricultural commodities (at least those traded on US exchanges). One source of retaliation on the US is via tariffs on agricultural exports. The impact of that is greater cost or scarcity in importing countries like China or Mexico, but that could prove to be price negative for the US where most of the liquid international futures contracts exist. We have already seen price divergence between Chicago Board of Trade (CBOT) and Dalian exchange prices.

Figure 5: US and China soybean prices appearing to decouple amid China retaliation threats



Source: Bloomberg, WisdomTree, data available as of close 26 June 2018.

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Conclusion

We believe that for internationally traded futures contracts in metals, the price impact of the burgeoning trade war will be positive as disruptions to supply chains outweigh the negative economic growth effect. Given that the US is a big exporter of agriculture and the large, international liquid futures contracts are based in the US, the retaliatory impact of trade wars is likely to be price negative for agriculture.

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