



## China tariff escalation—shades of April, but key differences

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- China's new export control regime for rare earths marks a new chapter in the strategic competition between the United States and China, a competition that extends beyond the military, financial and political spheres to control of critical materials and technology leadership.
- Near-term tactical considerations may have influenced the timing of China's announcement, as new trade talks with the U.S. are reportedly scheduled on the sidelines of the international monetary fund (IMF) meetings this week and for later this month in Germany. Hence China may have announced these measures to increase leverage ahead of talks.
- The Trump administration has responded with an additional 100 percent tariff on Chinese goods, to take effect on November 1. If implemented, these tariffs would materially weaken the U.S. growth outlook.

Last week, China announced a new, comprehensive export control regime for rare earths and related products. The regime expands on earlier export restrictions for rare earths, and is similar in intent and reach to the United States' own export control regime, which has been used to block direct and third- country semiconductor-related exports to China.

Under China's new policy, foreign entities must obtain a Chinese export license if they manufacture abroad or re-export any items that contain over 0.1 percent of Chinese-origin rare earths, or are produced using Chinese rare earth technologies. Crucially, the licensing requirement now applies to magnets produced anywhere in the world with Chinese rare earths that meet the minimum content threshold.<sup>1</sup> Rare earth-derived magnets are far stronger than conventional magnets and play an important role in a vast array of products, including vehicles, wind turbines, medical imaging devices, electronics, and products in the aerospace and defense sectors. Chinese authorities are likely to reject licensing requests where exports are destined for military use. Dual-use exports would face more uncertain prospects, while exports for strictly commercial use would likely be granted a license, though quantity restrictions are a distinct possibility. In this regard, it is worth noting that rare earths are used in semiconductor manufacturing equipment, and rare earth-derived magnets are also used extensively in equipment for artificial intelligence (AI) data centers. Hence, any limits on availability could slow the unfolding AI investment boom and negatively impact U.S. AI competitiveness over time.

This new export control regime creates significant uncertainty for global users of rare earths and magnets given China's dominant position in rare earth mining, processing and magnet manufacturing.<sup>2</sup> But the announcement largely flew under the radar of market participants until last Friday, when President Trump called it "an extraordinarily aggressive position" in a social media post and announced retaliation in the form of new export controls on critical software as well as a 100 percentage point increase in the existing tariff rate on Chinese imports, effective November 1.

It is challenging to identify the exact motivation for China's new export control regime. At a high level, it may simply be another move in the ongoing strategic competition between the United States and China. The fact that the regime bears similarities to the United States' export control regime for semiconductors suggests as much, though it should be noted that China's new regime is not U.S.-specific; all foreign entities must seek a Chinese export license for rare earths and related magnets. Another possibility is that China announced this measure to increase leverage ahead of upcoming trade talks with the U.S., which will cover tariffs but also the export control regimes of both countries. In this regard, it should be noted that just last month, the Commerce Department announced an interim final rule that expanded the types of entities subject to export controls for AI semiconductors and manufacturing technologies to include affiliates and partly-owned subsidiaries of Chinese firms and government bodies.

The administration's intention to significantly increase tariffs on Chinese imports is reminiscent of developments last April, in terms of the immediate market reaction and economic implications. At the height of the spring-time trade war, when announced tariffs on China reached 145 percent, we marked down our 2025 U.S. growth forecast to just half a percentage point and saw close to a 50 percent probability of a recession. We subsequently raised our growth forecast to 1.5 percent as the U.S.

twice delayed implementation and struck trade deals with other trade partners, and full-year growth is now tracking somewhat higher than that upwardly-revised estimate. Should the new 100 percent additional tariff rate go into effect, we would need to materially lower our growth forecast at least through the first half of next year. It is worth noting that in contrast to the start of the trade war, the U.S. economy is currently in a more delicate state; although we have been expecting an improvement in growth next year, we are also anticipating a weak fourth quarter as the August reciprocal tariffs make their way through the economy and inventories of imports purchased ahead of tariffs run low. The government shutdown will also weigh on near-term growth the longer it drags on, while the housing market is not showing any meaningful signs of recovery. Growth has largely been driven by the AI investment boom and a resilient consumer benefiting from strong equity-driven wealth gains; at least the last of these two drivers would likely falter if these new tariffs come into effect.

As for the immediate market reaction, last Friday saw a sharp 2.7 percent decline in the S&P 500 Index, more than a half a percentage point fall in the DXY dollar Index, wider credit spreads and a roughly ten basis point fall in yields across the Treasury curve - a classic risk-off pattern reminiscent of the immediate market reaction to the announcement of reciprocal tariffs last April. If the administration follows through with additional China tariffs, these risk-off moves could extend, especially with stocks trading near all-time highs. Still, there are some potential differences from the April market reaction. Notably, these tariffs, while potentially prohibitive of trade, are aimed only at China and are framed as a response to a perceived provocation. In contrast, in April investors were still adjusting to a new reality of broad-based protectionist trade policies, including against U.S. allies. This more targeted tariff threat suggests less impact on the dollar, especially given more neutral hedge fund positioning and significant hedging of dollar exposure by institutional investors in recent months.

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1. Licensing requirements and export controls for rare earth items and technologies take effect immediately. Extraterritorial controls such as licensing requirements for foreign-produced items containing Chinese-origin rare earth elements will come into effect on December 1.

2. According to the Financial Times, China controls 70 percent of global rare earth mining, 90 percent of global processing capabilities, and close to 95 percent of magnet manufacturing. Approximately 70 percent of all U.S. rare earth imports come from China.

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