

April 15, 2025

Tariff Turbulence: Lessons from History

What's the Point?

The world is in the midst of significant economic and geopolitical uncertainty. Frequent changes have been seen in 'reciprocal tariffs' presented by the US on April 2, including a pause for the rest of the world, while China tariffs escalate – last upto 145% (with an exception for electronic goods). Multiple objectives have been stated by the US, such as rebalancing trade flows, raising revenue from tariffs, among others. While the outcomes from the current tariff war remain uncertain, trade related conflicts have been witnessed at multiple points in history, for at least the last 1,000 years. We review some: Byzantine-Bulgarian war, Chola conquest of Srivijaya, Opium War, Smoot-Hawley Tariff Act, and the Plaza Accord. Tariff wars have led to a mix of outcomes – from escalation towards military conflict, to treaties being formed after mutual economic pain. With the current tariff war again taking primarily a US-China angle, India potentially stands to benefit in the changing economic order.

Tariff Turbulence / Trade Wars: History doesn't repeat, but it does rhyme

Chart 1: US Tariffs were below 10% since the introduction of global treaties in 1940s

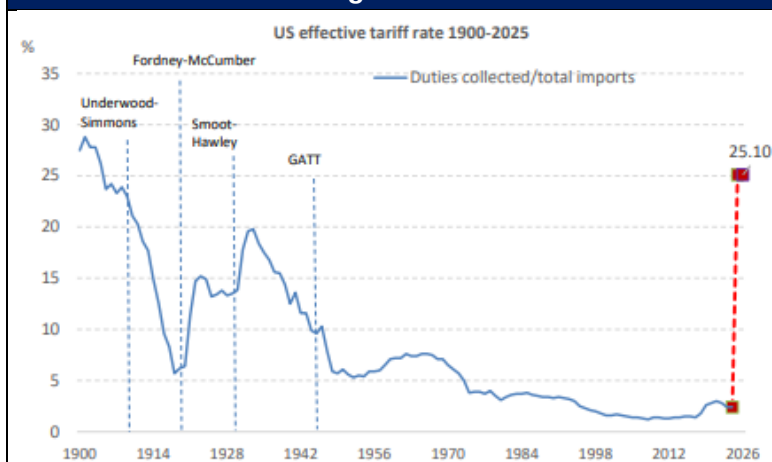
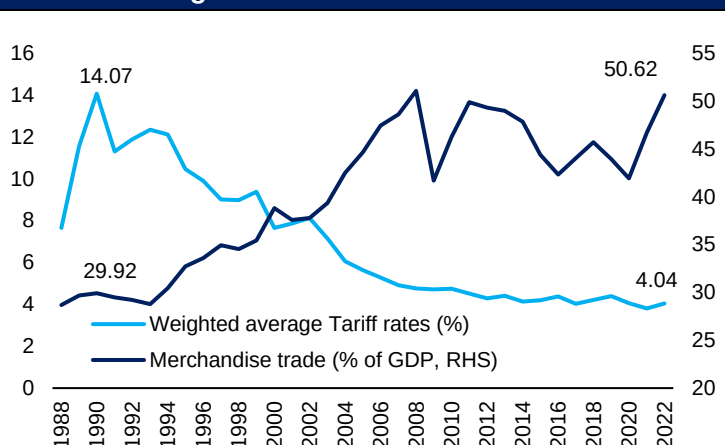


Chart 2: Global trade dependence saw a significant increase along with lower tariffs. This trend is at risk.



Source: UBS, World Integrated Trade Solution by WTO. Chart estimates Tariff rates according to the first round of 'reciprocal' tariffs, not accounting for the pause or tariffs imposed later on China. GATT: General Agreement on Tariffs and Trade, a multilateral agreement signed in 1947

Review of Some Tariff Wars to understand Outcomes

Trade is an extremely complex subject, yet is extremely crucial. As we potentially look at a US-World / US-China Tariff war, we review some similar instances in World and Indian history below:

1. Byzantine–Bulgarian War of 894–896

One of the oldest recorded trade related conflicts, this conflict emerged from the Byzantine empire attempting to shift the Bulgarian market in its territory in 894AD, in what was perceived to be harmful to Bulgarian interests and against a treaty signed in 716AD. This led to an armed conflict between the two empires, with the Bulgarians emerging victorious. The Bulgarian market was restored as an outcome of the conflict, and peace treaty signed.

2. Chola Conquest of Srivijaya (1025AD)

An early example of trade motivated conflicts in Indian history, the Chola dynasty invaded Srivijaya (in modern day Indonesia) to dominate South East Asian trade routes. According to current understanding of facts, Srivijaya was a major maritime power, exercising significant control over the Strait of Malacca and the Sunda Strait. Historians have suggested that the conquest of Srivijaya may have arisen from Srivijayan attempts to block Chola trade in the region.

3. Opium War of 19th Century

In the 1830s, China tried to curb imports of opium by British merchants, which were causing social disruption and widespread addiction. In response, it faced British military retaliation, and ultimately had to sign the Treaty of Nanking, which ended the conflict by ceding Hong Kong to Britain and opening Chinese ports to British trade.

4. Smoot-Hawley Tariff Act (1930) by the US

In an attempt to protect domestic farmers and businesses during the Great Depression, the US enacted laws that raised import tariffs by about 20%. It triggered retaliatory tariffs from more than 20 countries, and led to a compression of global trade by about 66%, only worsening the economic pain from the depression. It was eventually countered by the Reciprocal Trade Agreements Act of 1934, which reduced tariffs and aided in restoration of global trade.

5. Events leading up to the Plaza Accord of 1960

In the 1980s, the US felt important to address trade imbalances against its major trading partners. To *prevent* an escalation by way of Tariffs, the US and major trading partner countries (G5) agreed to coordinate currency interventions to depreciate the dollar by almost 50%. The essence of the plan was that the main current account surplus countries (Japan and Germany) would boost domestic demand and appreciate their currencies. This was backed by coordinated currency market intervention and a steady reduction in U.S. short-term rates. Accordingly, it triggered an exceptionally large appreciation of the yen, amounting to 46% against the dollar and 30% in real effective terms by the end of 1986. Interestingly, the Japanese counter to this economic setback was significant policy support to the economy, which in part created the Japanese Asset Price Bubble.

India and the Current Trade Turbulence

As mentioned last week, India's goods exports to the US account for ~2% of GDP, significantly lower than some Asian countries such as Vietnam (26%). Although several trade issues between the US and India remain unresolved, the reciprocal tariffs imposed on India are relatively lower compared to key peers. In fact, in the medium term India has an opportunity to capitalise on a potential reset in the global trade ecosystem. India holds a cost advantage over key global peers especially in labour-intensive industries. India's current global export share in merchandise trade is a fraction of China's, and even a small shift could be a game-changer. Since the US-China trade war of 2018, the China+1 theme has been in vogue, providing India with the opportunity to become a larger exporter of goods.

Conclusion

As seen in the above examples, trade wars take complex shapes, and result in a wide variety of outcomes, such as trade treaties, military conflict, currency devaluations and more. In the current instance, while the possibility of a direct military conflict remains low, economic issues could continue to create disturbances in financial markets. While the US initiated with 'reciprocal' tariffs on almost the entire world, it has delayed their implementation, except against China which saw larger tariffs being imposed. Even on China, there have been certain carve-outs made for import of electronic goods. India remains in a relatively insulated position.

While investors can continue to expect equity market volatility, maintaining the appropriate Asset Allocation through volatility remains important. We have covered in multiple notes, how missing the best 20/30 days in your investment journey can have a significant negative impact on portfolios. Investors may consider investing in the **HDFC Asset Allocator Fund of Funds**, which dynamically manages allocation *across* asset classes and *within* each asset class. Within Equity, allocation is managed across different market caps, and within debt, allocation is managed across different durations / themes.

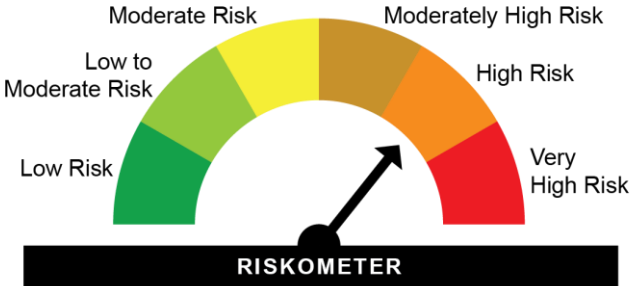
Sources: UBS, Bloomberg, and other publicly available information

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