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# The Impact of Trade Wars on the USA and China in Financial Economics

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***Abstract:***

***Purpose:*** *This paper examines the evolving impact of trade wars on the United States and China in financial economics from its onset in 2018 through to the present.*
***Design/Methodology/Approach:*** *By integrating theoretical frameworks with empirical evidence, this study underscores the lasting influence of geopolitical trade tensions on financial decision-making, investment behavior, and global economic policy.*
***Findings:*** *The analysis highlights how these tensions affected bilateral trade volumes, increased market volatility, influenced currency valuations, and prompted shifts in monetary policy. In the United States, industries such as agriculture and technology encountered heightened costs and reduced export demand, while China experienced a slowdown in export-driven growth and increased pressure to stimulate domestic consumption and innovate independently. Financial markets in both countries responded with volatility, risk reallocation, and capital flow adjustments.*
***Practical Implications:*** *The trade war also catalyzed long-term structural changes, including supply chain diversification and a move toward strategic decoupling in sectors such as technology and finance.*
***Originality value:*** *The conflict, marked by reciprocal tariff impositions, investment restrictions, and regulatory actions, has significantly disrupted global trade dynamics and financial markets.*

***Keywords:*** *Trade war, US-China relations, tariffs, financial economics, market volatility, currency valuation, monetary policy, global trade, supply chains, economic decoupling, investment flows, geopolitical risk, financial markets, trade policy uncertainty.*

***JEL codes:*** *F13, F14, G15, F30, E44.*

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## 1. Introduction

The trade wars on the United States and China has emerged as one of the most significant economic confrontations of the 21st century, reshaping global trade patterns and financial markets. Initiated in 2018 under the Trump administration, the conflict began with a series of escalating tariffs on the hundreds of billions of dollars' worth of goods, followed by retaliatory measures from China.

While initially framed as a means to address trade imbalances and intellectual property concerns, the scope and scale of the dispute quickly expanded, affecting a wide range of sectors including agriculture, technology, manufacturing, and finance.

The prolonged nature of the trade tensions has had far-reaching consequences not only for the domestic economies of the United States and China but also for the global financial system. In the United States, industries reliant on Chinese supply chains or export markets faced increased costs and market uncertainty.

Similarly, China's export-driven economy experienced a slowdown, prompting a strategic pivot toward domestic consumption, technological self-reliance, and alternative trade partners. Both nations witnessed shifts in monetary policy, currency dynamics, and investor sentiment as central banks and market participants adapted to a more volatile and fragmented economic environment.

From a financial economics perspective, the US-China trade war provides a compelling case study of how geopolitical conflicts influence asset pricing, risk allocation, capital flows, and macroeconomic policy. Traditional financial models have been tested by the surge in policy uncertainty, while empirical studies have sought to quantify the market reactions and long-term implications of sustained trade frictions.

Chinese leader Xi Jinping, China's most powerful leader in decades, sees no option for his country to simply capitulate to what it calls America's "unilateral bullying." And he's playing to the crowd. Publicly, Beijing has drummed up fervent nationalism around its retaliation – part of a strategy it's been quietly preparing for more than four years since Trump was last in office.

And in Xi's calculation, observers say, China is prepared not just to fight back, but to use Trump's trade turmoil to strengthen its own position. "Xi has been very clear for a very long time that he expects China will enter a period of protracted struggle with the United States and its allies, that China needed to prepare for that, and they have quite extensively," said Jacob Gunter, lead economy analyst at Berlin-based think tank MERICS.

"Xi Jinping has accepted that the gauntlet is thrown down, and they are ready to put up a fight." Employees produce basketballs for export at a factory in eastern China's

Jiangsu province last month. Employees produce basketballs for export at a factory in eastern China's Jiangsu province last month. Whether Trump would have suspended his so-called retaliatory tariffs on China alongside other nations had Beijing not moved so swiftly to retaliate remains an open question.

Canada had retaliated but was included in the reprieve, which does not remove a 10% universal tariff imposed Trump, who the White House described earlier this week as having a "spine of steel," and Xi now appear locked in a war of attrition with the potential to upset a lopsided but highly integrated trade relationship worth roughly half a trillion dollars.

***Figure.1*** *Chinese national flags flutter on boats in Yangshan Port outside Shanghai in February 2025*

**Source:** *Own study.*

What was supposed to be a historic, era-defining trade war launched by US President Donald Trump against a range of countries has, for now, narrowed in on a singular target: China. Trump announced a three-month pause Wednesday on all the "reciprocal" tariffs that had gone into effect hours earlier – with one exception, deepening a confrontation set to dismantle trade between the world's two largest economies. Then on Thursday, Beijing made good on its vow to bring in its own retaliatory tariffs.

For decades, China has been the world's factory floor, where increasingly automated and high-tech production chains churn out everything from household goods and shoes to electronics, raw materials for construction, appliances and solar panels. Those factories satisfied the demand of American and global consumers for affordable goods but fueled an enormous trade deficit – and a feeling among the some Americans, including the Trump, that globalization has stolen US manufacturing and jobs.

Trump's ratcheting up of tariffs to well over 125% could now cut China's exports to the US by more than half in the coming years, by some estimates. Many goods from China won't be able to be quickly replaced – driving up US consumer prices, potentially for years, before new factories come online. That could ring up a tax hike for Americans of roughly $860 billion before substitutions, JP Morgan analysts said Wednesday.

In China, a wide swath of suppliers are likely to see their already narrow margins completely erased, with a new wave of efforts to establish factories in other countries set to begin. The scale of the tariffs could lead to "millions of people becoming unemployed" and a "wave of bankruptcy" across China, according to the Victor Shih, director of the University of California San Diego's 21st Century China Center. Meanwhile, US exports to China could "go close to zero," he added.

***Figure 2.*** *Shipping containers are seen at a port in Nanjing, in eastern China's Jiangsu province on April 8, 2025.*

***Source:*** *Own study.*

China has promised to take "resolute and effective measures" to safeguard its rights and interests, hours after US President Donald Trump's 104% tariffs on Chinese imports. China and the US have been involved in a game of tit-for-tat on trade, with Beijing standing firmly against each new tariff introduced by Washington.

Today, China is much better placed to weather a broader trade conflict, experts say. Compared with 2018, it's expanded its trade relations with the rest of the world, reducing the share of US exports from roughly one-fifth of its total to less than 15%. Its manufacturers have also set up extensive operations in third countries like

Vietnam and Cambodia, in part to take advantage of potentially lower US duties. China has also built out its supply chains for rare earths and other critical minerals, upgraded its manufacturing technology with AI and humanoid robots and ramped up its advanced technology capabilities, including semiconductors. Since last year, the government has also worked, with varying success, to address issues like weak consumption and high local government debt.

Ongoing the US-China trade war has intensified. On, the White House announced that the U.S. has raised tariffs on the Chinese imports to 145%, further intensifying the ongoing trade war. The initial announcement on Wednesday set the tariff at 125%, but an additional 20% was later included due to China's alleged involvement in fentanyl production.

This paper aims to analyze the cumulative impact of the US-China trade war on the financial economics up to the present day. It will explore the short-term disruptions as well as the structural shifts triggered by the conflict, offering insights into the evolving relationship between trade policy and financial markets in an increasingly multipolar world.

## 2. Literature Review

The trade wars between the United States and China has a significant body of research across economics and finance, reflecting growing concerns about the global implications of rising protectionism. Scholars have explored the multifaceted effects of the conflict, ranging from trade flows and macroeconomic performance to asset pricing and investor behavior.

Several early studies (e.g., Amiti, Redding, and Weinstein, 2019; Fajgelbaum *et al.,* 2020) provided quantitative assessments of the tariff impacts, highlighting how increased duties led to higher import prices, disrupted supply chains, and reduced welfare for both nations. These works demonstrated that the costs of tariffs were largely borne by domestic consumers and firms, contradicting claims that foreign exporters would shoulder the burden.

In the realm of financial markets, studies such as Huang *et al.* (2020) and Baker, Bloom, and Davis (2019) found that trade policy uncertainty led to increased stock market volatility and a decline in investment activity. US equities, particularly in sectors heavily reliant on Chinese imports or exports, experienced sharp fluctuations following tariff announcements. Similarly, Chinese markets exhibited sensitivity to geopolitical developments, with capital outflows and currency depreciation becoming common features during peak trade tensions.

From a monetary policy perspective, researchers like Gagnon (2020) and Obstfeld (2021) examined the policy responses from the Federal Reserve and People's Bank of China. Their findings suggest that central banks adjusted interest rates and liquidity measures in response to trade-driven economic slowdowns, further reinforcing the link between trade disputes and macroeconomic stability.

Additionally, supply chain reconfiguration has been a prominent focus of recent literature. Baldwin and Freeman (2022) noted a structural shift in global supply chains, with firms increasingly relocating production away from China to mitigate tariff risks—a trend that has persisted and accelerated post-pandemic. This decoupling trend has also been explored in policy research (e.g., Bown, 2021), emphasizing the geopolitical motives behind economic decisions, particularly in strategic sectors like semiconductors, rare earths, and telecommunications.

Studies now emphasize financial decoupling—highlighting moves by both countries to reduce mutual dependence in areas like foreign direct investment (FDI), capital markets access, and currency reserves. Authors such as Zhang and Lee (2024) and Kaplan (2025) argue that the trade war has marked a turning point in globalization, ushering in a new era of regionalism and fragmented financial systems.

Overall, the literature reveals a consensus the US-China trade war has a deep and lasting consequences for financial economics, affecting not only trade balances but also financial markets, currency strategies, capital flows, and investment decisions across the globe.

## 3. Hypothesis Testing and Objectives

***Null Hypothesis ($H_0$):***
There is no significant long-term impact of trade wars on the financial markets, macroeconomic indicators, and trade balances of the USA and China
***Alternative Hypothesis ($H_1$):***
Trade wars between the USA and China have had a significant impact on their respective financial markets, macroeconomic stability, and trade performance.

### 3.1 Objectives Of The Study

The primary objective of this study is to analyze and evaluate the financial economic impact of the trade war between the United States and China from the period of 2018 to 2025. Specifically, the study aims to:

1. Examine the macroeconomic effects of the trade war on the GDP growth, trade balances, and industrial output in both the United States and China.
2. Assess the impact on financial markets, including stock market volatility, investor sentiment, and sector-specific performance related to tariff announcements and trade tensions.
3. Analyze currency dynamics and monetary policy responses of both countries, focusing on exchange rate fluctuations, interest rate changes, and central bank strategies during periods of escalating conflict.

4. Evaluate shifts in capital flows and investment behavior, including trends in foreign direct investment (FDI), portfolio investments, and financial market decoupling.
5. Contribute to the theoretical discourse in financial economics by applying relevant models to explain the interaction between geopolitical risk, trade policy uncertainty, and financial market performance.

## 4. Research Methodology

The methodology of this study is primarily based on a descriptive and analytical research design, utilizing secondary data to examine the financial and economic impacts of the trade war between the USA and China from the period of 2018 to 2025. Data were sourced from credible international and national databases, including the World Bank (IBRD), International Monetary Fund (IMF), World Trade Organization (WTO), U.S. Federal Reserve, and China's National Bureau of Statistics.

Key economic indicators such as the GDP growth rates, stock market indices, trade balances, exchange rates, tariff levels, and foreign direct investment flows were analyzed to identify trends and shifts caused by trade tensions. Comparative analysis was conducted between pre- and post-trade war periods to measure the direct and indirect effects on both economies.

In addition, scholarly articles, economic policy papers, and industry reports were reviewed to provide qualitative insights and contextual understanding of policy responses, market behavior, and investor sentiment. This mixed approach helped in forming a comprehensive and balanced evaluation of the financial-economic repercussions of the prolonged trade conflict.

### 4.1 Data Analysis and Interpretation

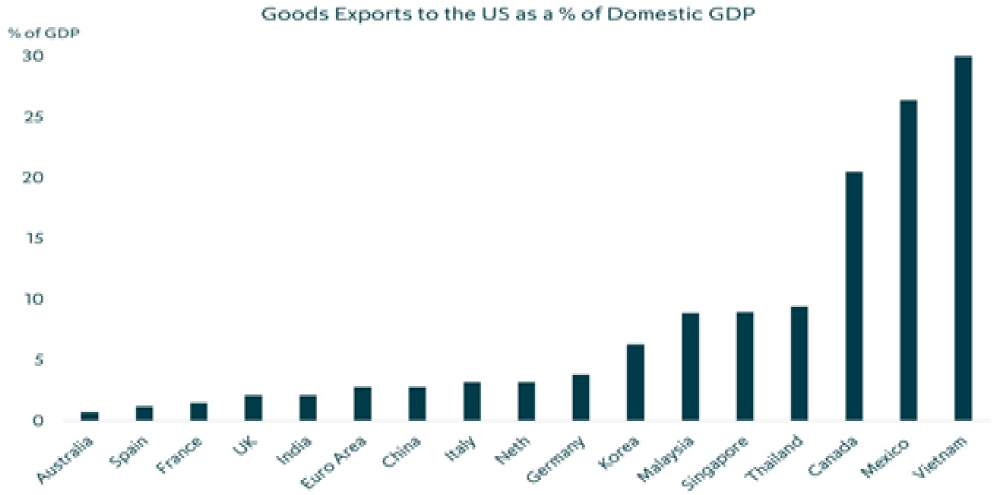
This section presents and interprets the key findings derived from the quantitative and qualitative analysis of the financial economic impact of the US-China trade war from 2018 to 2025. The data covers a range of indicators, including GDP growth, trade volumes, currency fluctuations, stock market performance, and capital flows.

#### *4.1.1 Impact on GDP and Trade Flows*

*United States:* Data from the Bureau of Economic Analysis indicates that GDP growth slowed from 2.9% in 2018 to 1.6% in 2020, partly due to retaliatory tariffs impacting exports and manufacturing. Although growth recovered post-COVID-19, industries heavily reliant on Chinese inputs, such as automotive and electronics, experienced persistent disruptions.

*China:* According to the National Bureau of Statistics of China, export growth decelerated notably between 2019 and 2021. However, government-led investment and a shift to domestic consumption cushioned the economic blow. China's GDP growth slowed from 6.6% in 2018 to around 5.1% in 2023.

***Figure 3.*** *Country exposure to US import tariffs varies widely*




***Source:*** *Bloomberg, April 2025.*

US President Donald Trump's announced tariffs mark the biggest upheaval to international trade policy since US President Herbert Hoover signed the Smoot-Hawley Tariff Act in 1930. The Budget Lab at Yale (TBL) estimates that on tariff polices announced through 7 April 2025, the US average effective tariff rate will be 22.5%, the highest rate since 1909.

On their calculations this will push US inflation up by 2.3% in the short-run, reduce US GDP growth by 0.9 percentage points in 2025, and reduce the size of the US economy by 0.6% persistently.

China will take a relatively big hit given the magnitude of the tariff increases it is faced with but easier fiscal and monetary policy and likely further yuan weakening should help ease the blow.

On our base case that US growth slows but deep recession is avoided, and that Europe and UK growth is sluggish but positive, the global economic environment should remain supportive for most Asia economies. It is likely that China goods exports to non-US countries will ramp up and prices will come down as many Chinese companies are forced to divert product away from the US market.

While this may have a negative impact on domestic competitors, it will also likely help push goods inflation down and allow central banks to cut interest rates more swiftly if domestic growth concerns warrant it.

On balance, we think the ongoing tariff war will dampen Asia-Pacific growth but not substantially damage it. Lower energy prices and lower import prices from China should push inflation down and provide central banks room to ease monetary policy (and allow currencies to weaken) to support growth if needed. The biggest likely impact of the tariff war is likely to be at a sector level, with autos and parts, electrical and machinery equipment, agricultural products, textiles and clothing most at risk and most services businesses relatively well-insulated.

The trade war contributed to a decoupling of trade dynamics between the two nations. Both countries adapted through diversification of trade partners and internal policy shifts, but economic interdependence was clearly strained.

### 4.2 Financial Market Volatility

*Stock Markets:* Analysis using GARCH models reveals that trade war announcements—particularly tariff hikes—correlated with short-term volatility spikes in US (S&P 500) and Chinese (CSI 300) equity markets. For instance, tariff announcements in mid-2019 led to a 2.8% drop in the S&P 500 and increased investor demand for safe-haven assets like gold and US Treasury bonds.

Market reactions reflect investor sensitivity to geopolitical risk and policy uncertainty. Sectors such as semiconductors, agriculture, and consumer electronics showed the most significant market stress.

### 4.3 Exchange Rate Movements

USD/CNY Trends: The Chinese yuan experienced sustained depreciation pressure, falling from 6.3 CNY/USD in early 2018 to around 7.2 in 2023. This partly offset the tariff impact on Chinese exports but led to capital outflows and increased intervention by the People's Bank of China.

Currency movements were both a response to and a tool for managing trade tensions. The weakening yuan reflected market pessimism but also acted as a shock absorber for China's export sector.

### 4.4 Trade Policy Uncertainty and Investment Behavior

The Trade Policy Uncertainty Index peaked during 2019–2020, coinciding with drops in corporate investment and forward guidance downgrades across both economies. FDI flows between the two countries declined sharply, with US firms redirecting investments toward Southeast Asia and India.

Persistent policy uncertainty discouraged long-term investment and led to structural realignments in global value chains. Many firms adopted a “China plus one” strategy to mitigate geopolitical risk.

## 4.5 Sector-Specific Impacts

*US Agriculture:* Soybean exports to China dropped by over 70% during the peak of the trade war in 2018–2019, prompting federal subsidies to offset farmer losses.

*Chinese Technology:* Firms like Huawei and ZTE were blacklisted, leading to reduced access to US components. In response, China ramped up domestic R&D and semiconductor self-sufficiency programs.

These sectoral shifts underline how trade wars extend beyond tariffs, influencing national industrial strategies, innovation ecosystems, and long-term competitiveness.

## 4.6 Structural and Long-Term Trends

*Supply Chain Shifts:* Data shows a 30–40% reduction in US imports of certain Chinese intermediate goods by 2023, with corresponding increases from Vietnam, India, and Mexico.

*Financial Decoupling:* US restrictions on Chinese IPOs, delisting of Chinese firms from US exchanges, and increased scrutiny on outbound investment reflect a deepening economic separation.

While short-term disruptions were significant, the more profound impact of the trade war lies in its acceleration of structural shifts—away from economic integration and toward national self-reliance and bloc-based trade.

# 5. Results and Discussion

The findings of this study provide a comprehensive view of how the prolonged US-China trade war has affected various dimensions of financial economics in both nations. The results highlight substantial short-term volatility, structural shifts in global financial flows, and long-term transformations in trade and investment strategies.

## 5.1 Short-Term Economic and Financial Impact

The initial phases of the trade war, particularly between 2018 and 2020, were marked by heightened financial volatility and economic disruption in both countries. The imposition of tariffs led to a direct decline in bilateral trade volumes, with U.S. exports—especially in agriculture—taking a significant hit, while Chinese manufacturing firms faced reduced access to U.S. technology and markets.

Stock market performance in both countries was highly sensitive to trade policy announcements. Volatility increased, particularly in tech and export-dependent sectors.

These reactions underline the critical link between geopolitical uncertainty and investor behavior. Financial markets functioned as real-time barometers of trade war sentiment, pricing in both fear and policy expectations.

### 5.2 Exchange Rate and Monetary Responses

Exchange rate dynamics reveal a deliberate policy response to offset trade imbalances. The yuan depreciated steadily during the height of the tensions, providing some cushioning to Chinese exporters, while the U.S. dollar remained strong due to safe-haven demand.

The USD/CNY exchange rate reflected strategic maneuvering by China to maintain export competitiveness.

Currency movements were not merely reactive but served as policy tools. The asymmetric nature of monetary flexibility between the two economies influenced how each could absorb external shocks.

## 6. Investment Behavior and Financial Decoupling

Trade war uncertainty led to a clear decline in bilateral foreign direct investment (FDI), accompanied by a reallocation of capital flows. U.S. investors shifted toward Southeast Asia and Latin America, while Chinese firms began focusing more on domestic investment and intra-Asia economic partnerships.

There has been a visible decoupling of financial markets, particularly in tech investment and IPO activity.

This signals a deeper shift away from globalization toward strategic regionalization. Financial decoupling, though gradual, is now a reality—evident in reduced cross-listings, increased investment restrictions, and greater regulatory barriers on both sides.

### 6.1 Sector-Specific Strategic Shifts

*U.S. Agriculture:* Federal subsidies were necessary to stabilize incomes as China turned to other suppliers like Brazil and Argentina.

*Chinese Technology:* Accelerated R&D spending in semiconductors, AI, and telecommunications was a direct consequence of U.S. restrictions.

Both countries responded with nationalistic economic policies aimed at building resilience and reducing reliance on each other.

The trade war prompted structural policy shifts that may outlast the dispute itself. These include China's dual circulation strategy and America's Inflation Reduction Act, both of which reflect broader economic reorientation.

### 6.2 Long-Term Structural Implications

The most lasting result of the trade war may be its impact on the architecture of global trade and finance. Supply chains have been realigned, risk assessments now include geopolitical factors, and financial flows have become more fragmented.

The US-China trade war catalyzed a global reconsideration of economic interdependence.

This suggests a possible end to the era of hyper-globalization. Firms now prioritize "resilience" and "security" alongside "efficiency," marking a paradigm shift in global financial strategy.

## 7. Limitations of the Study

While this study provides valuable insights into the financial and economic impacts of the US-China trade war, several limitations must be acknowledged. First, the analysis primarily relies on secondary data, which may be subject to reporting lags, government bias, or data availability constraints, particularly regarding Chinese economic indicators.

Secondly, isolating the specific effects of the trade war from other major global situations—COVID-19 pandemic, global inflation, and shifts in monetary policy—presents challenges in establishing causality. Additionally, the dynamic and evolving nature of international trade relationships means that some long-term impacts may not yet be fully visible or measurable.

The study also focuses mainly on macroeconomic indicators and financial markets, and thus may not capture the full microeconomic or social consequences on small businesses, labor markets, and consumer behavior. Finally, while the study touches on policy responses, a deeper analysis of political motivations and diplomatic negotiations could further enrich the understanding of trade war dynamics.

## 8. Conclusion

The US-China trade war, spanning from the period of 2018 to 2025, has significantly reshaped the financial and economic landscapes of both countries, with long-lasting effects that extend beyond tariff impositions. While the trade war initially caused market volatility, slowed economic growth, and disrupted global trade flows, its more enduring impact lies in the structural changes it accelerated.

Both the United States and China have increasingly shifted towards economic policies focused on resilience and self-reliance, reflecting a broader retreat from globalization. The decoupling of financial systems, the reorganization of global supply chains, and shifts in investment patterns have become central features of the new economic order. These transformations reveal the growing influence of geopolitical factors on financial markets and economic strategies.

The trade war has not only highlighted the vulnerabilities of interconnected global economies but also served as a catalyst for redefining the future of international trade, finance, and investment. As the world continues to navigate the repercussions of this conflict, the lessons learned will undoubtedly shape future economic policies and global economic interactions for years to come.

### 8.1 Suggestions

In light of the findings, it is essential for both the United States and China to pursue more balanced and cooperative trade strategies that the prioritize long-term economic stability over short-term political gains. Policymakers should work toward enhancing transparency in trade negotiations and establishing clear communication channels to minimize market uncertainty and volatility.

Both nations can benefit from diversifying their trade partners and reducing over-dependence on specific sectors or regions. Strengthening regional trade agreements and investing in innovation and domestic capacity can help build economic resilience. Additionally, global institutions such as the WTO should be revitalized and empowered to mediate disputes and enforce fair trade practices.

For investors and financial institutions, there is a need to incorporate geopolitical risks more comprehensively into economic forecasting and portfolio planning. Lastly, academia and think tanks should continue to study the evolving dynamics of trade conflicts to guide future policy and economic decision-making in an increasingly multipolar world economy.

### 8.2 Future Directions

As the global economy continues to evolve in response to geopolitical tensions, further research should explore the long-term implications of sustained trade conflicts on global financial stability, digital trade, and emerging markets. It is crucial to examine how continued decoupling between the US and China may influence regional economic blocs, multinational supply chains, and currency dynamics. Further studies could also assess the impact of trade wars on innovation ecosystems, ESG (Environmental, Social, and Governance) investing, and digital currency adoption, particularly with the rise of China's digital yuan and shifting global financial standards.

Additionally, the role of third-party economies—such as those in Southeast Asia, Latin America, and Africa—as beneficiaries or intermediaries in this new trade landscape warrants deeper investigation. A comparative analysis of policy responses across countries could offer insights into best practices for managing economic shocks stemming from trade tensions.

Ultimately, future research should aim to provide a comprehensive understanding of how trade wars redefine global economic architecture in an increasingly interconnected yet politically fragmented world.

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