ASIA - TRUMP | 22 JANUARY 2017

ASIA WEIGHS A TRUMP PRESIDENCY

With Mr. Trump officially inaugurated as the 45th President of the United States, the world is now shifting its focus to the implementation of his policies during his first 100 days.

From an Asian investor's point of view, the only significant threat likely to manifest itself within the first 100 days is the potential introduction of tariffs, which the President could theoretically introduce of up to 15%, for up to 150 days from day one[1].

Nevertheless, Asian investors, focusing on the longer term, remain unnerved by Mr. Trump's stance on China's trade and currency policies. Asian concerns have been further fueled by the aggressive tone adopted by both the Secretary of State[2] and Commerce Secretary[3] nominees during their Senate confirmation hearings.

While markets globally are digesting the ramifications of a Trump presidency (apart from US equities which have enthusiastically rallied), Asia has been less impressed. Asia's policy fall-out fears, however, may have been over discounted.

At the legislative level, for example, Mr. Trump may not get all he wants. Although the Republicans swept all three branches of government, control of the Senate is slim (52R-48D)[4]. This means issues on trade, international relations and the budget will need to be approved by a combination of drifting Democrats and stoic Republicans… and the Democrats know that. Moreover, the differing opinions of key individuals within Mr. Trump's proposed cabinet may result in a more moderate outcome[5].

Paramount to Asia is a potential US-China trade stand-off. Many Asian investors fear that Mr. Trump's "America First" policies appear too protectionist. In contrast, China's leader, Mr. Xi Jinping, positioned China as a champion of free trade at last week's Davos forum[6]. Complicating the picture, at the same forum, Anthony Scaramucci, Mr. Trump's newly appointed public liaison official, took great pains to explain that Mr. Trump was not against free trade per se, but against "asymmetrical" trade[7] (i.e. trade agreements that disadvantage the US).

At the time of writing, the Trump administration is already starting the process of withdrawing from the Trans-Pacific Partnership. There are also plans to renegotiate the North Atlantic Free Trade Agreement.

THERE ARE CLEARLY MANY MOVING PARTS. UNTIL BRINKSMANSHIP AND RHETORIC FIND A MIDDLE GROUND, EVERYTHING IS UP FOR NEGOTIATION.

The outcome may be less severe than Asian investors fear particularly given the evolving nature of Asian growth, which has been increasingly driven by rising domestic demand over the past decade.

ASEAN exports to the US, for example, have fallen as a percentage of GDP since 2000[8]. In addition, China's policy switch from investment and export led expansion towards domestically generated growth has already resulted in exports falling as a percentage of GDP[9,10]. On balance, the trade-war bark could be worse than its bite.

Interwoven with trade is uncertainty surrounding the US' strong dollar policy of the last two decades, which Mr. Trump's election rhetoric suggests he will abandon[11].

This possibility was further amplified last week as Mr. Scaramucci concurred at Davos[12]. But, in another "clarification", nominee for Treasury Secretary, Steven Mnuchin, maintained that a strong currency is strategically important if the US is to remain a favoured investment destination[13]. A further instance of "everything up for negotiation", it seems.

Missing in the discussion so far, is the "real" impact of "real" capital flows that could result from Mr. Trump's policies. The US' Twin Deficits[14] (Fig.1.), for example, suggest that the dollar is already peaking, particularly if Mr. Trump implements his spending plans in full. In this instance, the impact of the resulting rise of liquidity may outstrip the impact of rising interest rates.

From "Corporate Asia's" point of view, US dollar fears could also prove unfounded. Locally denominated debt, for example, comprises the larger portion of Asia's non-bank company debt[15]. In addition, the moderate rise in the net debt to equity ratio signals that rising debt reflects improving business conditions rather than leverage trouble[16]. The composition of Asian listed company sales to their domestic markets (Fig.2.) also highlights that "Corporate Asia's" exposure to the greenback varies widely.

One can easily conclude that Asian investors have built an excessive buffer of fear. This situation could change quickly; a political gridlock, recognition of Asia's changing growth drivers and a weaker than expected dollar could conspire to alleviate the current fears restraining Asian markets.

If these fears do indeed prove to be exaggerated during Mr. Trump's first 100 days, Asia's low valuations[17] have plenty of head-room to make up.

Fig.1. US' Twin Deficits suggest the USD is peaking

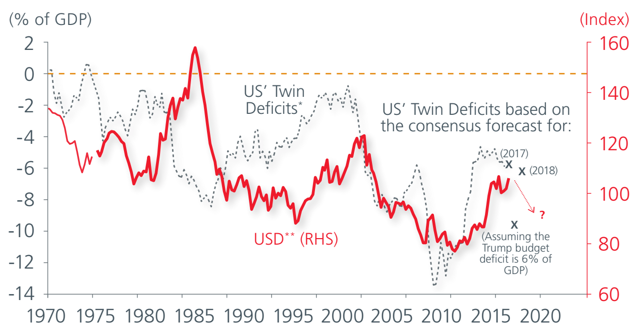
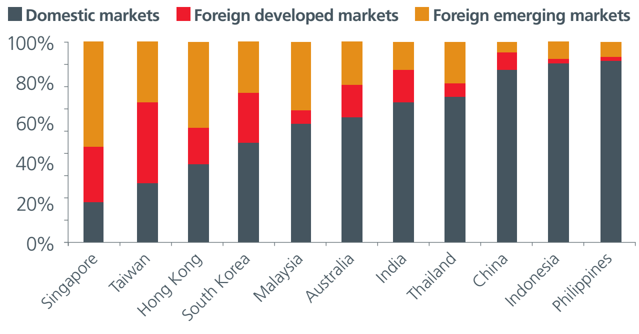


Fig.2. Most corporate sales are to the home market



References [1]US Trade Act of 1974, Section 122. Authorization trigger: Large and serious US balance of payments deficit. Presidential powers: Impose tariffs up to 15 percent, or quantitative restrictions, or both for up to 150 days against one or more countries with large balance of payments surpluses. [2]Recap of Rex Tillerson's Senate confirmation hearing for secretary of state, Politifact, 12 January 2017. [3]Ross escalates Trump trade criticism against Beijing, Financial Times, 19 January 2017. [4]The Democratic Party gained two seats in 2016 US Elections, resulting in a 52-48 majority for Republicans. The two independent members of the Senate are included in the Democratic totals, as they caucus with Democrats. [5]Clash of views in Trump cabinet sets stage for policy confusion, Financial Times, 19 January 2017. [6]Xi Jinping signals China will champion free trade if Trump builds barriers, The Guardian, 18 January 2017 [7]Donald Trump is committed to globalisation, Davos told, Financial Times, 17 January 2017 [8]ASEAN Secretariat, Table 21: Top ten export markets and import origins, % of total exports. 2000 @ 20.1%, 2015 @ 10.9%, 2020est @ 8.5%, November 2016. Note: While exports as percentage of GDP of Singapore and Thailand, (and Hong Hong for that matter) have remained broadly stable, the dependency has fallen in other ASEAN economies. [9]A truer picture of China's export machine, Mckinsey Quarterly, September 2010. [10]Thomson Reuters Datastream, 30 September 2016. [11]Dollar retreats on Trump's concern over currency's strength, Financial Times, 17 January 2017. [12]Davos 2017: Trump's Scaramucci warns over dollar strength, Financial Times, 17 January 2017. [13]Mnuchin reasserts support for strong dollar, Financial Times, 20 January 2017. [14]FRBSF Economic Letter, Understanding the Twin Deficits: New Approaches, New Results, Cavallo, Number 2005-16, July 2005. [15]Institute of International Finance, EM Debt Monitor March 2016. US dollar debt accounts for only 28% of total debt. In 2015, emerging market non-financial debt rose 6½ percentage points to circa 100% of GDP, (which compares with 87% for developed economies). Within Asia, China and Malaysia comprised most of the rise. The bulk of the rise was in local currencies with foreign debt, particularly US debt being repaid. This US debt reduction was pronounced in China (where debt fell by USD70bn in H2, 2015). [16]Asia leverage – After the boom, Standard Chartered, March 2016. [17]Price to book of MSCI Asia Pacific ex Japan @ 1.5x, MSCI World @ 2.2x, MSCI US @ 2.9x. Bloomberg, 31 December 2016.

Fig.1. US Bureau of Statistics and the US Federal Reserve Board from Datastream as at 20 January, 2017 and Consensus Economics Inc. as at 9 January, 2017. *The US budget and current account deficits as a percentage of forecast nominal GDP. **The nominal effective exchange rate.
Fig.2. Global Exposure Guide, Morgan Stanley Research, 22 May 2016. Around 28% of Asian corporate sales are in US dollars.

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