GEOSTRATEGIC ANALYSIS

China | Trump, tariffs and tensions

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Donald Trump will be inaugurated as 45th President of the United States today. During his campaign, he pledged to label China a "currency manipulator" and impose a 45% tariff on Chinese imports during his first day in office. While the likelihood of this scenario remains low, a number of factors point towards a more protectionist agenda under Trump. Together, these have contributed towards a deterioration in US-China relations. Intensifying risk-off modes in the context of rising rates in the US could trigger flows out of EM asset classes, spelling trouble for Asian EM economies going forward.

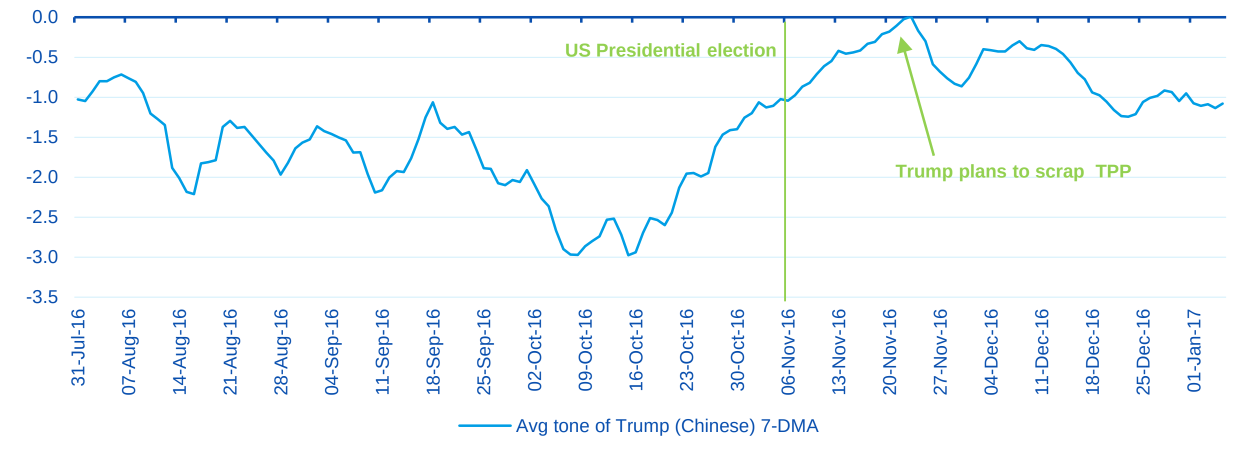
Fears of a trade war may be overblown

Currency manipulator status and 45% import tariffs unlikely: While we can't exclude this possibility entirely, such a move would contradict Trump's trade agenda with China. First of all, China intervenes in the FX market in order to prop up the value of the CNY. Less intervention would only lead to further depreciation vs. the USD. Moreover, the law does not specify tariff levels for currency manipulators and any punitive measures would need prior approval by the Treasury, a process which can be quite lengthy.

Targeted approach seems more probable: We believe that a scenario whereby the US implements a 5% border tax adjustment while simultaneously targeting individual Chinese sectors and companies to be more likely. Punitive measures are already possible under the current legal framework – the US imposes steep duties on imports of Chinese steel products. Moreover, the US Department of Commerce is currently investigating a number of Chinese sectors for unfair subsidies, including solar PV, chemicals and other metal products. These processes would certainly accelerate under Trump.

Figure 1

Trump's post-election honeymoon in China was short-lived



Source: www.gdelt.org and BBVA Research

Deterioration of Trump sentiment in China hints at rising tensions

The tone deteriorates: Prior to the election, Trump was perceived as a pragmatic “businessman”. However, his belligerent and often inaccurate comments on China have led to a significant deterioration of public opinion in the country (Figure 1). Ironically, China had viewed Clinton as the more hawkish candidate due to her involvement in the formulation of the US’s “Pivot to Asia” as Secretary of State under Obama.

Nominations in Washington DC sound the alarm in Beijing: The choice of China hard-liner Peter Navarro as head of the National Trade Council is concerning given that he has been one of the strongest proponents of tariffs. On the other hand, Secretary of State nominee Rex Tillerton likened China's island-building in the South China Sea to "Russia's taking of Crimea” during his confirmation hearing with Senate. This triggered a harsh response from Chinese state media, pointing towards a deterioration in US-China relations. The silver lining is Trump’s decision to appoint Iowa Governor Terry Branstad, who is President Xi’s long-time acquaintance, as US ambassador to China.

Expect flows away from Asian EM asset classes and rising tensions

Flows away from Asian EM asset classes: A deterioration in what is arguably the most important bilateral relationship will lead to an intensification of global risk-off modes. Typically, increased geopolitical risk has translated into flows away from EM asset classes such as FX, equities and bonds. Depreciatory pressures on Asian EM currencies will continue on trade woes as well as widening interest rate gaps. Paradoxically, broad-based depreciation should offset the effect of any US tax adjustments, strengthening the case for a more targeted approach to trade protectionism. On the equity front, major indexes in Asia could feel the blow, barring the Nikkei, which has actually seen inflows despite a correction in recent JPY depreciation.

Other risks to consider: There is sizeable upside risk in case China reacts by enacting retaliatory measures on the US. These include symmetrical tariffs on US imports as well as procurement restrictions of US goods and services (including technology providers) by Chinese agents. Chinese authorities may also press US multinationals with a presence in China. People exchanges could also be affected through limits on tourist and student visa numbers. Finally, reinforced presence of the US in the South China Sea could trigger an assertive response from China. This would inevitably lead to increased tensions, pushing other Asian EMs into an awkward position between a protectionist US and an expansionist China. We have already seen this in action with the Philippine’s “Pivot to China” under President Duterte, which followed The Hague’s PCA ruling in favor of Manila.

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