

ARTICLE FOR THE EDGE

WINNERS AND LOSERS IN TRUMP'S WORLD

President Donald Trump came to power vowing to shake things up. It is clear from his inaugural address, the composition of his cabinet and his comments in press interviews that he meant what he said. There will be seismic changes in American policies on trade, security alliances, energy and climate policies – and many of these will cause ructions in Asia.

Trade will be a major risk for Asia

That the Trump Administration would pull the US out of the Trans-Pacific Partnership Agreement was expected. What has shocked Asian observers though is the stridently protectionist tone of the inaugural address where Trump proclaimed that “Protection will lead to great prosperity and strength”. The references in his address to other countries “stealing our companies, and destroying our jobs” were chilling. It is clear that more restrictions on trade are coming soon.

Apart from demanding an early renegotiation of the North American Free Trade Area, one of Trump's next actions on trade will probably be measures directed against China. China will almost certainly be labelled a currency manipulator, which would help justify restrictions beginning with anti-dumping charges and expanding to other non-tariff barriers. It is unlikely that the new American trade authorities will act only against China, other trading nations are also likely to face trade restrictions as well – especially those who have had consistently large trade surpluses with the US. Our suspicion is that Trump is keen to demonstrate to his constituency that he is prepared to act tough and in doing so, it would not surprise us if he is willing to flout World Trade Organisation rules. After all, it would take years of litigation before any complainant WTO member is able to force the US to reverse such non-compliant trade restrictions.

Second, tax reforms that Trump's Republican allies in Congress are planning will include a “border adjustment tax”. This is a new form of corporate tax which essentially does not allow any imported item as a deductible expense. At the same time, export-related revenues will not be taxed. In effect, this border tax will discriminate against imports and subsidise exports. While it is not clear where Trump stands on this specific tax, there is a strong incentive for Congress to pass this measure. It will raise substantial revenues to pay for the tax cuts and higher defence spending that Trump plans.

Third, Trump's known opposition to outsourcing and the granting of H1B visas to skilled foreign professionals means that restrictions are likely on these areas. India and the Philippines could be big losers.

Fourth, the new Administration is likely to follow through on Trump's threats to penalise firms that move operations out of the US to cheaper locations. That would hurt US investment abroad.

How far Trump will press this protectionist line depends on two factors. First, does he see such actions simply as tactics to press trading partners to offer quick concessions which would satisfy him, or is he determined to fundamentally reverse decades of American commitment to the principle of free trade? We suspect it is the latter.

Second, will other countries retaliate or will they cave in? We think there will be a good amount of retaliation. Other nations will retaliate with targeted measures to hurt US interests while stepping up efforts to create exclusive trading blocs. This could lead to a prolonged period of trade tensions during which global trade volumes fall and there is considerable dislocation in the world economy. If this scenario unfolds, Asian trading nations will be quite severely damaged.

There could be other areas of economic risk

At one level, the incoming Administration's policies are likely to produce higher growth in 2017–2018 which should boost Asian export growth and help support the prices of commodities that Asia exports.

However, at another level, since the US economy is close to full employment, the risk of overheating will rise. That would result in a faster pace of monetary tightening and a stronger US Dollar. As deregulation and tax cuts boost corporate earnings in the US, US equities will also become more attractive. This could precipitate more capital outflows from Asia, depressing local currencies and causing turbulence in asset valuations.

Asia will be a major arena for geo-political competition

One theme that resonated through Trump's inaugural address was that America would be less engaged in helping with problems in the rest of the world – where it will act, it will do so unilaterally. While Trump said he would “reinforce old alliances and form new ones”, this seemed to be in the context of combating radical Islamic terrorism which he would “eradicate completely from the face of the earth”. In keeping with his America First sentiments, his emphasis was on “the right of all nations to put their own interests first”. Earlier, Trump had dismissed the NATO alliance as obsolete while also making clear his disdain for the European Union and its leaders such as Chancellor Merkel of Germany. There was nothing to suggest that Trump would look at foreign policy from the standpoint of enlightened self-interest.

Trump's signal that under him the US would be more focused on its immediate self-interest than previous administrations could encourage America's rivals to see this as an opportunity to advance their interests through bold moves which they may not have risked before. There are two risks in the Asian region to watch out for.

- First, China could become more confident that its long term goal of edging the US out of East Asia is now more achievable given American disengagement. It might announce an

Air Defence Identification Zone in the South China Sea to strengthen its controversial claims there. It is also likely to step up its pressure on, and inducements to, the smaller Asian nations assured that these nations are now so rattled by Trump's reduced commitment to the region that they would be more amenable to cutting deals favourable to China.

- Second, North Korea will almost certainly move quickly to strengthen its nuclear weapons capacity through testing more powerful nuclear weapons as well as developing an inter-continental ballistic missile which could threaten the mainland of the US.

Another consistent theme in Trump's comments to the press in recent months has been his deep suspicion of China. Our understanding is that the Trump national security team is much more agitated about China's enhanced military position in the South China Sea than the Obama Administration. Trump has now repeated his Secretary of State-designate's vow to block China's access to disputed rocks and shoals that it has seized from other claimants. The new Administration may well deploy more US air and naval forces in the region. It may also step up trade and military relations with Taiwan in order to penalize China for its assertiveness, which would enrage the Chinese. Tensions in East Asia are likely to be aggravated.

Who would be the winners and losers in Asia?

Putting all this together, here is our assessment of selected winners and losers in Asia:

First, China will face the greatest challenges.

- China hopes to benefit in one respect – should the US reduce its engagement in the region, smaller Asian nations would be left with little choice but to defer more to China's wishes. Indeed, the signals that Trump has sent so far will probably unsettle Asian nations and persuade some to shift closer to China. Of course, there will be some Asian nations who, remaining suspicious of China, who will seek to form alliances of their own to enhance their bargaining power. We can see Japan, Australia and India working more closely together. However, without some form of US support, there is no combination of Asian middle powers (Japan, India, Australia, Indonesia, Korea and Vietnam) that can wield enough power to counter-balance China completely. A unilateralist US will certainly be a boon to China's long term ambitions to be pre-eminent in the region.
- China, however, could suffer economic damage: It is clear that China will be a major target of Trump's trade policies, with higher tariffs and restrictions such as anti-dumping measures set to proliferate. Chinese investments in the US, especially its acquisition of technology companies would be scrutinized more rigorously. China's struggles to contain capital outflows could also be aggravated if expectations of US Dollar appreciation reduce the attractiveness of Chinese assets.

Second, India could make strategic gains but lose out modestly on outsourcing

- Trump's suspicion of China and determination to wage war against so-called Islamic radicalism fit could make India an appealing ally of the US. Many in the large and growing Indian diaspora in the US were supportive of Trump's candidacy in the elections.
- India does, however, have an economic vulnerability. It sends many professionals to work on H1B visas in the US and who remit large flows of income back to India. Trump has railed against such visas which are likely to be more restricted in future. India is a major exporter of services to the US, and is one of the few Asian countries to run a services account surplus with the US.

Third, South Korea should be nervous as well

- Trump's questioning of US alliances with Japan and Korea and his generally isolationist tone could encourage North Korea to engage in provocative actions that undermine South Korea's security as described above. This is especially so given the political crisis in South Korea where President Park's impeachment leaves a political vacuum and has reduced the country's ability to respond to such challenges.
- In economic terms, Korea's large trade surplus and its management of its currency leave it open to US trade pressure.

Fourth, Singapore has much to worry about.

- Singapore had allied itself closely with the US in recent years even in the face of China's growing disapproval. Singapore's relationship with China has become more troubled of late, culminating in the seizure by Hong Kong authorities, probably at China's behest, of armoured vehicles that Singapore was shipping back home from its training grounds in Taiwan. China has clearly decided to make an example of Singapore for not deferring to its interests by allying itself too closely with the US and by continuing its military relationship with a Taiwan that is now ruled by a pro-independence party. Singapore is now in the invidious position where its US ally may be less interested in providing security cover while it cannot now concede to China without losing credibility.
- On the economic front, Singapore would lose if there were to be a substantial hit to the global trade that is its lifeblood. However, it is less likely to suffer if Trump's trade policy is more targeted and limited. Singapore runs a trade deficit with the US on both goods and services while its free trade agreement with the US is less controversial. Singapore's strategic cooperation with the US will also help. However, its appeal as a location where US corporations seeking tax efficiency have located their capital may cause it to come under scrutiny.

The bottom line

The net effect will be a vastly more unsettled world for Asia that will endure both geopolitical and economic pressures as the Trump Administration sets about implementing its agenda. In this new world, there will be more losers than winners.

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