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Trump's Trade Agenda: What is it for Asia?

IIUM, 24 February 2017

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- What is Trump's plan?
- How will Trump's policies impact on:
  - Global financial markets
  - US economy
  - Malaysia economy
- Conclusion

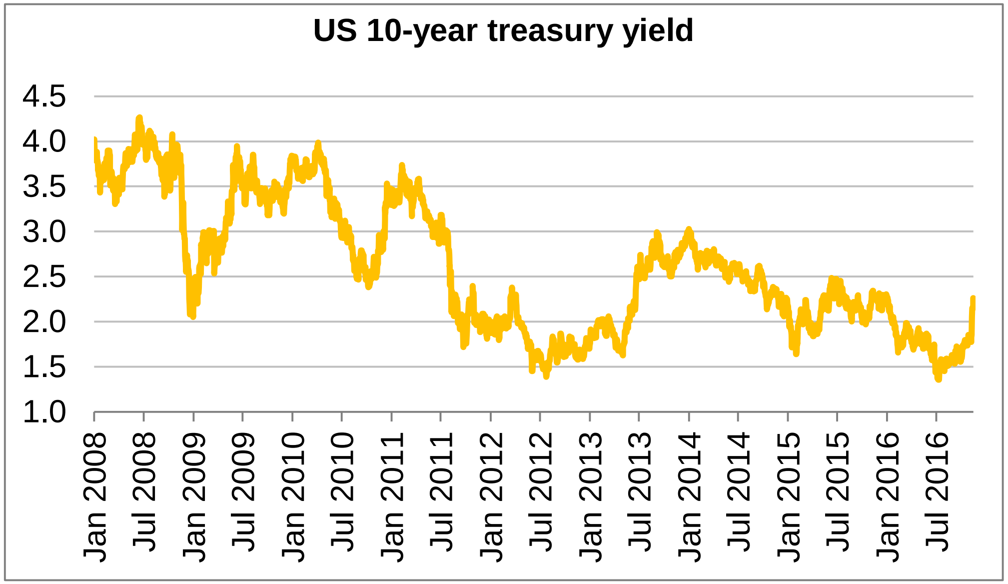
- **American-style Brexit.** Panic selling in global financial markets as nervous investors seek refuge in safe-haven assets (Japanese yen and gold). Global equities tumbled while emerging markets’ currencies fell against the US dollar

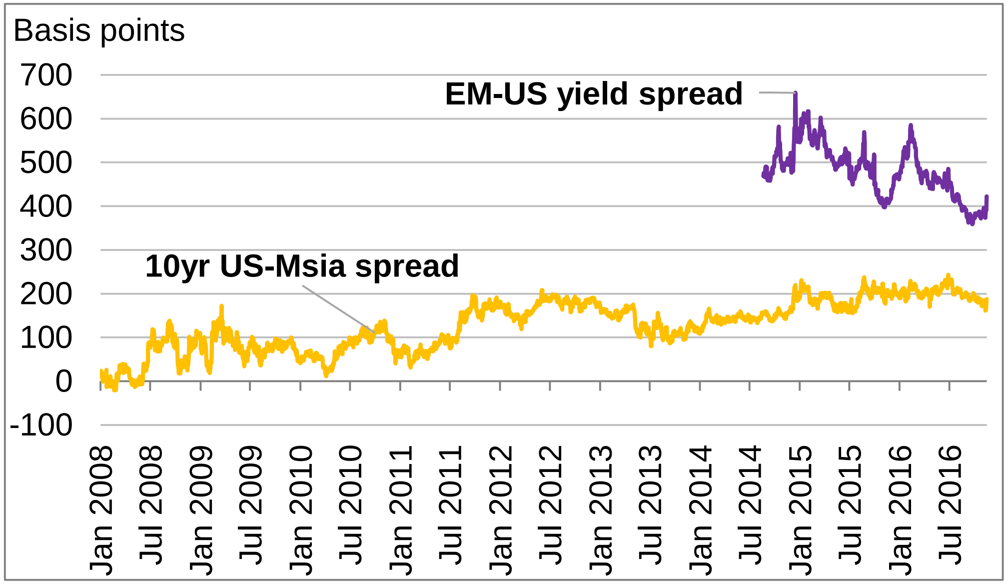
- **But recovered faster than Brexit.** The US three indices reversed earlier sharp looses to close higher. Volatility is here to stay as investors will asses what will Trump’s policies mean to the US economy and emerging economies

- **10-year Treasury yield rose above 2%** currently on worries about higher fiscal spending and budget deficit could stoke inflation risk

- **Emerging market currencies under pressure,** triggered by investors’ growing expectations that Trump's fiscal boost will be inflationary and could push US rates higher, driving funds out of emerging markets and into dollar-based assets

US YIELDS SPIKE PRESSURISED EMERGING MARKETS





Source: Bloomberg

- The greenback has soared on expectations the Trump administration would increase spending and lift inflation, which prompted an elevation of US Treasury yields
- Yields on US 10-year Treasury notes climbed to their highest since January 2016 at 2.60% on 15-16 Dec 2016 before easing to 2.42% on 17 Feb 2017
- The jump in yields on safe-haven US debt had a negative effect on emerging market assets as foreign investors have cut holdings of sovereign EM bonds
- Surging US bond yields and a stronger dollar have added to the pressure on emerging markets' currencies which are among the hardest-hit


TRUMP
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NO
TPP
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"MAKE
AMERICA
GREAT
AGAIN"

THREE ELEMENTS OF TRUMP's PLAN - "AMERICA FIRST"

I. **A big fiscal boost.** Proposed US$10 trn tax cuts on individuals and businesses

- Collapse the current seven tax brackets, which range from 10% to 39.6% into three brackets of 12, 25, and 33%
- Reduce the corporate income tax rate from 35% to 15%
- Increase standard deduction amounts and curtail many tax expenditures
- US$1 trillion over a period of 10 years to rebuild infrastructure

II. **Renegotiated trade deals**. Is it a threat or is only a negotiation tool? Trade protectionism invites retaliation or even sparks the "beggar-thy-neighbor" currency war.

- North American Free Trade Agreement (NAFTA) involving the US, Canada and Mexico
- Trans-Pacific Partnership Agreement (TPPA) is in limbo as Trump is anti-TPPA
- Higher countervailing duties of 45% on China's imports. Label China as a currency manipulator
- Hit Mexican imports with a 35% tariff

III. **Regulatory changes**

- Additional controls on immigration. Build a wall between Mexico and the US
- Fewer controls on the banks and on environmental issues
- Repeal the complex Dodd–Frank Wall Street Reform and Consumer Financial Protection Bureau which imposed new regulations in areas such as mortgage-servicing, foreclosure relief services, debt collection
- Repeal/amend Obamacare and the Clean Energy Policy

POTENTIAL IMPLICATIONS OF TRUMP's ECONOMIC PLANS

I. Boost to US economic growth amid inflation risk

- Tax cuts on individuals and businesses as well as fiscal stimulus boost spending, investment and increase economic growth
- But, concerns about fiscal stability given the stretched budget deficit and high debt
- Expansionary deficit-financed fiscal spending and domestic demand fuels inflation

II. Trade protectionism mindset hurts global trade

- Negative impact on the US, China and Mexico economy and their trading partners
- China and Mexico are two of the three US's largest trading partners with an export share of 8.0% and 15.9% respectively in 2016
- Dampening China's growth will have negative spillover on Asia given the deep economic and trade integration
- The TPPA fallout will undermine trade and investment prospects of 12 members countries
- Negative trade developments with US may also push Asia towards regionalization and closer trade ties with China

III. Financial and exchange rate markets

- **Bracing for more currency volatility**. Trump's expansionary fiscal spending may stoke inflation risk, prompting the Fed to raise interest rates higher than expected. The prospects of higher UST yield outlook supports a rebalancing of investment portfolio back to the US. Higher US interest rates lend support for a stronger US dollar against Asian currencies
- **Emerging economies with weak economic fundamentals** such as high budget deficit and external debt as well as current account deficit will remain vulnerable to the negative spillovers of capital reversals
- **Asian central banks caught in dilemma**. With growth outweighing inflation concerns, Asian central banks are likely to keep low interest rates for a longer while to mitigate external risks on domestic growth
- **Chinese renminbi (RMB) is under close watch**. The Trump Administration, which labelled China as a currency manipulator will see RMB under revaluation pressure by the US besides facing the threat of imposing higher countervailing duties on all imports of China

US PULLS OUT OF TPPA – WHAT's NEXT?

WHY TRUMP OPPOSES TPPA DEAL?

- On June 28, 2016, Trump said, "***The Trans-Pacific Partnership is another disaster done and pushed by special interests who want to rape our country*** — just a continuing rape of our country. It's a harsh word, but it's true."

- In an op-ed from March 14, 2016, Trump explained his opposition to the Trans-Pacific Partnership trade deal (TPP). He wrote, "***The number of jobs and amount of wealth and income the United States have given way in so short a time is staggering***, likely unprecedented. And the situation is about to get drastically worse if the Trans-Pacific Partnership is not stopped. One of the ***first casualties of the TPP will be America's auto industry***, and among the worst victims of this pact will be the people of Ohio. The TPP will send America's remaining auto jobs to Japan.

- During the Fox Business/Wall Street Journal Republican debate on November 10, 2015, Trump said that although he is a "free trader," he does not support the Trans-Pacific Partnership trade deal (TPP). Trump said, "***The TPP is horrible deal. It is a deal that is going to lead to nothing but trouble. It's a deal that was designed for China to come in, as they always do, through the back door*** and totally take advantage of everyone. It's 5,600 pages long. So complex that nobodies [sic] read it.

REACTIONS: TO REVIVE TPP; ENACT NEW AGREEMENTS

- **Australia**: "**The TPP, including the United States, certainly can't go forward unless the United States wants to change its mind** ... We have an agreement that has made a lot of very big gains. Gains that Australia, Japan, Canada, Mexico and other countries want to keep hold of. **Which is why a number of us had a conversation about a possible TPP 12 minus one**.“ -- *Steven Ciobo, Australia's Trade Minister*

- **Canada**: "**The agreement cannot enter into force without the United States**.“ -- *Kristine Racicot, spokeswoman for Global Affairs Canada*

- **Japan**: "I believe President Trump understands the importance of free and fair trade, so **I'd like to pursue his understanding on the strategic and economic importance of the TPP agreement tenaciously**. The new rules that finalized in the TPP agreement after several years of negotiation will serve the model for future trade negotiations and are expected to become the 21st century global standard.“ -- *Japan Prime Minister Shinzo Abe*

REACTIONS: TO REVIVE TPP OR ENACT NEW AGREEMENTS

- **Malaysia**: "Should the TPPA (Trans-Pacific Partnership agreement) fail to enter into force, it will be a missed opportunity for Malaysia since a number of research houses have singled us out as a clear winner in the TPPA ... ***Should the TPPA fail to materialise, our focus would be to enhance the economic integration of ASEAN***.
- "Notwithstanding the current position of the new US Administration on TPPA, **we will continue to engage with our American colleagues to strengthen our bilateral trade and economic relations,** given the US' importance as our third largest trading partner and a major source of investment.“ -- *Dato' Sri Mustapa Mohamed, Malaysia's Minister of International Trade and Industry*
- **Mexico**: "Our priority is to consolidate ourselves as a relevant actor to intensify the flows of commerce, investment and tourism. And particularly before the evident difficulty due to the materialization of the TPP. **Mexico will immediately initiate conversations to generate new bilateral trade accords with the participant countries in this partnership**.“ -- *Mexican President Enrique Pena Nieto*
- **New Zealand**: "The US position is disappointing but not unexpected as the President Trump's views have been clear for some time. Our preference was to have the US involved in the TPP. However, **the agreement still has value as an FTA with the other countries involved**.“ -- *Todd McClay, New Zealand's Trade Minister*

SO IS TPPA DEAD? OR A NEW FORM OF AGREEMENT?

- So what's the future of TPP? **From a technical perspective, it's nearly impossible to revive the TPP**
    - Article 30.5 of the agreement requires that it be ratified by at least six countries who represent 85% of the TPP's combined GDP. This means that the US and Japan would both have to ratify the TPP in its current form for it to go into effect

- The other 11 TPP members could **move forward via creating a different form of agreement without the US** but the economic benefits will be significantly reduced without the US participating

- If the 11 members decide to move ahead with TPP, **a new leader (possibly Japan) has to take the lead to bring the deal back to the drawing broad and amend the agreement**

- It is possible that other Asia-Pacific countries could eventually join the TPP agreement, adding to its importance

WITHOUT TPPA - WHAT DOES IT MEAN FOR ASIA?

- **Dampening impact on TPP members**
  - Without TPP, the 12 participating member countries will be impacted in terms of economic growth, trade and investment
  - As TPP pushes for economic reforms in all trading nations, its failure would slow down the pace of market reforms as well as regulatory liberalization in member countries

- **TPPA's failure good for China?**
  - **China flexes muscles**. China has been increasingly flexing its muscles in a battle of might with the US for power and influence in Asia
  - **Hasten negotiations on RCEP**. China is not sitting on the sidelines. The negotiation of the Regional Comprehensive Economic Partnership (RCEP) with 15 countries since early 2013. RCEP covers around 50% the world's population and 30% of global GDP
  - **RCEP vs. TPP**. TPP focuses on reducing tariff and non-tariff barriers while RCEP is focused primarily on cutting tariff barriers. Most countries in Asia already enjoy preferential access to the Chinese market

HOW WILL TRUMPNOMICS IMPACT MALAYSIA?

I. Volatility is here to stay

- Global investors will continue to keep a close watch on the shaping of Trump Administration's economic and trade policies
- With expectations of higher US Treasury yields and US interest rates on concerns about the expansionary fiscal spending may stoke inflation, the depressed interest differentials could prompt capital reversals
- Higher US interest rates mean a stronger dollar against the ringgit

II. TPPA fallout

- The main concern is on the fallout of TPPA and its ramifications on our trade growth with the US and other TPPA members
- Currently, the US is Malaysia's third largest trading partner, contributing to 9.2% of Malaysia's total trade in 2016. Of this total, our exports share to the US is 10.2% of total exports and that of imports share is 8.0%
- Higher import tariffs on China goods entering into the US market would have an indirect impact on Malaysia as it supplies intermediate goods to China for processing into final goods for exports to the US

TPPA: ECONOMIC BENEFITS WITH ADJUSTMENT COSTS

Overall Economy: Net Gains

- Higher GDP by USD107~211 bn[1]
  - Increase in GDP growth by 0.60~1.15 ppt[2]
- Additional investment of USD136~239 bn[1]
- Narrower trade surplus of 4.3~5.2% of GDP[2]
  - Higher export growth by 0.54~0.90 ppt[2]
  - Higher import growth by 0.65~1.17 ppt[2]
- >90% of economic gains driven by reduction in NTMs[1]

Sectoral Analysis: Increased Output & Competition

- Sectors contributing over 20% of Malaysia's GDP in 2014 are expected to register higher output growth
- Export-oriented firms to benefit from increased market access *(e.g. textiles, automotive components, E&E)*
- Firms in more liberalised sectors post-TPPA to face increased competition *(e.g. oil & gas, construction, retail)*
- Existing pharmaceutical manufacturers to be minimally impacted by stronger intellectual property protection for drugs

Thematic Issues: Some Concessions; Extensive Safeguards

- Bumiputera & SME flexibilities largely preserved; compromises made by Malaysia should hasten improvements in competitiveness
- SOEs' mechanisms to support nation building agendas may change
- Investor state dispute settlement ("ISDS") may increase cost to the Government; safeguards in place to mitigate nuisance suits and preserve policy space in health, security and environment
- Adoption of International Labour Organisation ("ILO") rights could increase risk of production disruptions due to labour disputes

Source: Economic impact of TPPA, PwC

COMPARISON BETWEEN TPP & RCEP

REGIONAL PARTNERSHIP AT A GLANCE

	TPP*	RCEP
Population	**816.9 million (11.1%)**	**3,518.7 million (47.9%)**
Real GDP	**US$ 28.3 trillion (37.8%)**	**US$ 22.5 trillion (30.0%)**
Trade Value	**US$ 11.1 trillion (26.3%)**	**US$ 11.6 trillion (27.6%)**

Figure in parenthesis indicates the % share of world's population, real GDP, and trade
Source: World Bank, data as of 2015, except New Zealand's trade data as of 2014

MALAYSIA'S EXTERNAL TRADES (2016)

Exports to TPP*: RM 325.6 billion

Trading Partner	Exports Share	Imports Share
TPP*	**41.4%**	**32.6%**
Singapore	14.6%	10.4%
United States*	10.2%	8.0%
Japan	8.1%	8.2%
Vietnam	3.0%	2.7%
Australia	3.4%	2.2%

Exports to RCEP: RM 477.3 billion

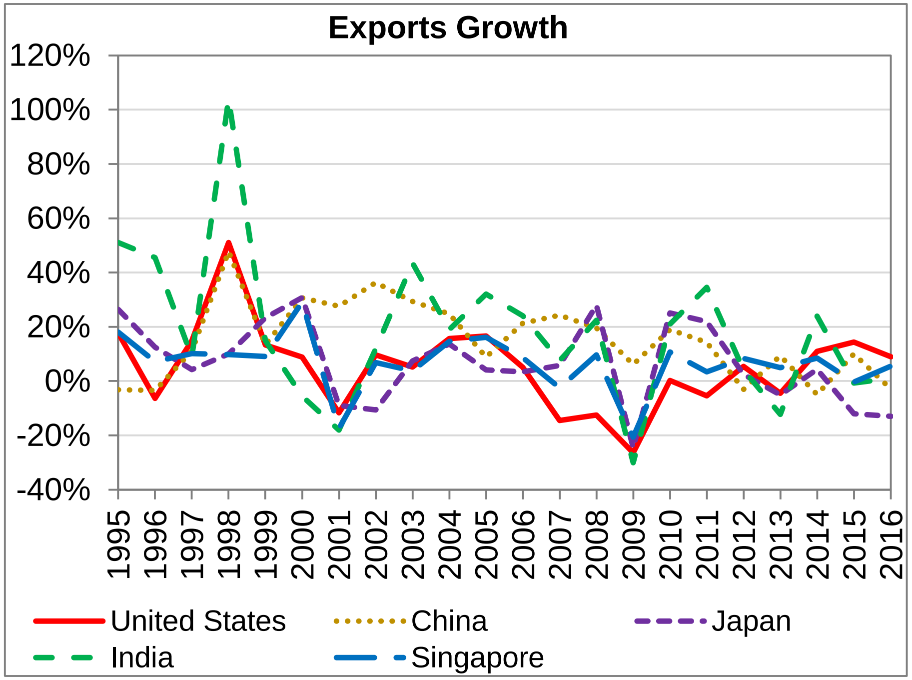
Trading Partner	Exports Share	Imports Share
RCEP	**60.7%**	**63.4%**
China	12.5	20.4
Singapore	14.6	10.4
Japan	8.1	8.2
Thailand	5.6	6.1
South Korea	2.9	5.3

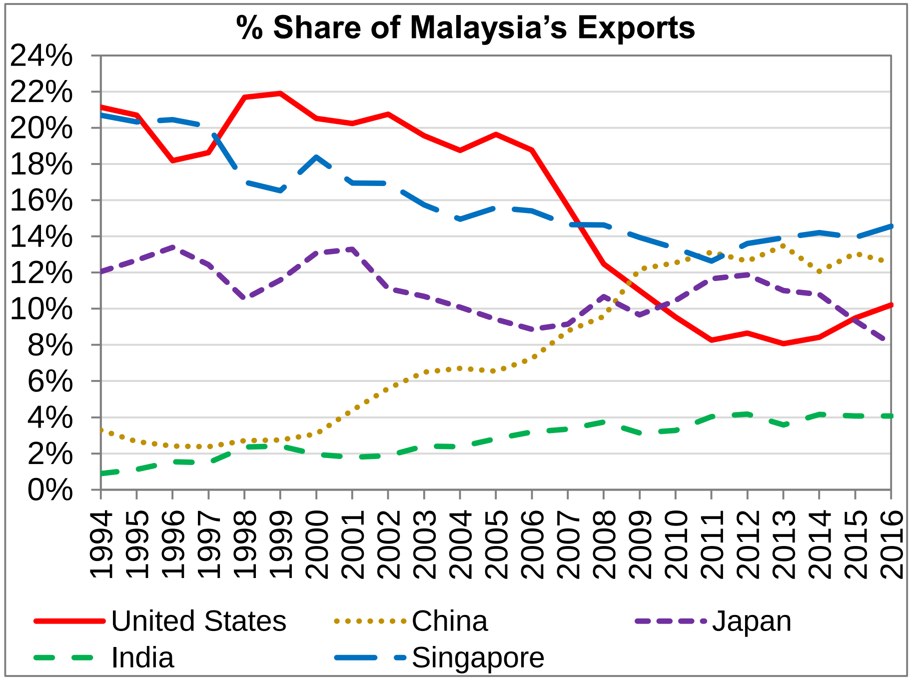
Source: Department of Statistics, Malaysia

** Although USA has withdrawn its participation in TPP on 23 January 2017, the TPP figures still includes USA for comparison.*

MALAYSIA's MAJOR TRADING PARTNERS

- Malaysia's export share to major trading partners are more evenly distributed now
- Exports to the United States have dwindled from around 20% to 10.2% now; exports share to China rose markedly from less than 4% in 2000s to more than 10% currently

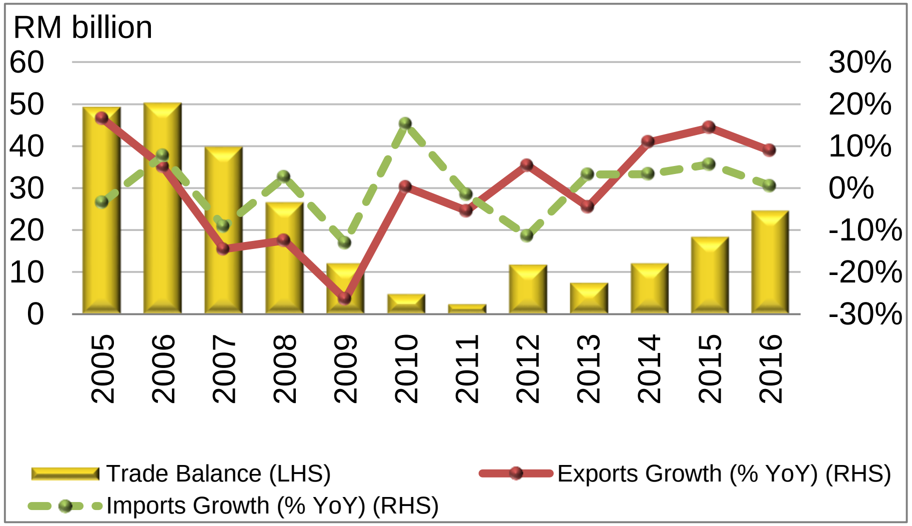




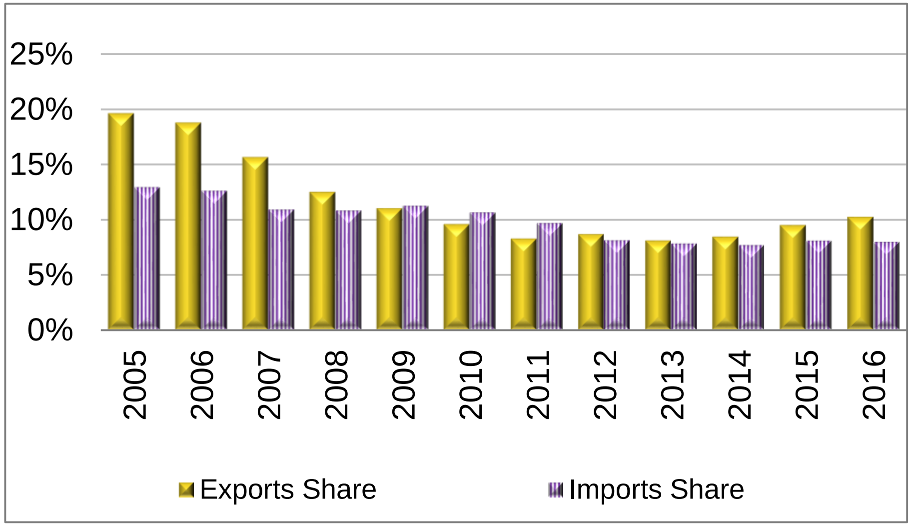
Source: Department of Statistics, Malaysia; Bank Negara Malaysia

MALAYSIA – US BILATERAL TRADE TRENDS

Malaysia enjoys trade surplus, albeit smaller

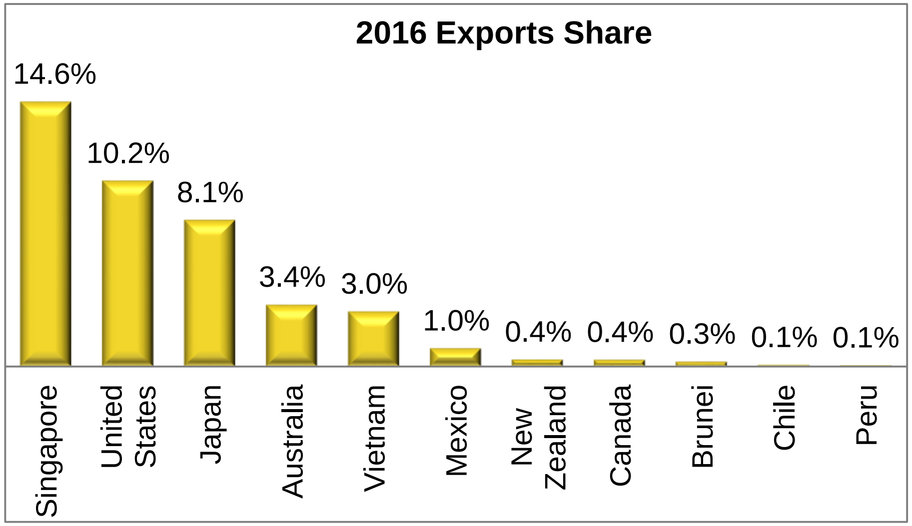


US is Malaysia's third largest trading partner



Major exports	Major imports
▪ Electrical and Electronics	▪ Electrical and electronics
▪ Machinery	▪ Machinery
▪ Medical instruments	▪ Medical instruments
▪ Rubber gloves	▪ Aircraft and parts
▪ Furniture	▪ Plastic products

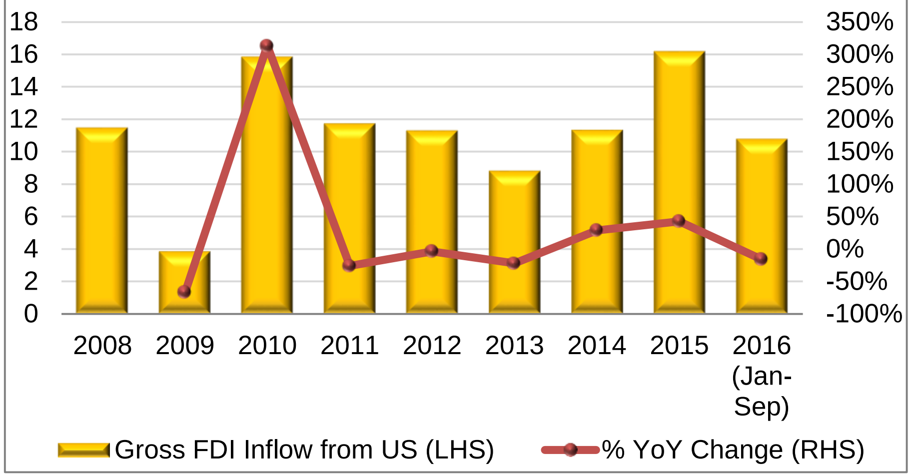
TPP members contributed 41.4% of Mal's exports



Source: Bank Negara Malaysia; Department of Statistics, Malaysia

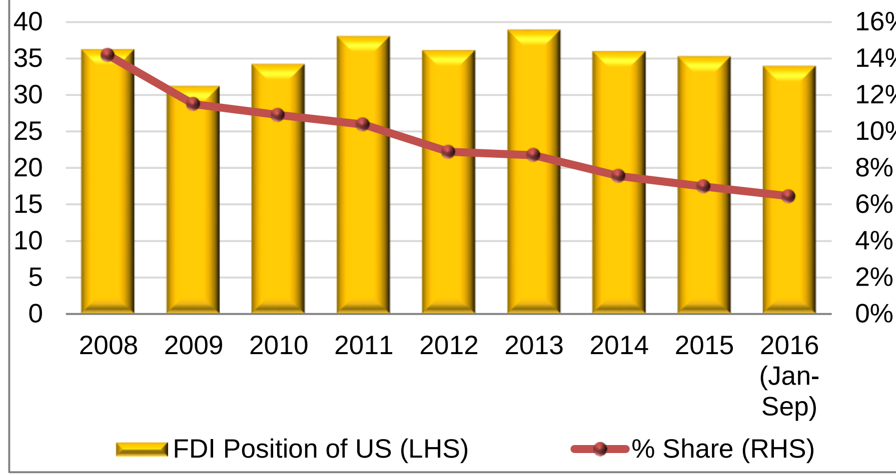
US is the fourth largest FDI source for Malaysia

Gross FDI inflows by US (RM billion)



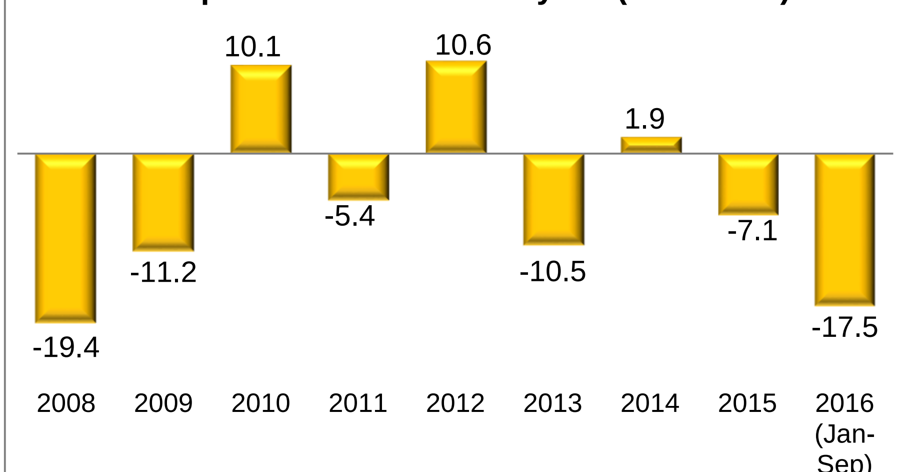
The share of US FDI stock is on a declining trend

FDI position of US in Malaysia (RM billion)



US portfolio investors were net seller

Net portfolio investment by US (RM billion)



US manufacturing projects

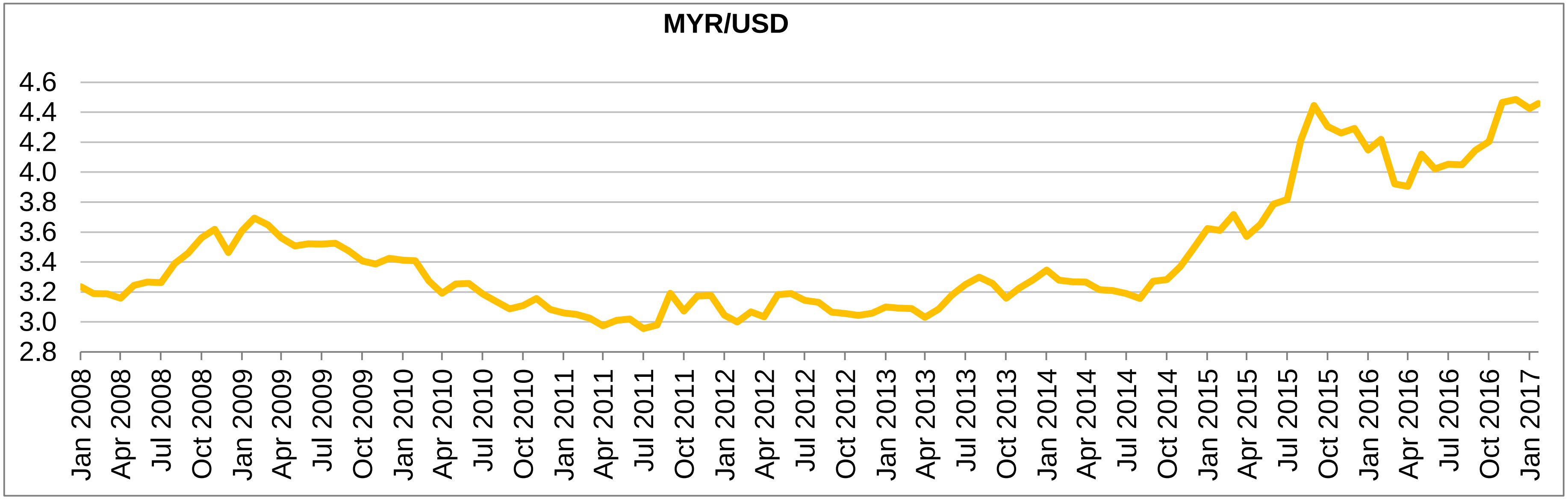
2010		2016 (Jan-Aug)	
Industry	**RM mn**	**Industry**	**RM mn**
E&E products	10,226	Scientific & measuring equipment	312
Machinery & equipment	469	E&E products	84
Others	1,043	Others	68
Total	**11,739**	**Total**	**464**

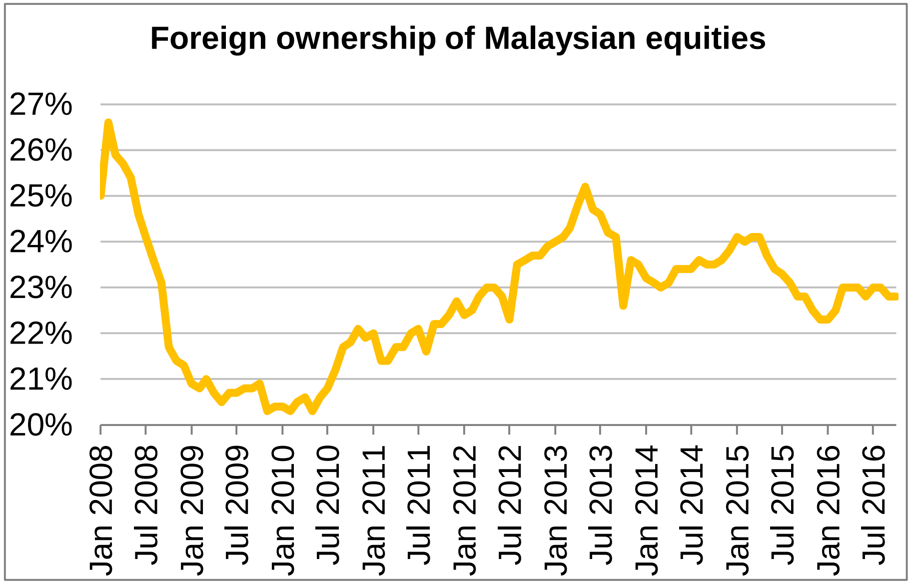
Source: Bank Negara Malaysia; MIDA

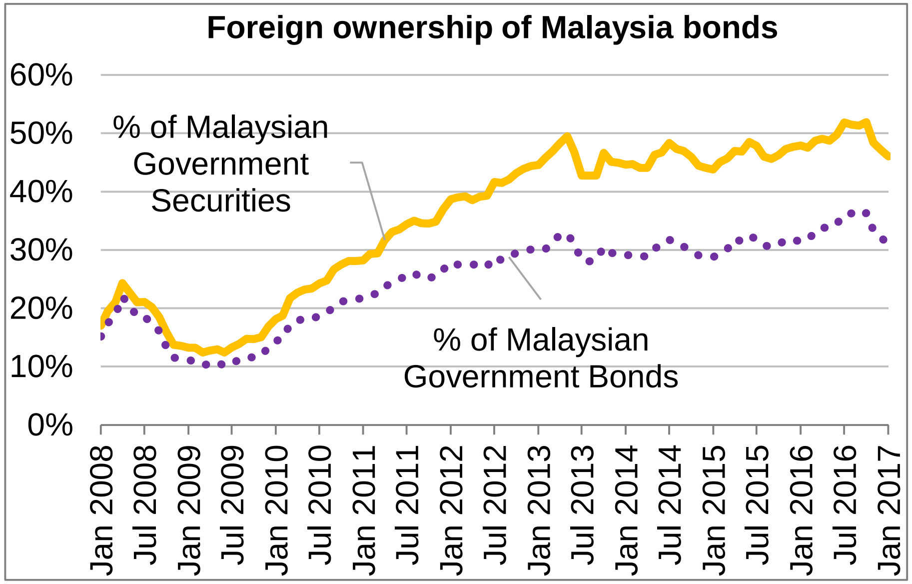
III. US FDI and portfolio investment

- US investors still favor Malaysia though the pace of investment has dwindled
- Gross FDI inflows from the US into Malaysia, which averaged RM11.3 billion per year during 2008-2015, have slipped to RM10.8 billion for the first nine months of 2016 with a share of 10.9% of total net inflows compared to a high of 17.1% in 2010
- US portfolio investors generally were net sellers as they recorded net cumulative portfolio outflows totaling RM30.8 billion during the period 2008-2015 and net outflows of RM17.5 billion for the first nine months of 2016
- Trump's proposed reduction of corporate tax rate to 15% from 35% currently as well as a one-time tax rate of 10% for repatriated corporate profits would encourage the retention of US investors at home as well as entice the repatriation of US corporations' profits back to the US. This could result in lower reinvestment in Malaysia as well as less investment in domestic equities and bonds
- As at end-January 2017, foreign investors owned 46.0% or RM166.4 billion of Malaysian Government Securities and they invested RM188.3 billion worth of total government bonds or 30.9% of total

HIGH FOREIGN-OWNED OF MALAYSIA DEBT REMAINS A RISK







Source: Bank Negara Malaysia

CONCLUSION

- We must have more clarity on Trump's policies direction to give a better assessment
- Pending the extent of policy changes, trade tensions and fiscal stimulus have offsetting impacts on the US economic growth in the medium term
- The failure of TPPA means a missed opportunity for Malaysia exporters to sell more in TPPA's participants countries. The affected sectors are electronics and electrical products, rubber products, palm oil as well as automotive components
- Expanding trade in ASEAN and countries in which Malaysia has Free Trade Agreements (FTA) with as well as the push for RCEP will be positive for boosting Malaysia's trade prospect
- Malaysia is currently working at having FTAs with four of the 12 countries, namely the United States, Canada, Mexico and Peru, which were participating members of the TPPA.
- The impact of shaken trade deals on Malaysia's economic growth should be manageable as counteracted by domestic growth drivers, including the planned mega public infrastructure spending

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