

The Donald, the devil and the detail

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Trump will keep protectionist promises

Key judgments

- Albeit with unprecedented speed, the balance of power globally — both economic and political — is shifting in a manner entirely consistent with what history tells us to expect at the end of a period of hegemony.
- Although President Donald Trump's stated aim to "*make America great again*" through his overarching "*America First*" agenda runs contrary to this, his policies seem more likely to accelerate the trend, facilitating China's bid to assume a global leadership role.
- Furthermore, the threat of descent into a trade war — and/or, possibly, violent conflict — with negative implications for economies worldwide currently seems only likely to grow through the coming months.

Foreword

This report has been written in significant part with an eye to a presentation under the same title at Nomura's 9 February *Global Emerging Markets Credit Conference*. Regular readers will find that it reproduces ideas covered in, among other reports, my Outlook for 2017, while updating and augmenting where necessary.¹

I recommend reading this report alongside Nomura's 27 January anchor report '*EM's struggle with "America First" policies*' (see also page 7 below).

The end of an era

"...conflict is endemic to our species. The return of the great power rivalry in the 21st century reminds us that we are not purely economic animals.... Geopolitics is back."

Edward Luce, 10 May 2015²

What we are witnessing in the world today is exactly what geopolitical theory tells us to expect at this stage in the geopolitical cycle.

¹ 'Outlook 2017: An increasingly uncertain world', *Alavan Business Advisory*, 3 January 2017.

² 'The end of the Golden Arches doctrine', published in the *Financial Times*.

The geopolitical cycle is characterised by the rise and fall of a hegemony, in this case the United States.

In the past millennium, there have been seven hegemonies, including that of the US. All have been good for economic growth, ie:

- They have removed barriers to trade so trade expands;
- Economies have therefore grown; and,
- Societies (but not necessarily all individuals in them) have become richer.

Unfortunately, history also tells us that the end of a hegemony is marked by:

- Increased trade protectionism (witness the latest IMF assessment of global trade);³
- Slower economic growth; and
- Resurgent nationalism.

Worse, all six of the previous hegemonies in the past 1,000 years have ended in violent conflict between the declining power and a rising power — a phenomenon known as **Thucydides's trap**.⁴

Where economics leads...

“Extrapolating growth in almost 700 locations across Earth...projects that the world’s economic centre of gravity to locate by 2050 literally between India and China.”

Danny Quah, January 2011⁵

Underpinning the return of geopolitics has been a tectonic shift in the global economy. Work by, among others, Professor Danny Quah tells us that in 1980 the global economic centre of gravity (ie the north/south line with half of global GDP on one side and half on the other) was somewhere off the west coast of Africa. Since then it has been moving back eastwards — and at an alarming pace — for the first time since the industrial revolution to the point where today it runs more or less through Riyadh.

³ See Chapter 2 of the October 2016 ‘World Economic Outlook’ — available at: <http://www.imf.org/external/pubs/ft/weo/2016/02/pdf/c2.pdf>.

Also worth reading in this context are *The Economist’s* first leader ‘In retreat’ and related ‘Multinationals’ Briefing ‘The retreat of the global economy’ in the 28 January edition of the newspaper.

⁴ Thucydides (c.460-c.400BC) was an Athenian political philosopher and general. He is widely viewed as the father of political realism, ie the theory that states and individuals act primarily out of fear and self-interest. His ‘History of the Peloponnesian War’ recounts the 5th century BC war between rising Athens and declining Sparta. Writing in the *Financial Times* in August 2012 Asia expert Graeme Allison concludes that: “[Thucydides’s] metaphor reminds us of the dangers two parties face when a rising power rivals a ruling power — as Athens did in the 5th century BC and Germany did at the end of the 19th century. Most such challenges have ended in war.”

⁵ See: <http://www.dannyquah.com/Quilled/Output/2011.01-Danny.Quah-The-Global-Economys-Shifting-Centre-of-Gravity-j.1758-5899.2010.00066.x.pdf>.

...geopolitics follows

"If soft power mirrors but lags economic power, then the source of global and political influence will be similarly gradually shifting east over the next 50-100 years."

Danny Quah, January 2011

This tectonic shift in the global economy has already left Western policymakers confronted with four major challenges, to none of which they appear to have any answers, as follows:

- Resurgent China;
- Revengeful jihadis;
- Revanchist Russia; and,
- Revolting electorates.

However, history and the resultant political theory only tells us so much, ie the general parameters within which we find ourselves. They do not tell us what to expect from all the "known unknowns" we now face, let alone the "unknown unknowns". And, as is so often the case, the proverbial devil is in the detail.

Transactional Trump and the end of *Pax Americana*

"...transformational presidents consciously set out to radically transform America and/or America's role in the world, while transactional presidents are pragmatists who focus on managing crises and responding with caution rather than taking bold and dangerous bets."

Joseph Nye Jnr, 1 March 2016⁶

For all the obsession with him today, it remains to be seen whether President Donald Trump, who has brilliantly exploited one of those "revolting electorates", will avoid going down in history as a mere detail. Or whether, in his efforts to "*make America great again*", he will prove to be a footnote who served merely to accelerate its (relative if not absolute) decline. In short, he may be far less transformational than he likes to think.

Indeed, if there is one word which seems to have slipped from the commentariat's lexicon since the 8 November election it has been 'transactional'. It is easy to understand why given Mr Trump's revolutionary rhetoric, not to mention his early actions. But it is an aspect of the businessman's character which we would do well to remember. And it is one which is not, in my view, incompatible, with the seemingly near-consensus view of him as isolationist, nativist and protectionist.

If we are right to focus on his transactional side, this does not mean that Mr Trump will not be transformational in some respects at least. A transactional approach to foreign policy, which is what we are clearly seeing already, marks a complete break away from the "*the spirit of enlightened self-interest that once defined the nation*", to which the *FT*'s Edward

⁶ 'Could Donald Trump be a new kind of transactional president?' by Tyler Durden, *ZeroHedge*, 1 March 2016.

Luce referred in another article published in May 2015.⁷ That, in turn, means that Mr Trump is, in effect, accelerating the already ongoing erosion of America's post-1945 world order and *Pax Americana*.

The conventional wisdom is that this is not 'a good thing'. After all, America's "*enlightened self-interest*" has, since 1945, underpinned a period of phenomenal economic growth globally — and not least in emerging markets — which is likely to be set back to an extent at least as Mr Trump looks to follow through to the full on his "***America First***" campaign rhetoric.

However, I believe that there is a counter-argument to the effect that he is, albeit unwittingly, bowing to the inevitable as the global economic centre of gravity continues to move back from west to east and, building on its renewed economic strength, **China** strives to undermine America's post-war monopoly in comprehensive national power.⁸

China is not, of course, alone in pushing back against the US — although it may be the only power ultimately capable of challenging America globally. **Russia** has made clear its demand for a regional sphere of influence in its near-abroad. And in the Middle East similar aspirations are to be found in **Iran**, **Saudi Arabia** and **Turkey**.

The principle of multipolarity, which now seems to be widely accepted, seems to me to make shifts in this direction more or less inevitable, suggesting that the big question is whether the US is prepared to step back peacefully from its "*global sphere of influence*" (as a Russian friend once put it to me) to allow other powers their niche; or whether it will resist to the point of precipitating violent conflict.

Thus — and with all due respect to other rejectionists of liberal democracy — **perhaps the biggest question preoccupying geopolitical theorists today is whether China and the US will be able to avoid Thucydides's trap.**

⁷ As I concluded in a report on what a President Trump would mean for Asia, published in July (see footnote 12 below): "*I see much in Mr Trump's campaign statements which can reasonably be described as "self-interest" by his definition of what is best for America. But I doubt that many would see his stance as offering a return to the sort of enlightenment which has defined the Pax Americana for much of the past 70 years or so, with all the benefits this has brought to the world in general and, perhaps, Asia in particular.*"

⁸ See, eg: 'Pivots: Economics, tectonics and geopolitics revisited' by Alastair Newton, *Aon Benfield*, September 2015.

Should we take President Trump at his word?

"[Mr Trump] wants a shake-up of US government and he wants it soon. That is why his first 100 days will be so definitive. He has set the timetable for an ambitious agenda and in the next three months we will find out how much he can really shift."

Katty Kay, 23 January 2017⁹

A large part of the answer to the question of Thucydides's trap may well lie in Mr Trump's hands in that what he actually does over the next four (eight?) years stands to have at least some impact on the prospects for peace and stability in Asia.¹⁰

This leads us to a bigger question which has increasingly been exercising policymakers worldwide since 20 January, ie **should we be taking Mr Trump at his word? Or, to put it another way, what does "America First" really mean in practice?**

The first challenge trying to answer this question lies in the fact that Mr Trump has made many contradictory statements (and continues to do so), as well as indulging regularly in what the highly influential White House senior advisor Kellyanne Conway has (in)famously referred to as **"alternative facts"**.¹¹ Nevertheless, everything we have seen from the 45th President so far suggests that, at minimum, **we should take him largely at his word about:**

- **Rolling back the established norms of free trade in an effort to bring manufacturing jobs back to the United States**, his determination to go down this track being made absolutely clear by his nominations and appointments to the key portfolios as well as his swift withdrawal from the Trans-Pacific Partnership (TPP);¹²
- Related (and the early focus on **Mexico** notwithstanding), pressuring **China** on a number of fronts, including geopolitically (see below) to prepare the ground to try to win concessions on trade;¹³
- Trying to isolate the US from the threat posed by **Islamist** terrorism (as well as being more accommodating of the Netanyahu government in Israel), even at the cost of significant damage to relations with traditional US allies;¹⁴ and,

⁹ 'What will happen in Donald Trump's first 100 days', *BBC News* — available at: <http://www.bbc.com/news/world-us-canada-38720658>.

¹⁰ Unsurprisingly, parts of the liberal press in the US (eg *The Huffington Post*) are already carrying articles about the possible (even "probable") impeachment of President Trump. I don't rule it out. But if it were to come to pass it could turn out to be an even bigger disaster for the US as it would almost certainly be seen by many who voted for him as the 'Washington elite' not only ignoring them but conspiring to their own ends against a man they see as their champion. Unless or until those who voted for him are really hurt directly by Mr Trump's actions — eg by slapping heavy border tariffs on goods from Mexico and/or China — he will likely continue to enjoy a great deal of support in 'Middle America', especially if, as 28 January *The Economist* rightly suggests in its Lexington column 'The Herbal Tea Party', anti-Trump protestors continue to patronise those who voted for him. It may be a long, painful and damaging process but the best way to oust Mr Trump would be for the Democrats to get their act together, if not by the 2018 Mid-Terms (when the deck is stacked against them in any case) then certainly by the 2020 general election. The fact is that Mr Trump was democratically elected and the best thing for democracy and social stability in America would be for him to be democratically defeated, not ousted by impeachment.

¹¹ See, eg: 'Conway: Trump White House offered "alternative facts" on crowd size' by Eric Bradner, *CNN*, 23 January 2017 — available at: <http://edition.cnn.com/2017/01/22/politics/kellyanne-conway-alternative-facts/index.html>.

¹² Euphemisms abound among Mr Trump's advisors here, ranging from "protecting jobs" in America to 'fair' trade. Nevertheless, as I have argued in several papers dating back to July 2016, one way or the other Mr Trump's principles on trade boil down to protectionism — see: 'What would a President Trump's Asia policy look like?', *Alavan Business Advisory*, 22 July 2016.

¹³ See, eg: 'Trump is bullying Mexico because Mexico is letting him do it' by León Krauze, *The Washington Post*, 27 January 2017 — available at: https://www.washingtonpost.com/posteverything/wp/2017/01/27/trump-is-bullying-mexico-because-mexico-is-letting-him-do-it/?utm_term=.82c52faada42; and: 'Trump's China policy: "This is how you stumble into a crisis"' by Dan De Luce, *Foreign Policy*, 26 January 2017 — available at: <https://www.yahoo.com/news/trump-china-policy-stumble-crisis-185156653.html>.

- Cosying up to **Russia's President Vladimir Putin** if only as part of Mr Trump's own 'war on terror', despite strong bipartisan opposition in Congress.¹⁵

And there are two other things the new President's first days in office tells us, ie:

- As I forecast immediately after the election, this particular leopard is certainly not about to change his spots, ie **Mr Trump intends governing in the same manner as he campaigned to all intents and purposes**,¹⁶
- He is likely to make even more use of **Executive Orders** to pursue his agenda than even his two immediate predecessors did, as well as pushing the envelope legally/constitutionally with them.¹⁷

Pulling all six of these bullets together within my general thesis about 'transactional' Trump, I draw two overarching conclusions, as follows:

- **President Trump will look to 'do deals' but, perhaps especially when it comes to trade, only on his own terms** (note well please UK Prime Minister Theresa May...and beware!);¹⁸ and,
- Related, he will work with Republicans in Congress and with his cabinet where he has to and can; but **his most influential advisors will be his key appointees in the White House**.¹⁹

Big implications for Asia

"Whoever replaces Barack Obama will face many difficult choices but few are likely to be as stark as those in the Asia Pacific region."

Geoff Dyer and Tom Mitchell, 16 July 2016²⁰

¹⁴ See, eg: 'Trump suspends US refugee programme and bans Syrians indefinitely', *BBC News*, 28 January 2017 — <http://www.bbc.com/news/world-us-canada-38777437>; and: 'Trump policies in Israel harm Palestinians, and hope for peace' by Rebecca Vilkomerson, *Boston Globe*, 27 January 2017 — available at: <http://www.bostonglobe.com/opinion/columns/2017/01/27/trump-policies-israel-will-harm-palestinians-and-hopes-for-peace/Ek016Ges0mt4akcAt4XTfN/story.html?event=event25>.

¹⁵ See, eg: 'Trump faces growing GOP pressure to maintain Russia sanctions' by Terrence Dopp, *Bloomberg*, 27 January 2017 — available at: <https://www.bloomberg.com/politics/articles/2017-01-27/trump-faces-growing-gop-pressure-to-maintain-russia-sanctions>. The Kremlin's press release on the 28 January Putin-Trump phone call contains what I take to be another euphemism (see footnote 12 above), ie *"the importance of rebuilding mutually beneficial trade"*...which sounds to me remarkably like agreement on sanctions alleviation — see eg: <http://www.bbc.com/news/world-us-canada-38786199>.

¹⁶ 'President Trump's foreign policy: Of leopards and spots', *Alavan Business Advisory*, 10 November 2016 and 'President Trump's foreign policy: Leopards & spots Pt 2', *Alavan Business Advisory*, 17 November 2016.

¹⁷ See, eg: 'First 100 days: What executive actions has Trump taken?', *BBC News*, 27 January 2017 — available at: <http://www.bbc.com/news/world-us-canada-38695593>; and footnote 20 below.

¹⁸ For more on the risk to Brexit see, eg: 'Donald Trump is a disaster for Brexit' by Gideon Rachman, *Financial Times*, 30 January 2017.

¹⁹ See, eg: 'Trump's economic "kitchen cabinet"', *Alavan Independent*, 20 January 2017, in which (in reply to a question which was put to me) I listed the five individuals whom I expect to be most influential on economic policy. Of those five, I would expect Chief of Staff Reince Priebus to tend to argue for working with Congress. But I would also expect him to be less influential than my other four, ie Special Advisor Jared Kushner (and his wife, Ivanka Trump), NEC Head Gary Kohn, Head of the Trade Council Peter Navarro and Senior Advisor Kellyanne Conway. On security I expect National Security Advisor Michael Flynn to be very influential; and it seems that Chief Strategist Steve Bannon will be too, following his appointment to the NSC on 28 January and the downgrading of the joint chiefs of staff and the director of national intelligence — see, eg: 'Trump puts Bannon on security council, dropping chiefs of staff', *BBC News*, 29 January 2017, available at: <http://www.bbc.com/news/world-us-canada-38787241>.

²⁰ 'South China Sea: Building up trouble', *Financial Times*.

Thus, it was with particular interest that I picked up the recent Nomura anchor report on the implications of “America First” for emerging markets.²¹ I found myself in total agreement with the following, plucked from the executive summary:

“This week’s souring of US-Mexican relations could be a taste of things to come. Yes, US fiscal stimulus is positive for EM, but we foresee two stronger counteracting forces that could have an earlier impact. One is a faster Fed hiking cycle and a strengthening USD, which exposes EMs – many of which have become heavily indebted since 2008 – to capital outflows and credit defaults. The other is the triumvirate of rising US trade protectionism, tougher immigration rules and a reassessment of US foreign policy positions, which seem to be at the heart of President Trump’s ‘America First’ goal. EM, with its trade-orientated economies and delicate geopolitics, are much more exposed to this than developed markets. When we polled investors on whether increased trade protectionism can lead to rising geopolitical tension, the result was striking: 46% replied ‘definitely yes’ and 41% said ‘probably yes’.

While we are cautious on EM, underlining this report is a warning against lumping all of EM together. EMs economic starting positions already vary greatly and Trumponomics stands to further widen this chasm.”

However, I also found myself somewhat at variance with the Nomura view in two respects, as follows:

- I am increasingly inclined to think that **Nomura’s “downside risk scenario involving a tougher set of ‘America First’ policies, including greater US trade protectionism, tougher immigration policies, faster Fed rate hikes and more USD appreciation”** is looking increasingly like it should be the base case,²² and,
- Although I would not argue with Nomura’s view that EMs in Asia stand to be less adversely affected than those in other regions by Trumponomics *per se* (and notwithstanding the undoubted threat some of Mr Trump’s stated intentions could pose to peace and stability in other regions), I am absolutely firm in my view that **it is in Asia where the greatest geopolitical risks appear to lie.**²³

Needless to say, this second point takes me back to Thucydides’s trap.

I would start by offering a heterodox argument that a US withdrawal from the Western Pacific, as Mr Trump once threatened, might ultimately be a safer option than the now seemingly much more likely boosted and assertive US military presence in the region.²⁴ For, if the US were to cease policing, notably, the South China Sea it could greatly ease Sino-US tensions. And who is to say that China would be any less benign in ensuring freedom of navigation for all than the US has been?

²¹ ‘EM’s struggle with “America First” policies’ by Robert Subbaraman *et al*, *Nomura Global Markets Research*, 27 January 2017.

²² I am, of course, thinking primarily about trade and immigration; I leave rate hikes and dollar appreciation primarily to the experts in those fields.

²³ In its risk scenario, Nomura argues that — despite being more exposed to Trumponomics than Latin America (*pace* Mexico) — Asian growth would not be hurt as much because Asia has more room for a bigger fiscal stimulus response and several countries can cut policy rates (as opposed to a hike in case of Mexico), supporting Nomura’s call for steeper yield curves in Asia.

²⁴ ‘What would a President Trump’s Asia policy look like?’, *Alavan Business Advisory*, 22 July 2016.

I think that China would probably settle for even fairly serious trade frictions with the US if it were to be coupled with a military pullback from the region by Washington — which would likely be the result if Mr Trump were to stand by his pledge of making Japan and South Korea meet the full cost of US bases they host and if President Rodrigo Duterte were to kick the US military out of the Philippines, as he has promised.

However, what I think is more likely is that China gets the worst of both worlds. Consider.

- As I have already asserted, Mr Trump has always been highly likely to implement at least some of his trade-related pledges (and it is quite frightening what a US President can do without Congressional approval), if only in the interests of trying to ensure that those who voted for him last year go out and do so again in 2020. Beijing is hardly likely ultimately to sit quiet and take this on the chin; so, there is a genuine risk that we descend into an all-out trade war between China and the US.²⁵
- The TPP aside (which China is clearly delighted to see fail), Mr Trump shows every sign of being a staunch supporter of the strategic pivot.

If this assessment is correct, **China will finish up having to deal with a trade war and an increasingly vigorous US military presence in its neighbourhood.**

Although this might appeal to Beijing in terms of promoting nationalist sentiment at home, it would nevertheless be fraught with risk. After all, a serious trade war would likely be a drag on economic growth, thereby adding to socio-economic tensions and the risk of serious civil unrest; inevitably, this would have China's leaders resorting increasingly to the nationalist 'drum' (see below).²⁶

Of course, noting Mr Trump's promise that US foreign policy under him would be "unpredictable", there is a significant degree of uncertainty around both these predictions. And that uncertainty raises serious problems for China's neighbours who, with the arguable exception of Japan, are all trying to find the 'right' balance in their relations with Beijing and Washington.

Unfortunately — but, I would argue, inevitably — for the latter, the US has come increasingly to be seen as an unreliable ally (and not only in Asia), a sense which is only likely to have been deepened by Mr Trump's withdrawal from the TPP. As a result traditional allies — **Malaysia, the Philippines, Thailand** — are moving across the spectrum towards Beijing. And the domestic political crisis in **South Korea** raises questions about its steadfastness following the inevitable early departure of Park Geun-hye, despite President Xi Jinping's seeming unwillingness to crack down on Kim Jong-un's nuclear aspirations (another major headache for Mr Trump in the coming weeks).²⁷ Admittedly, **Vietnam** seems to be moving in the opposite direction. Nevertheless — and overall — there must be a real and justified sense in Beijing that the balance of regional power is moving steadily China's way.

²⁵ 'President Trump's foreign policy: Of leopards and spots', *Alavan Business Advisory*, 10 November 2016.

²⁶ 'President Trump's foreign policy: Leopards & spots Pt 2', *Alavan Business Advisory*, 17 November 2016.

²⁷ 'Donald Trump and North Korea: Naïve or Nixon 2.0?', 30 May 2016 — available at: <http://www.globalpolicyjournal.com/blog/30/05/2016/donald-trump-and-north-korea-naïve-or-nixon-20>.

Maritime borders: Potential for confrontation...

“To preserve the status quo, the US needs to prevent every one of China’s moves, something it has been unable to do. China needs merely to pick a few small battles that it knows the US has no wish to fight”.

David Pilling, 28 May 2014²⁸

One particular policy area where there appears to be at least some uncertainty, if not outright unpredictability, lies in the Trump Administration’s intentions in the **South China Sea**. Certainly, what is clear is that Mr Trump fully intends retaining a major US military presence there. Where the uncertainty creeps in is in determining just what he will authorise it to do in the name of ‘freedom of navigation’.

In his confirmation hearings Secretary of State nominee Rex Tillerson seemed to suggest that it was the Administration’s intention to bar China’s access to its island constructs in the disputed waters.²⁹ Although Mr Trump’s press spokesman appeared subsequently to back off this a little, there is still at least a suggestion that the US would be prepared to use force to stymie Beijing’s territorial ambitions.³⁰

Furthermore (and related), it is far from clear that Mr Trump and his closest advisers in the White House understand how neuralgic Beijing is over the ‘One China’ policy and **Taiwan**.³¹

...but Beijing will try to play for time

“...China has been shrewdly cautious. President Xi Jinping has deftly promoted Beijing as the new guardian of the multilateral trade order.”

Philip Stephens, 26 January 2017³²

Despite a robust reaction in China’s media to Mr Tillerson’s remarks, the emphasis for now in Beijing seems still to be on ‘soft power’ projection.³³ I fully expect to see China continue down this track, perhaps most notably by pushing the **Regional Comprehensive Economic Partnership** (RCEP) with ASEAN (now under the presidency of the Philippines) and the six states with which the Association has FTAs.³⁴ Furthermore, Beijing will continue to enjoy growing international recognition of the **Asia Infrastructure Investment Bank** (AIIB) which has well over 20 applications for membership before it.³⁵ And, in all probabil-

²⁸ ‘China is stealing a strategic march on the US’ by David Pilling, *Financial Times*, 28 May 2014.

²⁹ See, eg: ‘Tillerson says China should be barred from South China Sea islands’ by David Brunnstrom and Matt Spetalnick, *Reuters*, 12 January 2017 — available at: <http://www.reuters.com/article/us-congress-tillerson-china-idUSKBN14V2KZ>.

³⁰ See, eg: ‘Is Trump ready for war in the South China Sea, or is his team just not clear?’ by Simon Denyer, *The Washington Post*, 25 January 2017 — available at: <http://www.msn.com/en-ie/news/world/is-trump-ready-for-war-in-the-south-china-sea-or-is-his-team-just-not-being-clear/ar-AAmaD1w>.

³¹ See, eg: ‘China/Taiwan/US: Dire straits’, *Alavan Business Advisory*, 5 December 2016.

³² ‘What the world hears from Donald Trump’, *Financial Times*.

³³ See, eg: ‘Chinese state media slams Tillerson over South China Sea’ by Katie Hunt, *CNN*, 13 January 2017 — available at: <http://edition.cnn.com/2017/01/13/politics/us-tillerson-china-reaction/index.html>.

³⁴ https://en.wikipedia.org/wiki/Regional_Comprehensive_Economic_Partnership.

³⁵ See, eg: ‘More countries seek to join China’s Asian Infrastructure Investment Bank’ by Elizabeth Shim, *UPI*, 25 January 2017 — available at: http://www.upi.com/Top_News/World-News/2017/01/25/More-countries-seek-to-join-Chinas-Asian-Infrastructure-Investment-Bank/7191485371428/.

ity, China can be expected to assume a global leadership role on climate change whether Mr Trump withdraws the US from **the Paris Agreement** or not.³⁶

However, the current drift in the region towards Beijing, coupled with Mr Trump's inexperience, is only likely to encourage Beijing to continue to pursue an assertive stance in both the South China Sea despite the PCA's ruling, and, perhaps even more so, the East China Sea. **Nevertheless (and in contrast to my sense just a few weeks ago), I think it unlikely in the light of Xi Jinping's recent efforts to assume the moral high ground that he is intending an early test of Mr Trump's resolve.**³⁷

Consistent with this, I think the *FT*'s James Kynge is absolutely right in forecasting that **China will quietly look to take advantage of the Trump-type turmoil afflicting liberal democracies by advancing in the developing world in particular (where it has the financial and diplomatic muscle to make the biggest impact) its "vision" of "globalisation without liberalism"**.³⁸

This being said, as I wrote in my Outlook 2017, Xi Jinping's number one priority this year has to be ensuring that his proteges are eased into key positions on the politburo in general and its standing committee in particular at the 19th Communist Party of China (CPC) Congress due in October or November. He therefore has a major interest in avoiding anything between now and then which could have a negative impact on China's economy and/or domestic stability.

At the same time, however, he cannot afford to be seen as weak in the face of US assertiveness. So, the risk of a serious miscalculation between Beijing and Washington is, I believe, a very real one. And it is one which probably grows bigger after the Congress.

Converging courses

"Globalisation has survived many things, but the rise of mercantilist populism in the form of Mr Trump may be its biggest challenge for decades. The year 2016 was not a disastrous one for international commerce, but it may prove to be an uneasy calm before the trade wars begin."

Financial Times, 27 December 2016

Unfortunately, Washington's political timeline may converge with Beijing's in the latter part of this year. In the context of the former I wrote in my Outlook for 2017 as follows.

"[The FT's] Edward Luce, rightly in my view, argues that investors need to reassess carefully the implications of the Trump boom. It will not happen overnight; but by

³⁶ See, eg: 'China steps up as US steps back from global leadership role' by Flynt L Leveret and Robert Sprinkle, *The Conversation*, 23 January 2017 — available at: https://theconversation.com/china-steps-up-as-us-steps-back-from-global-leadership-70962?utm_medium=email&utm_campaign=Latest%20from%20The%20Conversation%20for%20January%2022%202017%20-%206584&utm_content=Latest%20from%20The%20Conversation%20for%20January%2022%202017%20-%206584+CID_fc7f31e4fc1a21b16eaa1cc65279d379&utm_source=campaign_monitor_us&utm_term=Trumps%20inaugural%20speech%20is%20it%20morning%20or%20mourning%20in%20America.

³⁷ See, eg: 'Xi Jinping's Davis speech defends globalization but does China really mean it?' by Douglas Bullock, *Forbes*, 18 January 2017 — available at: <http://www.forbes.com/sites/douglasbulloch/2017/01/18/xi-jinpings-davos-speech-defends-globalisation-but-does-china-really-mean-it/#702171057531>.

³⁸ 'China stakes a claim for globalism without liberalism' by James Kynge, *Financial Times*, 27 January 2017.

mid-2017 at the latest I expect the downsides to be becoming clear. Mr Luce highlights the following in particular:

- **The President vs the Fed:** As Mr Luce quips: “No president likes the central bankers who take away the punch bowl just as the party is hotting up”. And we may be sure that Mr Trump will be no exception. Contrary to his campaign promise, he cannot fire Janet Yellen. But he can look to fill the two vacancies on the Fed’s board with dovish candidates (which is what I expect to see); and he can look to undermine Ms Yellen through making public (by Twitter or otherwise) his disapproval of any move she oversees. Furthermore, we should not expect any real resistance to pressure for loose monetary policy from Republicans on the Hill who are also likely suddenly to be far less averse to deficits than they were with a Democrat in the White House.³⁹
- **Currency ‘war’:** Further dollar appreciation looks inevitable, cutting the cost of imports (thereby triggering an import boom) and increasing the cost of exports (and pushing down commodity prices). First and foremost, **this will boost the US trade deficit**, which in 2015 stood at almost US\$400bn with China alone and which Mr Trump has vowed to cut. Second, it will make Beijing’s task of managing any decline of the RMB even more difficult both economically and, in terms of relations with the US, geopolitically.⁴⁰

May you live in interesting times⁴¹

“President Trump sees the strong dollar as a burden for exporters and an obstacle to boosting manufacturing employment. But he fails to appreciate that his own policy proposals, and those of his Congressional allies, are responsible for driving the exchange rate up.”

Barry Eichengreen, 26 January 2017⁴²

There is no question other than that these are indeed ‘interesting times’ for any student of geopolitics. However, it is equally clear that this is a tough time for investors.

It is worth the investors keeping in mind, therefore, that there is a whole community of commentators out there determined to treat ‘worst case’ as ‘base case’. For sure, there is no shortage of tail risks — and some of these are ‘fat tails’. But, for the time being at least, the biggest Trump-related threat, including for emerging markets, may lie not in geopolitics but in US domestic politics, ie:

- Mr Trump succeeds in pushing through a major fiscal stimulus including tax cuts, incentives for repatriation of foreign earnings by corporates and debt-financed infrastructure investment;

³⁹ Another important issue related not only to the deficit question but to the ‘big picture’ aim of bringing manufacturing back to America is the **proposed import tax** which is now running into heavy resistance from clothing manufacturers, big retail etc. A key question for equity investors in particular is whether this proposal survives as Republicans look to carry out a wide-ranging overhaul of the tax code. See, eg: ‘Republicans face corporate tax revolt’ by Barney Jopson, *Financial Times*, 14 December 2016.

⁴⁰ See, eg: ‘Managing the inevitable decline of the renminbi’, *Financial Times*, 14 December 2016.

⁴¹ https://en.wikipedia.org/wiki/May_you_live_in_interesting_times

⁴² ‘Powerful forces will lead to a strong dollar under Trump’, *Financial Times*.

- The domestic energy boom, which is already taking off again without the aid of climate change-denying policy shifts, pushes the US closer to energy self-sufficiency, reducing the balance of payments deficit in so doing; and,
- Consequent inflationary pressures cause the Fed to raise rates not just once but possibly three times in the next 12 months.

The bottom line? In considering the implications of the Trump presidency investors would do well to focus first on the 'known knowns' of the economics. But please do not lose sight of the 'known unknowns' of the geopolitics as, especially if 2016 is anything to go by, at least some of those political tail risks will come to pass.

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