Big Picture

OCBC Bank

A Huge, Huge Deal

What if Trump wins?

Jul 29, 2016

- **Say what you may of his personality, Trump has obviously come a long way in his political journey – and he is hardly done yet. Having secured the Republican presidential nomination, he is now just one contest away from ruling the world's largest economy.**
- **While market appears to be assuming that his contender, Hillary Clinton, will win the day, the sting of Brexit surprise reminds us to take nothing for granted. In short, we should at least think seriously about the possibility of a President Trump.**
- **What he says as a candidate is unlikely to reflect what he does as a president completely, that's true. Even a subset is confounding enough, however. From pulling out of WTO to slapping discounts on US Treasuries, elements of his unorthodox platform can be a huge, huge deal for us all.**

Treasury Advisory

Corporate FX & Structured Products
Tel: 6349-1888 / 1881

Fixed Income & Structured Products
Tel: 6349-1810

Interest Rate Derivatives
Tel: 6349-1899

Investments & Structured Products
Tel: 6349-1886

We've got to talk about him

Donald Trump is a man who has said a lot of things. That America should build a wall along its southern border that it would bill Mexico for was just one controversial comment he made early on in his political gambit in June last year. Since then, one has probably lost count of the times when he graced news headlines for the wrong reasons. The ironic thing, of course, is that the more controversial comments he makes, the better his political fortunes appear to be.

Once upon a time, Trump was just an often-bankrupt property developer. His whims and actions would only matter greatly, if you happen to be one of the contestants at the receiving end of his "You're Fired" missiles on reality TV shows. Alas, times have changed. He is now a contestant himself, in what is arguably the greatest race of all, that of becoming the 45th president of the United States. Aside from having the constitutional prerogative to launch non-verbal missiles and much, much more, the office would also decide key economic policies that carry important implications not just for Americans, but multitude of families outside his wall – metaphorical or otherwise.

Hence, in the spirit of hoping for the best while preparing for the worst, we believe it's high time we dissect some key aspects of his economic platform and ponder upon the implications for Asia, in particular.

Wellian Wiranto
Economist
Treasury Research & Strategy,
Global Treasury,
OCBC Bank

+65 6530-5949
wellianwiranto@ocbc.com

No Country for Old Trade

One of the major ways in which what happens in the US can quickly transpire into what happens in Asia is via the trade channel. Countries like Indonesia and India with large domestic economies, with relatively little dependence on trade in general and trade with US in particular, are relatively more insulated. However, there are plenty of others in the region that would have to fret more. In particular, any fallout from US would be felt especially strongly in economies such as Singapore, Hong Kong and Vietnam, whereby exports to US make up chunky portions of the overall GDP.

Source: UNCTAD, OCBC.

Hence, the old saying that "When America sneezes, the world catches a cold" still applies for Asia. Not only do Asian economies depend on the health of the US economy and its demand for imported goods, they also depend on the fact that the closely knit web of global trade flows would remain undisturbed. It does not help then, that the US presidential election season is busy kicking up swirls of dust and fanning them on with gusto – almost as if to make sure that America would indeed sneeze. In particular, even though trade policy in general has been a regular feature in past elections, it appears to take on a whole new degree of antagonism this time round.

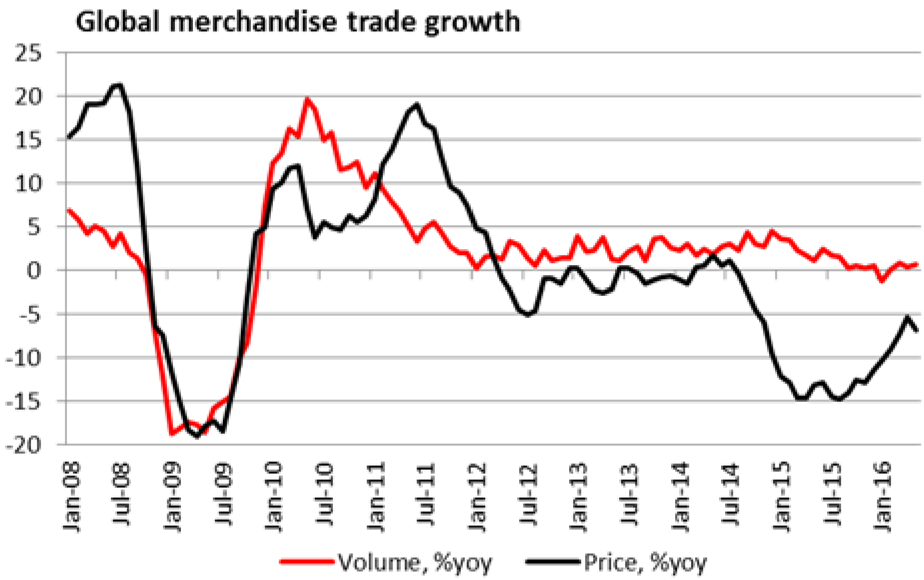
As an illustration, Trump's official campaign website had a video, with a headline screaming "TRADE WAR: Our country is getting ripped off. We need the smartest people negotiating for us!" In it, he claims that there is already a trade war and that countries ranging from China and India to Vietnam and Japan are ripping hundreds of billions of dollars off the US economy.

The belligerence echoes what he has said elsewhere. On the NAFTA pact with Canada and Mexico, he variously said that he would either renegotiate it or threaten to impose a 35% tariff on imports from Mexico or rip it up altogether. An even more punitive 45% tariff will be slapped on Chinese imports, he proclaimed. On top of that, he also threatened to impose penalties on companies that move production away from US. When told that these moves would run afoul of WTO rules in a recent TV interview, he simply said it does not matter and that he could just pull out of the organization – which has formed the very cornerstone of global trade architecture since 1995 – altogether.

If he is that keen on dismantling the existing global trade structure as it stands, there is fat chance then that Trump would endorse any additional trade deals that allow for even freer global trade in goods and services. This includes the Trans-Pacific Partnership, an Obama initiative that is yet to be ratified by the Congress. Indeed, the strong stance that Trump has exhibited against trade pacts in general and TPP in particular has inadvertently contributed to the lukewarm support that the Democratic nominee, Hillary Clinton, has on the issue. For one, both she and her running mate, Tim Kaine, have reversed their support of the TPP program as of now.

Such developments are bad news for global trade.

On a cyclical basis, it is already suffering from weakness in demand from major economies. Going by data from World Trade Monitor of Centraal Planbureau of the Netherlands, growth in global trade flows remain stunted at just 0.8% yoy in volume terms, as of May this year. In price terms, things look even less comforting, with negative growth rates remaining the norm.



Source: Centraal Planbureau, OCBC.

If anyone was hoping to see trade pacts such as TPP becoming a structural pillar of support for the global trade architecture, it appears that chances are more depressed than before. For Asian countries such as Malaysia and Singapore which have already signed on to the TPP, this represents a potential setback. For Indonesia, whose president has expressed an interest in joining the pact, partly to boost his chances of pushing for tough reforms at home, it would mark a missed opportunity. (See our WSJ op-ed on the issue, for details). All thanks to Trump's loaded posturing on his anti-trade and anti-globalization platform.

Yes, I'll do this. No, I'll do that.

While Trump's foreign economic policy poses a threat to the real sector of Asian economies via potential trade disruptions, the domestic elements of his platform would be a cause for concern for Asia as well through the financial channels. Here, the main conduit will be how his fiscal stance and incursions into the Fed's independence can potentially lead to shakiness in the US Dollar and the US Treasury markets.

First, on the fiscal front, Trump said that his "core beliefs" are that he wants "a major tax cut." Indeed, his plan calls for a slashing of top individual tax rate from 39.6% to 25%, that of corporate tax from 35% to 15%, together with the abolition of the estate tax. His campaign website claims that these heavy tax cuts will be revenue-neutral. They will apparently be fully paid for by closing loopholes for the very rich and big corporations, as well as a presumptive "one-time repatriation of corporate cash held overseas".

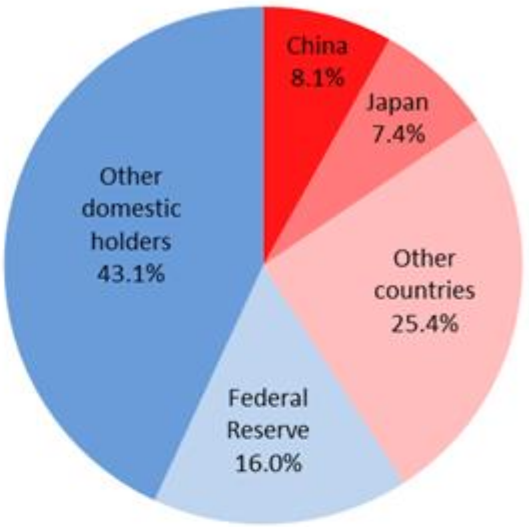
That claim did not stand the test of scrutiny by the non-partisan Tax Policy Center, however. Indeed, going by its calculations, Trump's plan would mean a revenue loss of as much as USD9.5tn, or 20% of projected federal taxes over a decade. Curiously, the biggest benefits of his plan would ostensibly go to the richest folks, with the top 1% of households projected to get a nearly 18% boost in their after-tax income. The same report also points out that, unless it is "accompanied by very large spending cuts, it could increase the national debt by nearly 80 percent of gross domestic product by 2036, offsetting some or all of the incentive effects of the tax cuts."

For the sake of comparison, US debt-to-GDP ratio now stands at around 106%. Hence, Trump's fiscal plan could thus see a significant jump in the indebtedness of the US government. In and of its own, this is already a tricky prospect. It gets even hairier, however, if we consider the uninformed nonchalance in which the presidential candidate spoke about the responsibility of honouring US debt.

In an interview with CNBC in May this year, Trump said that he might seek to reduce the US national debt by persuading creditors to accept a write-down. That is to say, facing a potential uptick in government debt from his tax plans, Trump reached for what he thought is a magic solution of just paying the creditors less than they are owed. This looks to be stemming from a misguided thinking that bond repurchase at a discount that corporations sometimes engineer – banking on debt holders' fear of a full default otherwise – can be applied directly to the sovereign debt market without dire consequences.

US is no banana republic. And, the US Treasury market is no place for such loose talks by a potential top-office holder, especially when it serves as a crucial risk-free benchmark for financial assets globally. Moreover, about 41% of outstanding US Treasuries are held by foreigners, including a multitude of central banks worldwide which are attracted to the liquidity and depth of the market and global investors who value its traditional safe-haven status. Within this group of foreign holders, China makes up the lion's share. Any potential disturbance to the US Treasury market would thus not only have direct economic implications, but also broader geopolitical considerations as well, posing an additional risk to what is already an uneasy bilateral relationship between the world's two largest economies.

Holders of US Treasuries, % of Total



Source, Bloomberg, OCBC.

Hence, while Trump had tried to reverse his initial comments by saying that "The bonds are absolutely sacred", the casualness in which he flips and flops on such fundamental underpinnings of global financial market as the US Treasury market will not go unnoticed.

The same pattern of first making some outlandish comments and then backtracking on them seems to hold when it comes to the Federal Reserve, as well. After saying that Janet Yellen ought to raise rates and that she might have held rates low for political reasons and risking inflation back in November last year, he has since reversed his position in May and said that he supports low interest rates. It is one thing for a presidential candidate to weigh in on interest rate policy, which is solely the purview of the independent central bank, it is quite another to have him do so in such a brashly open manner that is so prone to reversals.

Maybe he doesn't mean it at all?

One hope for global markets is that all that Trump has said on economic policies thus far, be it on free trade or the sanctity of US Treasury and the independence of the Fed, is merely just random thoughts that somehow stream out of him, rather than representing any fundamental belief that he holds true and will look to implement should he be elected come November 8th. Moreover, if he can change his mind this frequently now – sometimes seemingly halfway through his sentences even – then maybe, just maybe, he would see the pragmatic light once he comes into office. After all, in all fairness, which good politician in America and anywhere else in the world has not backtracked on at least some election promises before?

The potential of those scenarios taking place is there, even if the fact that we might have to hold on to the hope that he absolutely will not do what he says he would do cannot be all that reassuring in and of its own.

If we take a step back and try to better understand Trump's personality throughout his life, including before he sauntered onto the political stage, there might exist another explanation behind it all. In particular, there appears to be a core strategy that served him well as a businessman, and continues to do so for Trump as a presidential candidate: Publicity.

In his 1987 book, "The Art of the Deal", he offered that "Good publicity is preferable to bad, but from a bottom-line perspective, bad publicity is sometimes better than no publicity at all. Controversy, in short, sells." For good measure, he added that, "The point is that if you are a little different, or a little outrageous, or if you do things that are bold or controversial, the press is going to write about you."

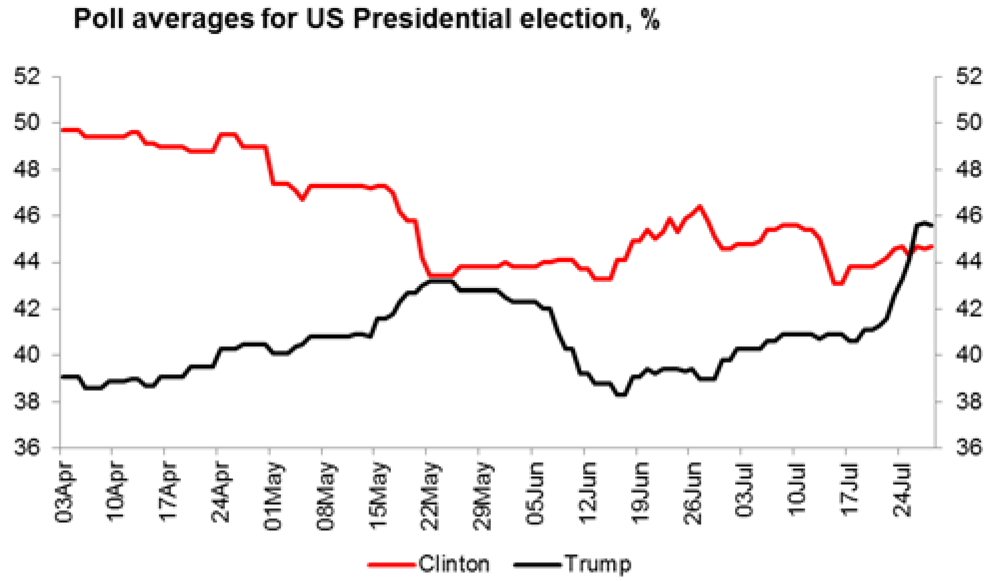
If the 29-year-old book is any guide, there is some chance that he is filling his campaign with as many outlandish policy rhetoric as possible, not because he believes in them or would carry them out, but to serve a single-minded goal of maximizing press coverage, simply because he equates publicity to potential votes.

Interestingly, media-tracking firm mediaQuant reckons that as of April 2016, Donald Trump has received the equivalent of more than USD2.4bn worth of free media exposure in the past year. That's worth more than the free publicity that Taylor Swift, Kim Kardashian and Kanye West have gotten, combined. Indeed, viewed from this angle, one might be tempted to say that Trump's is not so much a rags-to-riches story, but more of a brags-to-riches one.

Thin Margin

At the end of the day, no amount of psychoanalysis or punditry can truly unmask what a Trump presidency would mean to the global economy. Still, please forgive us for trying, given the gravity of the outcome and the closeness of the race.

While polls had been suggesting that Hillary Clinton would be the one clinching the US presidency, Trump has edged up and bested her of late. Even if this might be reflecting a temporary boost from last week's Republican convention and Clinton may yet get a lift from the coverage of her own formal nomination today, the ups and downs of the polls just remind us that we still have more than 3 months to go before election day. Given the thinness of the margin between the two candidates, this race is likely to appear to be a toss-up in the interim enough for markets to remain wary. This may be especially so after the sting from the shocking end-results of Brexit referendum last month.



Source: Real Clear Politics, OCBC.

The thin margin is not limited to the US presidential polls alone. Zooming out into the global economic conditions and we can see its twin in the thin margin of error for economic policies, as well. The global economy, reeling from the assaults by 2008 global financial crisis and 2011 European sovereign debt crisis and still threatened by a host of uncertainties – about China's growth transition, pockets of terrorism and unrests globally, and lately ripples from Brexit referendum – is already testing the limits of economic policies.

This has been most evident in terms of monetary policy. Major central banks, having rolled out quantitative easing and then negative rates, may be increasingly compelled by circumstances to seriously consider helicopter money too – implications of which the global markets are just starting to grapple with.

In all honesty, things are already confusing and concerning as it is. Given what we can gather, it is perhaps fair to say that it will be even more so if Trump wins. Whether the man gets to carry out whatever plans he really has to "Make America Great Again!" or not, is therefore a question that will probably make Asian policymakers fret again, and again, in the coming months.