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Global Markets Research

Research Alert

No clear winners from trade tensions

Trump's protectionist policies will heighten the elevated US-China trade tension

History shows higher tariffs only mean lower GDP growth and higher inflation for the US

Trade tension poses risks to Malaysia's growth; impact varies by sectors

Background

Former president/presidential candidate Donald Trump has pledged to scrap the federal income tax and replaced it with revenue ***from a flat 10% tariff on all imports, and 60% tariff on Chinese imports*** in a fiscal swap with lower taxes, if he is re-elected. The objectives for these moves were to protect domestic industries, particularly those vital to national security and to incentivize foreign countries to change their unfair practices (specifically directed to China - Figure 1), and NOT to raise revenue.

While we do not have clarity on likely Democrat nominee Kalama Harris' view on this, the Biden administration has recently in May 2024, introduced a slew of strategic and targeted tariff hikes on Chinese imports.

History repeating itself

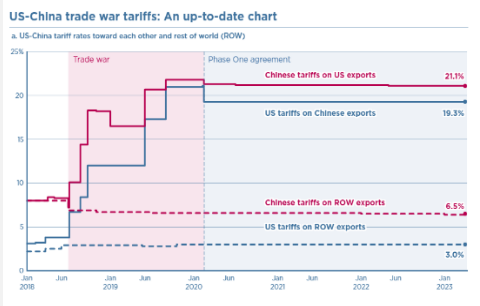
For recap purposes, US tariff rates have been on a downward trend since the 1947 General Agreement on Tariffs and Trade (GATT) was enacted (Figure 2), only reversing when the Trump administration took over in 2017. He raised tariffs on several products, especially those imported from China and sparked a trade war. The tariff hikes stalled temporarily when the Biden administration took over (although he kept Trump-era tariffs in place), before increasing again in May 2024 when the Biden administration slapped more tariffs on products like steel, aluminium, medical equipment, electric vehicles, lithium-ion batteries and solar cells.

China was the target of most of Trumps' trade war

Jan-18	Targeted at solar panels (30%) and washing machines (20-50%), carve-outs for small number of developing countries
Mar-18	Tariffs on all steel (25%) and aluminium (10%) imports, carve-outs for a handful of trading partners
Jul-18	Covering $34bn of Mainland Chinese goods, focused on industrial products (25%)
Aug-18	Targeting an additional $16bn of Chinese industrial exports (25%)
Sep-18	10% tariff on $200bn of Chinese exports
May-19	Tariffs on Chinese exports targeted in September 2018 raised to 25%
May-19	Proposed 5% tariff on all imports from Mexico, rising by 5ppts monthly to 25% (never implemented)
Aug-19	10% tariff remaining $300bn not covered, only partially implemented

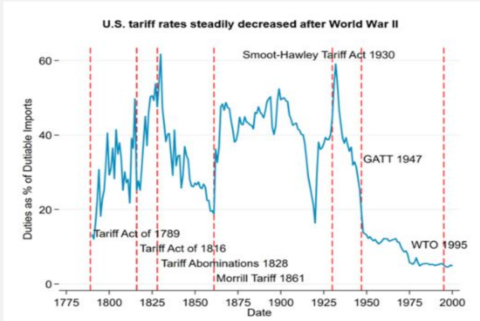
Source: Brookings, Congressional Research Service, BMI

Figure 1: China tariffs (towards US and rest of the world) were higher



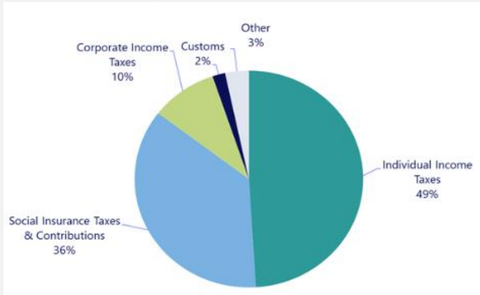
Source: Brookings, Peterson Institute of International Economics

Figure 2: US tariff rates have steadily declined since the 1947 GATT was enacted; higher again since the Trump era



Source: Brookings, The Coalition for a Prosperous America

Figure 3: Tariffs have not provided meaningful share of revenue to the US since 1900s up till 2023



Source: The White House, Monthly Treasury Statement, Council of Economic Advisors

What to expect

In a scenario where Donald Trump is re-elected (Fitch Solutions BMI polls: 61%, Reuters: 44% to Harris and 42% to Trump) and the tariff hikes will no longer be just a bark but a bite, there is a risk that US economy may face a stagflation.

- First and foremost, the burden of tariffs in the US, if implemented, will fall on both the consumers (who has to pay higher prices) and on importers (who may absorb the additional cost by not passing it to consumers, reducing their profits), with varying degree depending on the level of pass-through in terms of prices.

- Some consumers may switch to domestic goods, which is positive for the economy. On the other, the purchasing power of consumers goes down as imported goods become more expensive, a negative for the economy.

- The fiscal swap (from income tax to tariff) would shift the burden from the upper-income Americans to those who don't make enough income to pay much, if any, income taxes, and those who have the higher marginal propensity to spend (Figure 4).

- According to the White House's calculation, ***Trump's across-the-board tariff rates would likely need to be much larger than 70%, to plug the loophole from the income tax*** *(Figure 3)*, ***potentially sending inflation rate up by about 0.75ppts***, and resulting in a more hawkish Fed again, sell-offs in the Treasury and a firmer USD. (Figure 5).

- No doubt, tariffs could lead to a narrower US trade account deficit, which is positive on GDP calculation but historical data proved otherwise or temporarily. US goods trade deficit fluctuated from an average of $66.0bn in 2017 to $72.5bn in 2018, $70.5bn in 2019 and $75.1bn in 2020 (Figure 6).

- All in, the impact on GDP is ambiguous, but most believe that a free trade policy is positive for economic growth, more than a protectionist policy. In an article dated August 2019, the Congressional Budget Office (CBO) estimated that the trade barriers imposed since January 2018 ***cut both real output and real household income by 0.3ppts and $580*** respectively by 2020. The Tax Foundation estimated that the Trump-Biden tariffs ***will reduce long-run GDP by 0.2% and employment by 142k full-time equivalent jobs*** (negligible compared to 168m civilian labour force).

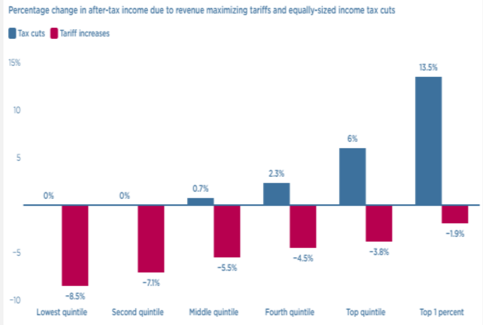
- Potential beneficiary sectors, if Trump is to win, include the targeted ***auto and manufacturing industries, critical supply chain-related sectors***, and because of his buying American and hiring Americans manifesto, potentially consumers, or not**.**

Impact for Malaysia neutral-to-mildly negative

Broadly speaking, trade tensions will definitely be detrimental to world trade (Figure 7). That said, several countries like Malaysia, which are not directly linked to these 2 giants, could be less impacted as conduits are sought.

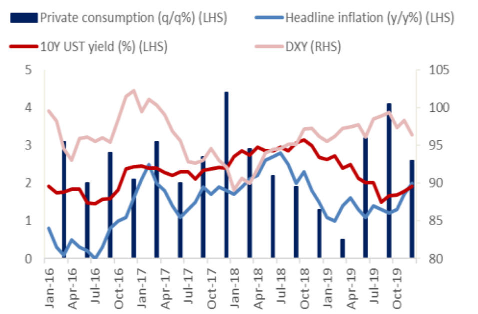
- ***Total exports amounted to 66% of Malaysia's GDP in 2023 and the duo – US and China – accounted for approximately 25% of our total exports***. Our exports will be affected directly by any lower demand and slower economic growth from these affected countries as well as indirectly from

Figure 4: Lower-and middle-income Americans would lose more in the fiscal swap from tax cuts to higher tariffs



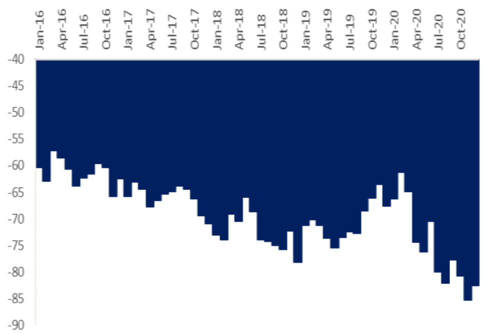
Source: Brookings, Peterson Institute of International Economics

Figure 5: Theoretically speaking, higher risk of stagflation with tariff hikes



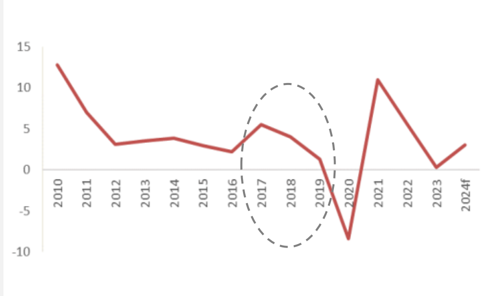
Source: Bloomberg

Figure 6: US goods trade deficit did not see significant improvements post tariff-hikes ($bn)



Source: Bloomberg

Figure 7: World trade volume slowed from +4.0% y/y in 2018 to 1.3% y/y in 2019



Source: IMF

any disruptions and/or shifts in the global supply chain from trade tension and any spillover to employment and income growth from the export-oriented industries in Malaysia. A BNM stimulation showed that ***trade tensions in 2018 were estimated to have shaved Malaysia's GDP by at least 0.3-0.5ppt in 2019.***

- As mentioned earlier, several sectors and regional countries, nonetheless, could stand to benefit from trade diversion from China (but bearing in mind that Trump is eyeing for an across the board 10% tariff on all imports) but this is not expected to fully offset the negative impact from slower global trade activities.

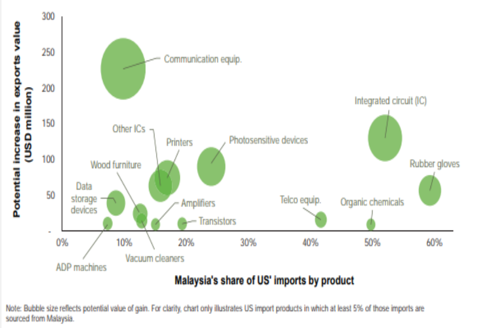
- For Malaysia, the impact on various sectors from the trade tensions will also vary (Figure 8):

  - In our research alert entitled "Positive on electronics and electrical sector" dated 27th March 2024, we have already pointed out that US and European tech companies have started to diversify its supply chains from China to regional peers and Malaysia could benefit from this. Already, US Commerce Secretary Gina Raimando has already urged the doubling of chip plants in the Philippines, A&T will officially open its first plant in Kulim, Malaysia while TSMC opened its first chip plant in Japan as it diversifies supply chains away from Taiwan amid intensifying U.S.-China trade tensions (Figure 9).

  - Malaysian rubber glove manufacturers have faced intense competition from China due to its lower average selling prices. With the Biden administration raising the tariffs on Chinese rubber medical and surgical gloves from 7.5% to 25% in 2026, this will make Chinese gloves more expensive in about 2 years' time, a positive for domestic rubber glove makers.

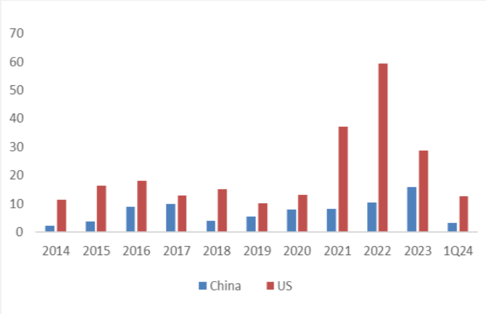
  - Impact on other industries varied. History showed that local manufacturers stopped exporting to the US following the blanket tariff on steel imports (Figure 10), but impact on solar panels were highly dependent on demand.

Figure 8: Malaysia's exports to the US and potentials gains from trade substitution



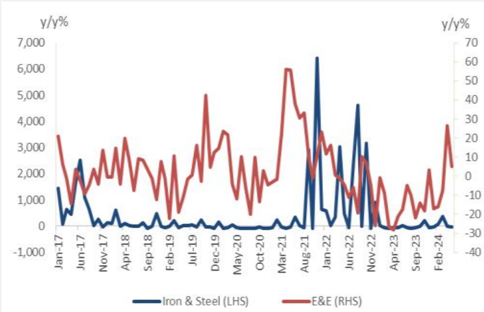
Source: ITC Trade Map, Global Trade Atlas, BNM Estimates

Figure 9: US' FDI into Malaysia has picked up since 2019 (RMbn)



Source: BNM

Figure 10: US imports of Malaysian steel has stalled since the tariff hikes



Source: CEIC

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