FINANCIAL MARKETS VIEWS&ANALYSIS

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FX, Fixed income, Econ, Facts & Fallacies

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Tariffs, Bark or Bite?

Shots are being fired across the bow, i.e., Trump 2.0 Tariffs. Trump Tariffs: are they more bark or more bite? Listening to President Trump more often, one can't wonder if tariffs are a threat or promise. We might be seeing more Poker Faces of Trump, Xi Jinping, etc.

One might also wonder why President Trump is coming down hard on Canada and Mexico. The US shares a long border with Canada (8,891 kilometers, the longest in the world) and Mexico (3,145 kilometers), facilitating cross-border trade. This long border can enable back door imports from the likes of China, i.e., China exports goods to Mexico, which are later re-exported to the US to circumvent bilateral tariffs.

Who else is in the Tariff hot seat? One crucial criterion President Trump often mentions as the litmus test for unfair trade is countries with a massive trade surplus with the US. This condition is one of three that the US Treasury uses. The other two are: 1) Current account surplus of at least 3% of GDP and 2) Repeated foreign currency purchases making up at least 2% of GDP over 12 months.

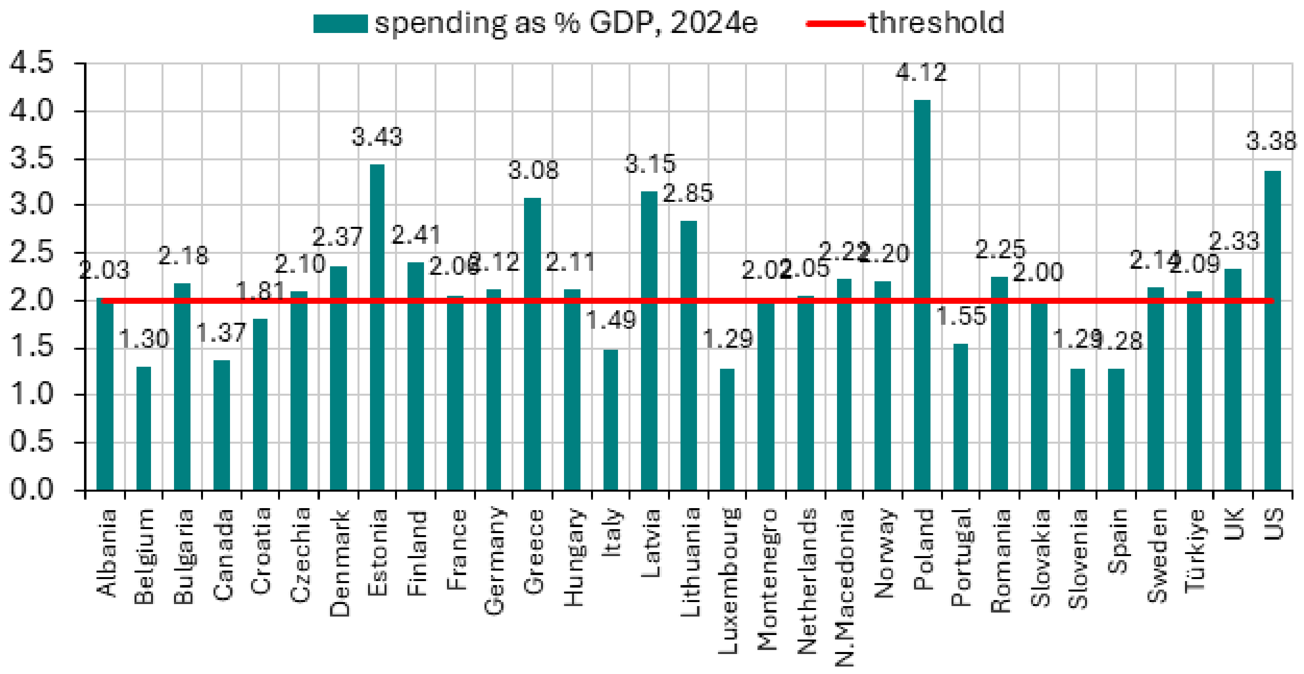
Figure 1: Our estimates of US Treasury currency manipulator criteria

		US TRADE DEFICIT WITH, USD MN	C/A TO GDP	CHANGE FX RES/GD
1	CHINA	-282,541	2.42	0.6%
2	MEXICO	-233,557	-0.36	0.9%
3	EUROZONE	-231,966	1.69	0.0%
4	CANADA	-124,916	-0.63	0.3%
5	VIETNAM	-116,214	3.00	-1.2%
6	GERMANY	-83,916	6.20	0.0%
7	IRELAND	-70,213	14.12	-0.1%
8	JAPAN	-62,874	3.82	-0.8%
9	SOUTH KOREA	-55,961	1.93	-0.1%
10	ITALY	-49,030	1.14	0.0%
11	INDIA	-45,766	-0.92	0.9%
12	THAILAND	-40,855	1.49	1.8%
13	MALAYSIA	-23,397	1.55	0.5%
14	SWITZERLAND	-19,493	5.25	9.9%
15	INDONESIA	-14,021	-0.16	0.8%
16	AUSTRIA	-12,813	2.94	0.0%
17	ISRAEL	-12,734	4.52	2.8%
18	CAMBODIA	-11,927	N/A	2.4%
19	FRANCE	-11,481	-0.42	0.0%
20	SWEDEN	-11,170	6.98	-0.1%
21	HUNGARY	-10,114	0.73	-1.1%

Source: Bloomberg, KBank

After China and Mexico, the US has a huge trade deficit with the Eurozone of about USD231,966 million for the past 12 months (based on our estimates). President Trump has expressed his displeasure with this bloc, as many Eurozone nations are members of the North Atlantic Treaty Organization (NATO) and are not paying enough for national security. The 2% to GDP spending is a guideline established after Russia annexed Crimea in 2014.

Figure 2: NATO member's defense spending as % of GDP



Source: Bloomberg, KBank

Germany, the largest member of the Eurozone, is estimated to be spending about 2.12%, higher than the 2% threshold. However, President Trump has said that 5% is more appropriate given that the new Cold War is getting hotter (the US may call on NATO members to help should there be a military exchange in the Western Pacific).

The US also has a large trade deficit of USD 116,214 million compared to Vietnam. However, in our opinion, Vietnam has a mitigant. As the saying goes… "the enemy of my enemy is my friend." Today, Vietnam is leaning more toward the US and less on Russia, especially for military hardware, as Russia is already facing a weapons shortfall due to the war with Ukraine. Last year, Vietnam took delivery of 5 T6-C Texan trainers from the US, with 7 more on order. The word is, F16s may be next on Vietnam's fighter shopping list instead of Russian Sukhois. The US will need Vietnam, like the Philippines, to counter the threats in the South China Sea.

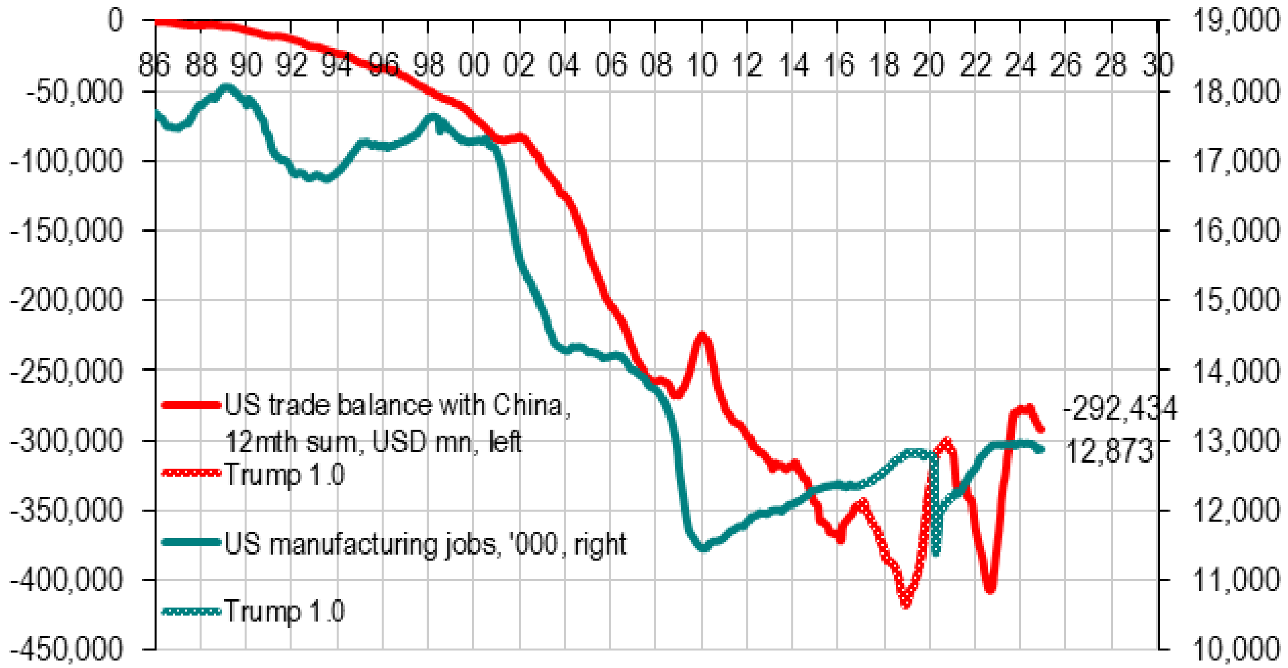
Thailand is also on a slippery slope, given that the US has a trade deficit with Thailand of nearly USD 41 billion, which is greater than the US Treasury threshold of USD 15 billion. Thailand's current account surplus of 1.49% and estimated FX intervention of around 1.8% of GDP helps to breathe a small sigh of relief.

To ponder again whether these tariffs are barks or bites, one has to consider whether the US has the excess production capacity or labor capacity to offset the long-term impact of Trump tariffs. An already tight labor market coupled with reshoring initiatives will accelerate wage pressures and inflation. Such an outcome will tie the Fed’s hands and make any further cuts and dovish tendencies unnecessary.

Also, if US companies that have invested offshore contemplate reshoring, the Trump tariffs may only last 4 years (but more like 3 years since the last year of a second term presidency is usually a "lame duck" year). To bring manufacturing back to the US, companies will have to contend with many issues, e.g., higher labor costs, labor unions, etc., after President Trump is no longer in the

White House. There are grounds for President Trump's argument that the larger the US trade deficit with China, the lower the US manufacturing jobs. Still, with 3 to 4 years to turn around the US trade deficit and tepid manufacturing jobs, time might not be on the side of the world's largest economy (but not the world's largest manufacturer).

Figure 3: US trade balance with China and US manufacturing jobs



Source: Bloomberg, KBank

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