Trump Rhetoric Raises Specter of 1930s-Style Trade War With Asia

U.S. President-elect Donald Trump’s promise to shrink a trade deficit with China through punishing tariffs wouldn’t just hurt the world’s second-biggest economy -- it would also damage the rest of Asia too.

That’s the increasing view of economists who say the risk of significant Trump-triggered trade tensions could slow growth in the world’s best performing region, which accounts for 67 percent of America’s goods trade deficit, according to a Morgan Stanley.

“Donald Trump’s campaign proposal to impose hefty tariffs on China has raised the specter of 1930s-style trade wars,” said Priyanka Kishore, lead Asia economist at Oxford Economics in Singapore. “While we attach a low probability to a full-blown escalation, economies across Asia will have to brace themselves for rising protectionism amid subdued global growth and rising Western populism.”

Kishore added that another risk is that Trump goes beyond targeting expected areas such as iron and steel, and imposes new trade restrictions on textiles, electronics, cars, computers and more. Under such a scenario, she said the pain would spread well beyond China because of the potential downstream impact.

China is prepared to step up its scrutiny of U.S. companies in the event Trump takes punitive measures against Chinese goods, according to people familiar with the matter. The options include subjecting well-known U.S. companies or ones that have large Chinese operations to tax or antitrust probes, the people said, asking not to be identified because the matter isn’t public.

Complex Picture

A smartphone exported to the U.S. may only be assembled in China with parts sourced from other countries in Asia. However, headline trade statistics don’t necessarily capture that supply chain. Instead, they label the phone as a Chinese export, distorting its trade balance with the U.S.

Analysis of foreign value-added content of China’s exports shows how complex the picture is.

“China accounts for only 16 percent of electronic and computer imports into the US, while the rest of Asia-ex Japan accounts for a similar share and Japan 8 percent,” Kishore said. “But standard trade statistics show that China’s share in total U.S. imports of electronic products is more than 40 percent.”

Twitter Pronouncements

Since winning the U.S. Presidential election, Trump has backed up fiery campaign rhetoric toward China with a series of pronouncements on Twitter and the appointment of China hawks, including Peter Navarro, to key roles. Navarro has blamed China’s 2001 entry into the World Trade Organization for eroding America’s manufacturing base.

“The recent shift in political rhetoric in the U.S. has increased the risk of potential policy changes related to trade,” Morgan Stanley economists led by Hong Kong-based Chetan Ahya wrote in a report. “As these potential policy changes are aimed at improving the U.S. position in global trade, Asia will be a main focus.”

China, Korea and Japan would be the worst affected given they sell more to the U.S. than they buy back and because of their roles in a deeply intertwined regional supply chain, according to Morgan Stanley. Vulnerable industries include telecommunications, computers and cars.

Chinese state media has warned the country can fight back, saying that Trump will be met with “big sticks” if he tries to ignite a trade war or further strain ties.

“There are flowers around the gate of China’s Ministry of Commerce, but there are also big sticks hidden inside the door -- they both await Americans,” the Communist Party’s Global Times newspaper wrote in an editorial Thursday.

Trade Retaliation

China can also retaliate against U.S. investment in China by targeting sectors like electronics and textiles. As the world’s second biggest financier of U.S. government debt, it could also respond by selling down its holdings of Treasuries. Then there’s the nuclear option: devalue the yuan.

“This could the first step towards, the first step on a long ladder, the end of which is a 1930s-style environment where we’ve got collapsing global trade, we’ve got default on debt, we’ve got international relations gradually falling apart, eroding, and we’re back into that environment,” Erik Britton, a director at Fathom Consulting in London, said on Bloomberg Television.

While a sudden move to sell Treasuries or weaken the yuan look unlikely, for now, China would still likely hit back, said Chi Lo, greater China senior economist at BNP Paribas Investment Partners in Hong Kong.

“Trade retaliation is very likely,” he said, noting that U.S. investment in China is higher than Chinese investment in America. “This means that the U.S. would be hurt more by China’s retaliation than it could hurt China. This also implies that the US does not have much leverage over China in a trade war.”

It remains to be seen by just how much the President-elect will deliver on fiery campaign rhetoric but, for now at least, the risk of a full blow trade war remains remote. The U.S. Chamber of Commerce in China on Friday called for an easing of trade tensions.

Yet the risk remains.

“The possibility that a Trump administration will impose substantial, across-the-board, trade tariffs on trading partners cannot be completely ruled out,” said Oxford’s Kishore.

China Chip Policy Poses Risk to U.S. Firms, White House Says

China’s push to develop its domestic semiconductor technology threatens to harm U.S. chipmakers and put America’s national security at risk, the Obama administration warned in a report that called for greater scrutiny of Chinese industrial policy.

China’s goal to achieve a leadership position in semiconductor design and manufacturing, in part by spending $150 billion over a 10-year period, requires an effective response to maintain U.S. competitiveness in the industry, according to the report released Friday.

“We found that Chinese policies are distorting markets in ways that undermine innovation, subtract from U.S. market share, and put U.S. national security at risk,” the President’s Council of Advisors on Science and Technology said in the report.

The warnings about China could give ammunition to President-elect Donald Trump two weeks ahead of his swearing in. Since winning the election, Trump has backed up fiery campaign rhetoric toward China with a series of pronouncements on Twitter and the appointment of China hawks to key roles. Trump’s attacks have stoked fears of a trade war between the world’s two biggest economies.

Chinese Scrutiny

China is prepared to step up its scrutiny of U.S. companies in the event Trump takes punitive measures against Chinese goods, according to people familiar with the matter, Bloomberg News reported Thursday.

The options include subjecting well-known U.S. companies or ones that have large Chinese operations to tax or antitrust probes, the people said, asking not to be identified because the matter isn’t public. Other possible measures include the launch of anti-dumping investigations and scaling back government purchases of American products, according to the people.

"China has gained from global openness but has been less committed to sustaining it -- and, in some cases, has worked against it," the White House report said. "Now, globally, more countries are questioning the benefits of economic openness -- a trend that will shape, and be shaped by, how the United States responds to challenges in the semiconductor arena."

U.S. industry leaders don’t want Trump to engage in a standoff with China. Giving corporate tax breaks to U.S. companies is the way Trump advocates bringing back jobs to this country, according to Intel Corp. Chief Executive Officer Brian Krzanich.

"The real answer is not a trade war, it’s not restrictions, it’s really about making the U.S. more competitive," Krzanich said on CNBC Friday. "Lowering the tax rates, making it easier for people to do manufacturing here, that’s what will bring manufacturing back to the U.S."

Working Group

Krzanich attended the recent meeting between the president-elect and leaders of technology companies. The Council of Advisors on Science and Technology’s semiconductor working group includes several industry executives such as Paul Otellini, the former chief executive officer of Intel, and Paul Jacobs, the chairman of Qualcomm Inc.

Foreign acquisitions of U.S. businesses are routinely reviewed for national security risks by a panel of officials led by the Treasury Department. That panel -- the Committee on Foreign Investment in the U.S. -- has frustrated some Chinese investment in the U.S. semiconductor industry. In December, President Barack Obama blocked a Chinese company from buying the U.S. business of Germany’s Aixtron SE, a semiconductor-equipment supplier.

The White House report recommends a strategy for U.S. policy makers that includes countering “innovation-inhibiting” Chinese industrial policy and improving the business environment for U.S. chipmakers. It suggests broadening what is considered a national security risk as part of CFIUS reviews in certain circumstances, while also cautioning against blanket opposition to China’s advancement in the industry. U.S. officials should also work with allies to strengthen global export controls, according to the report.

Industry Leaders

The U.S. has led the semiconductor industry since it took off in the 1960s. Companies such as Intel and Qualcomm have pushed the technical bounds of innovation in the $300 billion market. In 2015, China didn’t have one company among the top 10 industry suppliers. China, the world’s most populous country, is nonetheless the biggest buyer of the electronic components.

The main rivals to the U.S.’s dominance are in South Korea and Taiwan, where companies such as Samsung Electronics Co., the second-largest chipmaker by revenue behind Intel, and Taiwan Semiconductor Manufacturing Co. have gained ground over the last decade.

To strengthen its position in chip manufacturing, China relies on subsidies for domestic suppliers, according to the White House report. That can harm U.S. firms by allowing Chinese companies to sell below cost and reduce U.S. market share, the report says. China also encourages domestic customers to buy only from Chinese suppliers and requires technology transfer to China in exchange for access to its market, the White House said.

A representative of the Chinese embassy in Washington didn’t respond to an e-mail seeking comment about the report.

Underlining some of the difficulties that U.S. chipmakers have faced gaining unfettered access to their largest market, in February 2015, Qualcomm announced it had paid $975 million to settle a case brought by China’s National Development and Reform Commission accusing the company of abusing its dominant position in the chip market for mobile phones. Under the settlement, Qualcomm agreed to lower its licensing fees for phones sold in China to rates that are lower than it charges in other countries, but it’s still striving to get Chinese handset makers to pay up.

Baidu Joins BAIC as China Pushes for Homegrown Driverless Cars

Baidu Inc. and state-owned Beijing Automotive Group Co.’s collaboration on telematics and autonomous driving is almost ready for its coming-out moment, as industry and government join hands for a self-driving vehicle push within China.

A BAIC-built model equipped with Baidu tech will debut in April at the Shanghai auto show, BAIC Chairman Xu Heyi said in interview Friday at the trade show CES 2017 in Las Vegas. The two companies also plan to conduct road testing of a car that will be autonomous in limited environments by the end of this year.

China has set a goal for 10 percent to 20 percent of vehicles to be highly autonomous by 2025 in the world’s biggest auto market, and for 10 percent of cars to be fully self-driving in 2030. State broadcaster China Central Television began airing a five-part series this month on one of its prime time programs to highlight the country’s efforts in autonomous vehicles and related technology.

“It’s a smart move for both to team up,” said Bill Russo, managing director of Gao Feng Advisory Co. “BAIC can bring manufacturing and Baidu can bring technology capability to solve mobility problems.”

The cooperation with BAIC is Baidu’s most comprehensive, though the internet giant also is working with other automakers on joint development of self-driving cars, Baidu President Zhang Yaqin said Friday. The Beijing-based company is close to setting up a new research center near Seattle that will focus on artificial intelligence and cloud computing and security, he said.

Baidu formed a self-driving car team in Silicon Valley in April that it said would employ more than 100 researchers and engineers by the end of last year. It’s partnered with chip maker Nvidia Corp., has been testing its autonomous vehicles in eastern Chinese cities including Wuhu and Shanghai and earned a permit from California to test in the state last year.

BAIC, owned by the local government of Beijing, has made progress of its own. The automaker whose joint-venture partners include Daimler AG and Hyundai Motor Co. in April let customers ride in self-driving cars on a test track.

China is seeking to shed its image as a cheap manufacturer of products with little value-added content. The government is pushing its technology and manufacturing industries to create more sophisticated products and services in line with the global trend toward digitization and internet connectivity.