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EMERGING MARKETS & CHINA STRATEGY

November 12, 2024

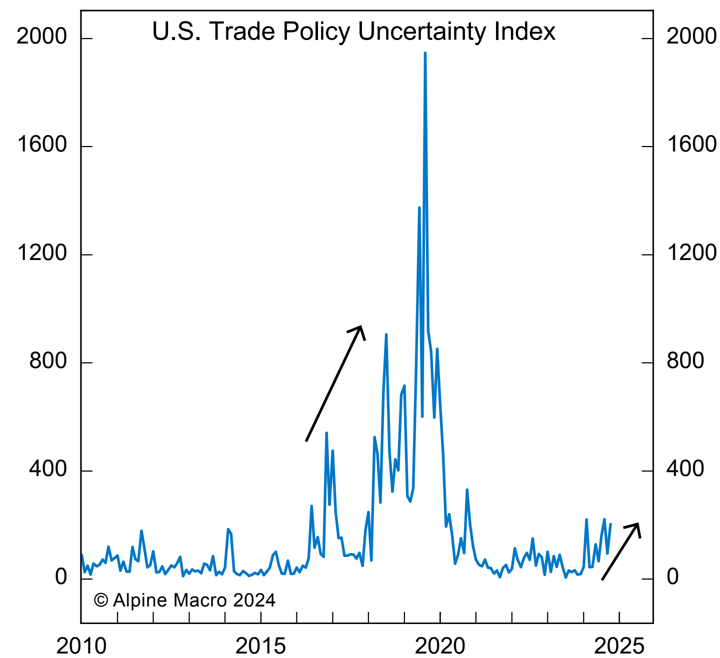
Trump's Sweep And Beijing's Playbook

In This Report

Volatility in EM assets spiked last week, which could be a harbinger of things to come in the coming months, or even years. A Trump sweep would inevitably lead to higher uncertainty in U.S. trade policies (Chart 1), but any realistic analysis of the true economic impact will only be possible once more details are available. U.S. fiscal policies, Fed actions, and other countries' responses to U.S. tariffs will also be crucial in shaping the growth outlook and asset prices.

The tariff overhang may also be one reason why China's latest fiscal stimulus announcement is underwhelming. The fiscal plan released last Friday focused entirely on a multi-year local government "debt swap" program, with no additional fiscal spending to support aggregate demand. Beijing may be preparing for a protracted trade war and has hinted that further stimulus measures could be forthcoming. What's more certain is that without additional "G," the economy will not be able to withstand another trade war. So far, Beijing's policy easing measures have been disappointing. Chinese stock prices are unlikely to advance further until new stimulus programs are mapped out.

Chart 1 Uncertainty In Global Trade Is To Re-Intensify



Source: Economic Policy Uncertainty

Trump Challenge: The Knowns And Unknowns

While Trump 2.0 has yet to begin, a few observations about his future policies are more certain:

- Trump will enter his second term with fewer constraints. Not only did he secure enough electoral college votes to win the White House, but he also won the nationwide popular vote, and his party appears poised to take control of both chambers of Congress. He is also expected to appoint more conservative judges and may even have the opportunity to secure a majority on the Supreme Court.

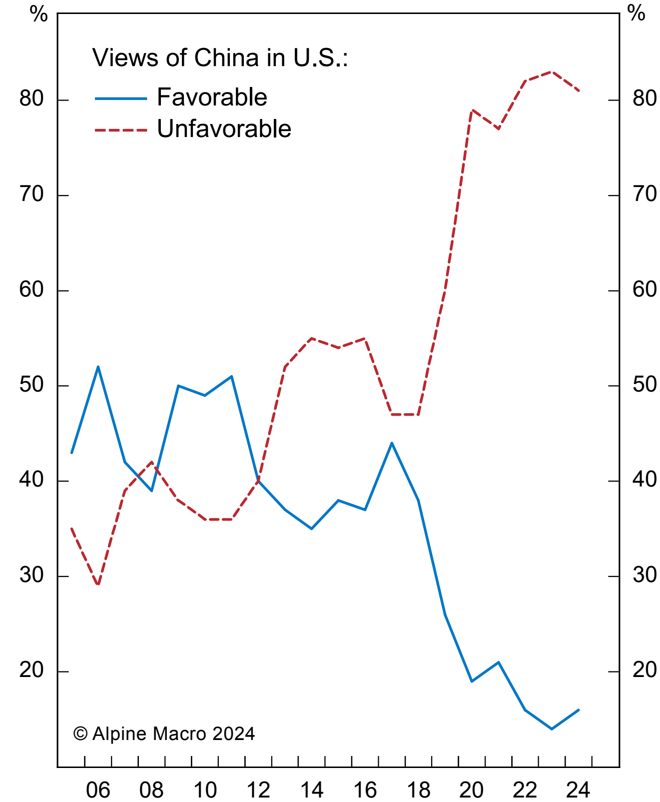
- Even though Trump will likely soften some of his campaign-trail rhetoric, certain priorities are clear. Domestically, he plans for deregulation and tax cuts; externally, he aims to enforce stricter border controls and higher import tariffs. This could significantly impact some EM countries, particularly China and Mexico.

- The trade war with China is expected to re-intensify, with deepening rivalry in technology and national security. While the Biden administration attempted to install "guardrails" in the bilateral competition, President Trump takes pride in being unpredictable. This approach likely means more headline risks and knee-jerk reactions in financial markets going forward.

- Trump's pro-business instincts suggest he will stay attuned to market reactions to his policies. In his first term, he essentially viewed financial markets as a real-time barometer for his approval rating. In this light, he is likely to adjust any "ruthless" policies that could cause significant harm to the U.S. economy.

From Beijing's perspective, there was still hope for an improved relationship with the U.S. when Trump was voted out of office four years ago, but there is no such expectation this time (Chart 2). The current hope is that Trump's "America First" agenda may undermine efforts by the Biden administration to build an effective "containment coalition" with America's key allies, potentially allowing Beijing to improve ties with other major economies. However, Trump could appoint tough China hawks to roles in trade and national security, making it even harder to manage bilateral relations. Regardless, Beijing is preparing for another four years of a turbulent external environment.

Chart 2 U.S.: The China Debate Is Over

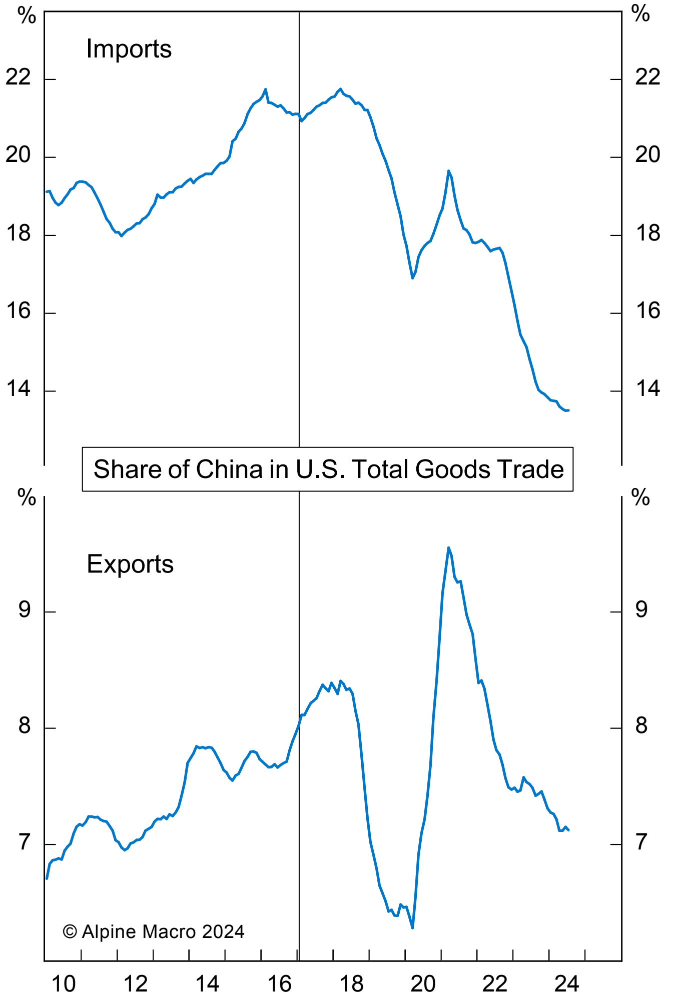


Note: "Don't know" responses are not shown
Source: Pew Research Center

How Will China Cope: Three Scenarios

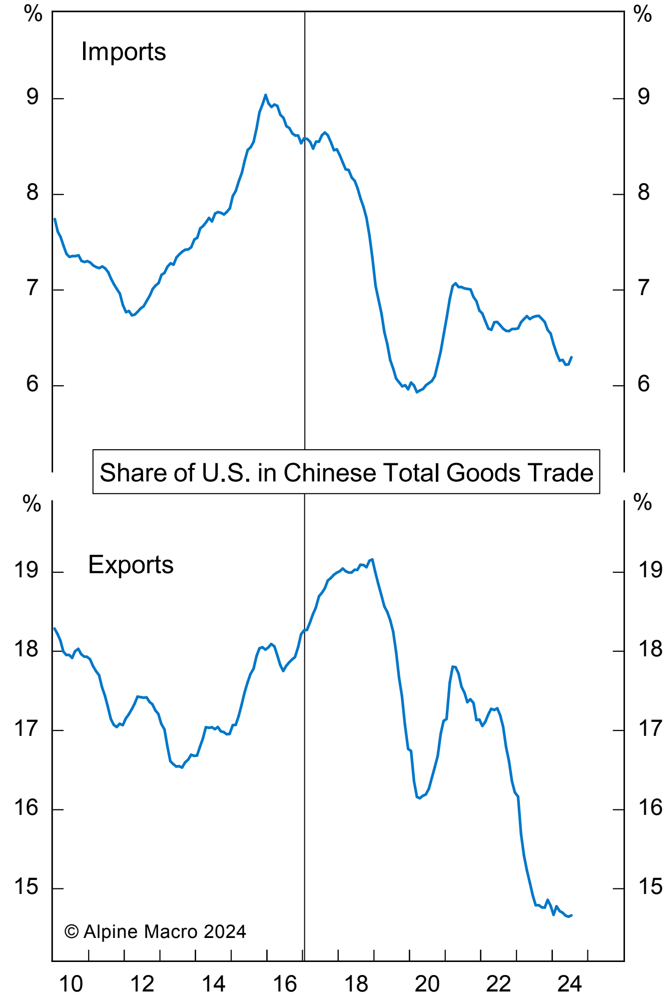
Unlike President Trump's first campaign eight years ago, when China featured prominently in nearly all his speeches, this time the China issue was barely mentioned. This, however, does not mean that China is "off the hook." On the contrary, it indicates that both political parties and the American public have reached a strong consensus on this issue, leaving little need for further debate. For the U.S., China's status has rapidly shifted from responsible stakeholder to strategic competitor to America's most dangerous threat.

Chart 3 Reduced U.S. Trade With China…



Note: Vertical line represents the onset of "Trump 1.0"; both series are shown as 12-month moving average; source: IMF DOTS

Chart 4 … Ditto For China



Note: Vertical line represents the onset of "Trump 1.0"; both series are shown as 12-month moving average; source: IMF DOTS

Economically, a major change over the past eight years is the substantial reduction in bilateral trade between the two countries (**Chart 3**). U.S. imports from and exports to China now account for 14% and 7% of U.S. total, respectively, down from 22% and 8.5% in 2017, at the start of Trump's first term. Similarly, the share of Chinese imports from and exports to the U.S. has dropped significantly (**Chart 4**). Bilateral investment flows, tourism, and educational and academic exchanges have also cooled sharply.

The backdrop of deteriorating diplomatic and economic ties will shape America's China policy for years to come. Beijing will remain defensive, with three potential scenarios for managing the challenges.

The first is aggressive tit-for-tat retaliation, which would mirror Beijing's response at the start of Trump's "Trade War 1.0." In this scenario, China would match punitive tariffs and expand embargos on key minerals, potentially escalating the conflict into an all-out confrontation with serious repercussions for China's economic growth and asset prices, affecting markets globally.

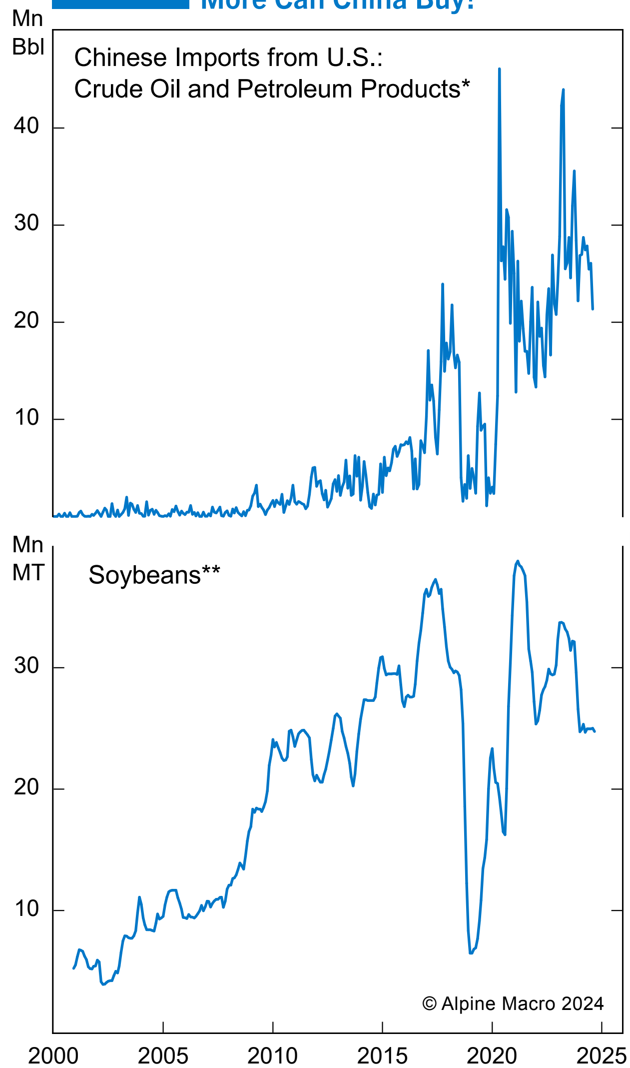
The odds of this scenario are low, as Beijing is now better prepared for a trade conflict than it was during Trump's first term and has a genuine interest in improving bilateral relations. Furthermore, China's current weaker economic growth may make it more inclined to accommodate some of Trump's demands in order to stabilize the external environment, even if only temporarily. However, there is a risk that Trump might leverage Beijing's weaker bargaining position. China's reduced reliance on the U.S. market could also embolden its own policy hawks. Importantly, Beijing is likely to respond forcefully if it perceives Trump's trade policies as aiming at regime change.

The second scenario is pragmatic engagement. In this scenario, President Trump uses tariff threats as leverage to reach a "grand bargain." Notably, four months into his first term, Trump signed a tentative 10-part trade agreement with President Xi Jinping in May 2017, declaring that bilateral relations had reached "a new high." In 2019, the two countries signed the "Phase One" deal, temporarily halting the "Trade War 1.0." Trump still claims to have a friendly relationship with President Xi, and certain foreign policy priorities, such as addressing the Russia-Ukraine conflict and Middle East tensions, may benefit from China's cooperation.

This scenario is the one Beijing hopes for most, and some of Trump's top economic advisers have suggested this possibility.[1] As China's imports of U.S. petroleum and agricultural products are already near record highs, and with high-tech product sales to China restricted, moving Chinese manufacturing to the U.S. may help reduce the trade imbalance (Chart 5). The Trump administration could allow leading Chinese companies to invest in the U.S., and China's dominance in sectors like electric vehicles and renewable energy could support Trump's goal of reviving manufacturing jobs.

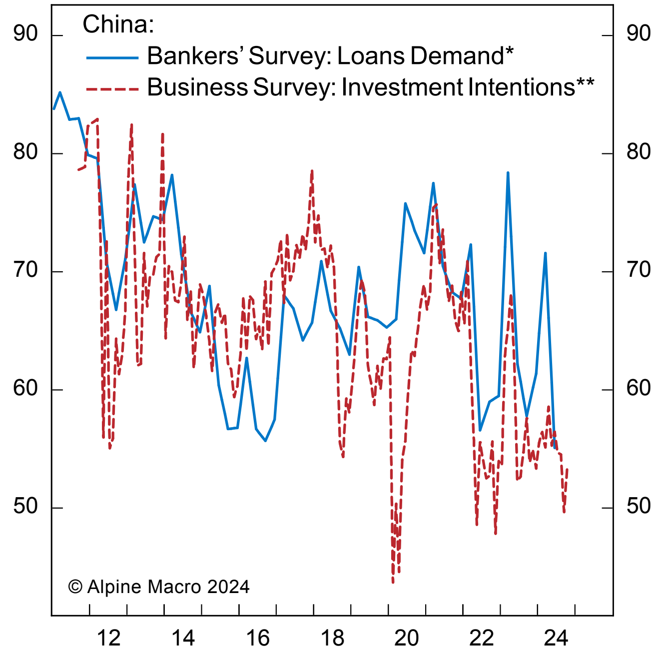
1 Financial Times "Trump would not weaken the dollar, says adviser Scott Bessent" (October 13 2024).

Chart 5 U.S. Primary Goods: How Much More Can China Buy?



*Source: Energy Information Administration (EIA)
**Shown as 12-month moving sum; source: U.S. Department of Agriculture

Chart 6 China's Business Confidence Crisis



*Source: PBoC
**Source: Cheung Kong Graduate School of Business

The third scenario is proactive reforms in China. Beijing could take proactive steps to advance reforms further. We have long held the view that some of Trump's pressure tactics to open China's markets align with Chinese own reform agenda, aiming for a more transparent and equitable business environment for both foreign and domestic private enterprises. It has become evident that Beijing's anti-market policies in recent years have hurt policymakers' credibility and weakened business confidence among entrepreneurs, a key reason for China's recent poor growth performance (Chart 6). In essence, Beijing's own policy missteps have proven more damaging than the trade war itself.

Therefore, the best-case scenario is that renewed pressure from the U.S. on Chinese trade and business practices could compel Beijing to correct these missteps and reorient the country toward liberal reforms. In this case, a lose-lose trade war could eventually yield a win-win outcome. We can only hope that policymakers in both countries work toward this scenario.

Read MRB's "China Feel Good Fiscal Non Stim" for best explanation of this debt swap

Beijing's Stimulus: "G" Is Urgently Needed

On Friday, China's top legislature unveiled a plan to issue RMB 10 trillion (US$1.4 trillion) in local government bonds over the next five years to address "hidden debt" – off-balance sheet liabilities from shadow banking institutions and accounts payable to government contractors. However, the plan fell short on other stimulus measures to support the housing market and consumer spending, which disappointed the market.

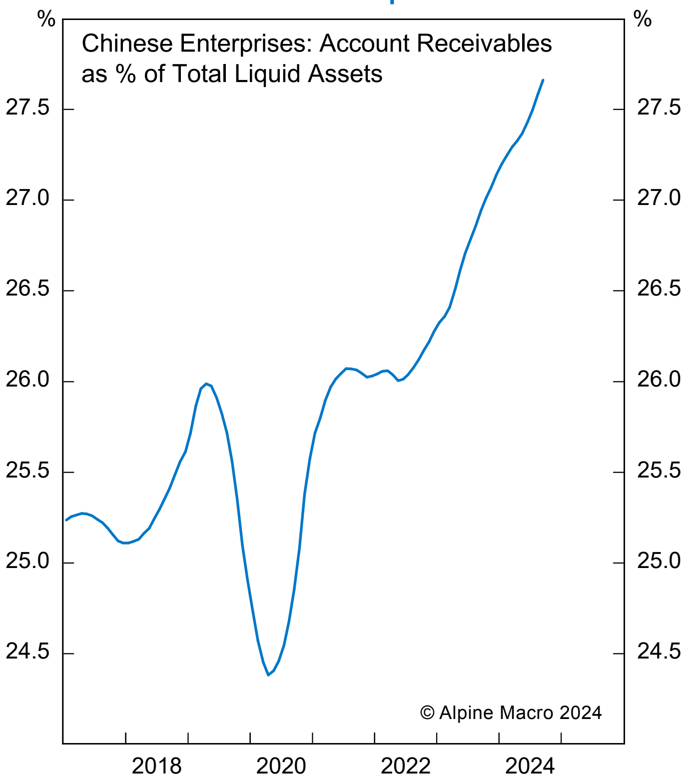
Policymakers indicate that there is room for additional fiscal spending, with the next round of fiscal measures expected soon. For now, a few observations can be made.

First, the "debt swap" is one of the "three arrows" on our policy checklist for Chinese reflation and is a crucial step.[2] It alleviates fiscal stress for local governments, enabling them to provide public services and support local business activity. Meanwhile, unpaid accounts owed to private entities have compounded liquidity issues in the corporate sector (Chart 7). Most importantly, fiscal stress has led some local governments to arbitrarily impose fees and fines on businesses, inflicting massive damage on business confidence.[3] In this regard, the debt swap could help ease fiscal pressures and restore business confidence.

2 Alpine Macro *EM & China Strategy* "Will Chinese Reflation Work?" (October 22, 2024).

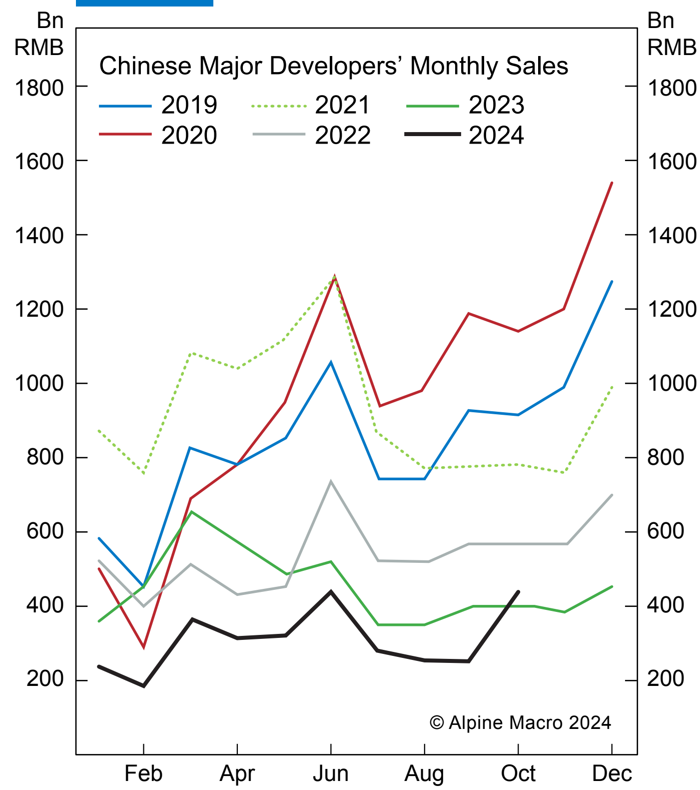
3 Alpine Macro *EM & China Strategy* "Is China In A Slow-Motion Implosion?" (August 27, 2024).

Chart 7 Surging Account Receivables In Chinese Corporate Sector



Note: Shown as 12-month moving average; source: NBS

Chart 8 Is Housing Finally Bottoming?



Source: CRIC

Second, it is clear that the "debt swap" alone is insufficient to revive the economy. With the ongoing housing crisis, private sector contraction, and consumer retrenchment, the government must intervene more forcefully to break the deflationary downward spiral.

The volatility in Chinese stocks last week underscores that domestic policies will likely outweigh the impact of the Trump factor. Chinese stocks in both onshore and offshore markets dropped sharply on Wednesday after Trump's election victory, rebounded on Thursday on hopes for Beijing's fiscal stimulus, and fell again on Friday due to policy disappointments. The message from the market is that Beijing needs stronger policy easing to counter external shocks.

Finally, Beijing may be waiting for clarity on U.S. trade policies before deciding on its own policy playbook. We believe this is misguided. Beijing's previous piecemeal measures are precisely the reason of the economic deterioration, and policymakers should ease pre-emptively, regardless of the U.S. tariffs. Otherwise, the economic downturn will worsen, leaving the country even more vulnerable in the trade war. Deflation and stagnation will further deprive policy flexibility.

To be sure, there are some early signs that China's economic momentum has improved, albeit slightly. The latest PMI numbers have all returned to expansionary territory, exports have accelerated, monetary aggregates appear to be bottoming, and

Read MRB's "China Feel Good Fiscal Non Stim" even home sales appear to have started to recover (Chart 8). It remains to be seen if this budding strength will continue to gain momentum. Beijing's policy actions in the coming months will also be crucial to monitor.

In terms of investment recommendations, we continue to hold Chinese stocks as a tactical trade, as their valuations are still deeply depressed, and we anticipate that Beijing will aggressively ramp up easing measures if the economy relapses. Meanwhile, we recommend maintaining a short position on the RMB versus the USD and the Japanese yen.

Yan Wang, CFA
Chief Emerging Markets & China Strategist

Investment Recommendations

Strategic Positions (6 - 12 months)				
Recommendations	**Open Date**	**Closing Date**	**Total P&L**	**Notes**
Long Colombian 10-year Government Bond, Currency Unhedged	11/21/2023		4.2%	Long Colombian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long MSCI Greece Equity Index	11/21/2023		7.9%	Long MSCI Greece Equity Index in US$ terms; stop point at -10%.
Long Indian 10-year Government Bond, Currency Unhedged	06/04/2024		3.5%	Long Indian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long Malaysian Equities, Currency Unhedged	08/20/2024		-0.9%	Long MSCI Malaysia Equity Index in US$ terms; stop point at -10%.
Long ASEAN Equities, Currency Unhedged	09/17/2024		-5.7%	Long MSCI EM ASEAN Index in US$ terms; stop point at -10%.
Long BRL/MXN	09/23/2024		0.7%	Long Brazilian *Real* versus Mexican Peso; stop point at -10%.
Short CNY/JPY	10/29/2024		0.8%	Short Chinese Yuan against Japanese Yen; stop point at -10%.

Tactical Investment Positions (3 - 6 months)				
Recommendations	**Open Date**	**Closing Date**	**Total P&L**	**Notes**
Short CZK/HUF	06/05/2023		2.0%	Short Czech Koruna versus Hungarian Forint; rolling stop point at -5%, or -1.2% from current level.
Long MSCI China Equity Index	02/20/2024		29.6%	Long MSCI China Equity Index in US$ terms; rolling stop point at -10%, or -9.9% from current level.
Short COP/CLP	03/05/2024		7.2%	Short Colombian Peso versus Chilean Peso; rolling stop point at -5%, or -1% from current level.
Long CSI 300 Index	02/20/2024*		14.3%	Long China A-shares Index in US$ terms; stop point at -10%. *Trade opened on Feb 20, 2024, closed on Sep 13, 2024 and reopened on Sep 24, 2024.
Short CNY/USD	10/29/2024		1.3%	Short Chinese Yuan against US Dollar; stop point at -5%.
Short THB/SGD	11/05/2024		0.8%	Short Thai Baht versus Singapore Dollar; stop point at -5%.

EM Equity Country Allocation				
Strong Overweight	**Overweight**	**Neutral**	**Underweight**	**Strong Underweight**
	Brazil Chile China Colombia Greece South Africa Indonesia Philippines Malaysia Thailand South Korea		India Czech Republic Hungary Mexico Peru Poland Taiwan Turkey	

EM Equity Sector Allocation	
Strong Overweight	**Overweight**
	Materials Health Care Consumer Discretionary Consumer Staples
Neutral	
Energy Communication Services Information Technology Financials	
Strong Underweight	**Underweight**
	Industrials Utilities

EM Local-Currency Government Bond Allocation		
Overweight	**Neutral**	**Underweight**
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