Trump's Presidency: How will China Fare?

President-Elect Painted China as the "Enemy"

After the nail-biting campaign on November 8, Donald Trump was elected the 45th president of the United States. In light of his precedent speeches and debates, the fresh president-elect is likely to preside on the turnabout of deglobalization and shift from loose monetary policies to vigorous fiscal expansion in America.

According to Mr. Trump, China has "manipulated the currency" to support the export businesses (RMB has depreciated by 11% since 2015) and that "China's devaluation of the yuan would be 'devastating' for the United States". Trump has claimed the trade deficit to China is unfair and pledged that after he takes office, there will be less RMB depreciation pressure, which is somewhat a good news for the RMB-denominated asset prices in China, but not so for Chinese exporters.

Furthermore, Trump announced in his campaign speech that he would "support the U.S. by putting a massive 45% tariff on Chinese exports to the U.S." Yet an adviser on Trump's team, Wilbur Ross, said that there may be some misunderstandings about the 45% tariff against China and that it could merely be a negotiation tactic.

Will "President Trump" Really Pick a Fight?

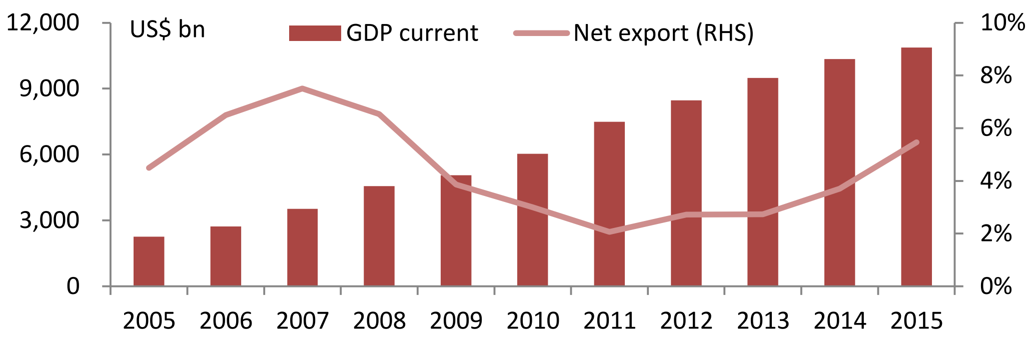
Trump always talked tough on China. But his real plan may be explored in his foreign policy statements. China is not the first priority and although unspecified economic pressure against China was proposed, Trump also asserted that common grounds should be sought with China based on shared interests.

Mr. Trump's position on global leadership is founded on isolationism. He believes that U.S. should play a lesser global role. On a political and military level, his previous speeches chanted that U.S. ceases to be the world police. In terms of economy and trade, Trump showed amity to the Asian Infrastructure Investment Bank (AIIB) and, in his speech on Monday November 21st, firmly announced a retreat from the TPP agreement on his first day in office. The Monday speech laid out his action plan for the first 100 days in office and featured a focus on domestic affairs and national development. The proposed initiatives are generally in line with his previous policy advocates.

U.S. presence in the Asia Pacific region is expected to be subdued. This means China may be able to take more initiative in the APAC area, in terms of trade and financial cooperation. Besides, Trump compromised on the repeal of Obamacare in an interview on November 12th, stating that part of the healthcare plan will remain intact, despite previously slamming Obamacare as "a total disaster". Considering for Trump's constant flip-flops on his political and diplomatic stances, his position against China might be worth a second thought.

In the unlikely event that a full-fledged trade war or anti-dumping sanction against China is to take place, the U.S. itself will suffer and it is debatable whether it will be fundamentally detrimental to China. Above all, there will be certain levels of restrictions imposed on a range of exported commodities to the U.S., in anticipated Trump's attempt to retain blue collar support. Trade frictions will be inevitably sparked on a number of fronts and the U.S. demand for China commodities is expected to refrain. However, the impact of these factors is weakening. The labor-intensive manufacturing, the main source of the "enemy China" assertion by Trump, have largely left China because of surging labor costs. Exporters have further integrated along the supply chain, reducing Chinese economy's reliance on overseas demand. The country is currently undergoing economic transformation and the market conditions next year will be largely dependent on shifts of domestic demand.

Exhibit 1 Net Export Makes a Declining Contribution to China GDP



Source: Wind

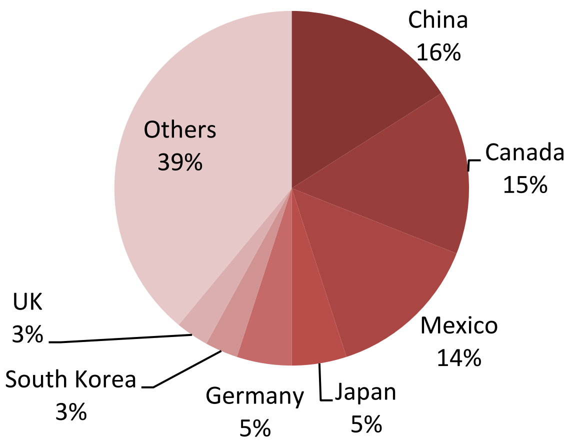
Exhibit 2 Export to U.S. Represents a Lowering Proportion of Total China Export

Source: Wind

China Market's Exposure to the New U.S. Administration is Limited

With all else considered, Chinese exporters will be strained under the upcoming U.S. administration, especially those that rely heavily on overseas sales. Chinese exporters provided U.S. consumers with cost efficient products over the past two years due to the depreciating RMB. This trend may reverse due to the pending tariffs and trade restrictions proposed by Trump.

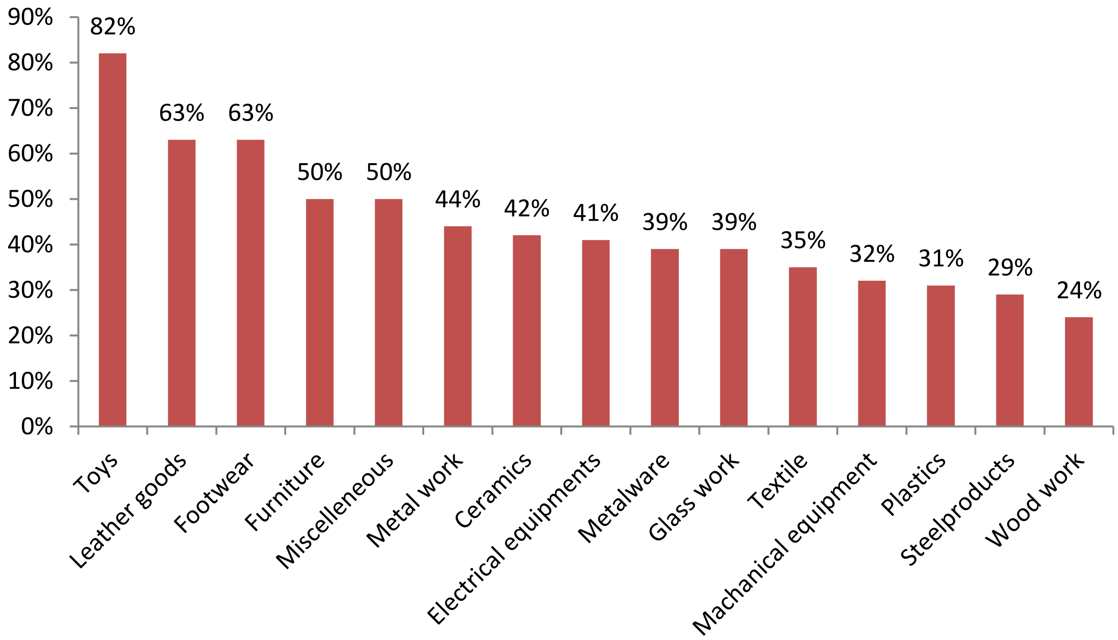
Exhibit 3 U.S. Aggregate Amount of Import and Export, Country Breakdown, 2015



Source: CICC, Wind

On the other hand, benefited from declining involvement of U.S. in the Southeast Asian affairs, China is likely to assert stronger might in regional economic development. In promoting the Regional Comprehensive Economic Partnership (RECP) and bringing along the Belt and Road initiative, more cooperation in cross-border infrastructure development will be facilitated, which would be conducive to multiple Chinese sectors ranging from construction to energy, etc.

Exhibit 4 China Exporters' Share in Major U.S. Imported Industries



Source: CICC, Wind

Exhibit 5 Influences of the Trump presidency on multiple China sectors

Sectors	Influences
Sectors that are adversely exposed to Trump administration	
Hardware & equipment, durables & apparel and semiconductor	Hurt by trade restrictions being exporters with over 8% of industry listed companies revenue from U.S.
Utilities	Hurt by risen upstream energy prices
Sectors that might benefit from the new presidency	
Raw materials, industrial and energy	Benefit from U.S. massive infrastructure spending to come
Financial	Benefit indirectly from a reflation environment
National defense and military	Benefit from China's increased demand to strengthen national defense.
Sectors that remain neutral	
Healthcare, consumer staples, TMT, etc.	

In the mid-term, there is a possibility of stagnation in the U.S. economy as labor force shrinks due to the deportation of illegal immigrants and drops in productivity due to trade protections. Yet the proposed fiscal stimulus including a wide range of tax reductions and mounting government expenditures will drive the U.S. economy upwards in the foreseeable short term.

While a stronger American economy in the coming months will impose depreciation pressure on China RMB, the rising expectation of U.S. rate hikes furthers this tendency. The Fed fund rate, indicator of the probability of U.S. rate hikes, has jumped after the election and is currently implying a 100% probability of a rate rise in December according to Bloomberg as of November 22nd. "It is just around the corner", as suggested by recent Yellen interviews. The interest rate increase will lead to more capital outflow from China and intensify the RMB devaluation pressure. While it could weaken an independent monetary policy in China, it would also partially negate the threat on Chinese exports of potential trade war.

However, Trump's unpredictable temperament and his long-term discrepancy with the Fed put his next move and proposal in question. The uncertainty exacerbates the volatility of Dollar-denominated assets, thereby decreasing the Sharpe ratio of these assets, and in turn raising the attractiveness of RMB-denominated assets. The RMB bond market is likely to benefit and will by and large depend on country-wide factors such as further changes of economic and political policies and the trend of domestic demand, given the limited influence of U.S. demand variations on Chinese economy as aforementioned.

A-share stocks will react based on their respective sectors. Compared to a broad range of assets, equity market's valuation is suppressed. Therefore, it would be more appealing in the context of growing attractiveness of RMB-denominated assets and smooth economic transformation as partially supported by RMB depreciation.

The attention is unprecedented on cyclical sectors of A-shares and offshore Chinese stocks. For cyclical sectors, improvement of actual domestic demand will still take some time to show and there may be three stages: speculation, disappointment and reflation. The speculation may continue in the short term, and market remains volatile in the mid-term. Offshore China stocks may demonstrate more upside in the long term due to their lower valuations.

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