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IMPLICATIONS OF TRUMP 2.0 FOR TRADE

December 2024

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Since winning the presidential election in November, Donald Trump has expanded his threat to impose biting tariffs against US trade partners. Trump's protectionist rhetoric is driven by a concoction of factors. These include his ambition to right trade imbalances, to boost US industry, to generate more jobs at home, as well as to stem the flow of illegal immigration and drugs into the United States. Countering China – the US's arch nemesis – and protecting the US dollar as the world's preeminent currency reserve are likely to be chief priorities for Trump 2.0.

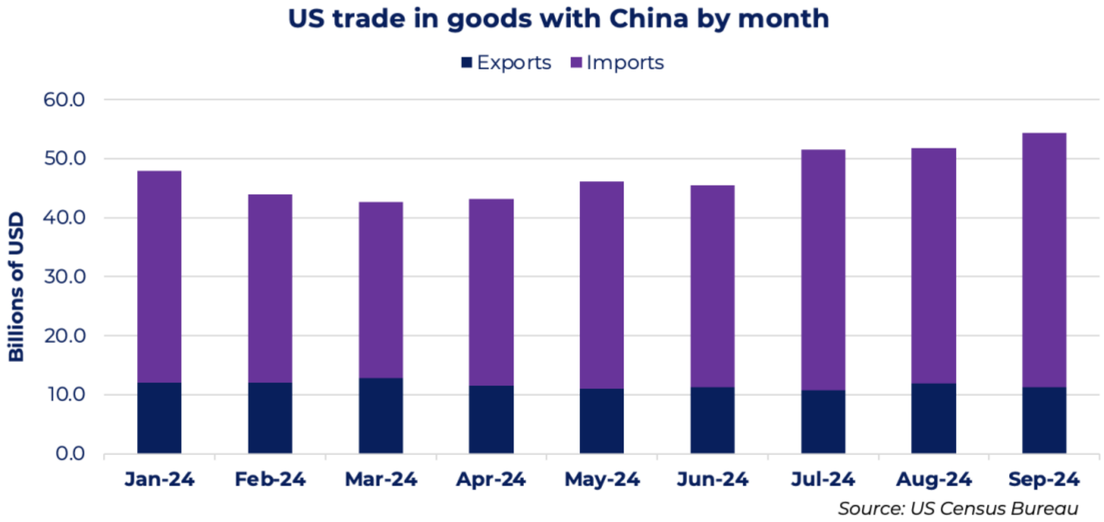
Interpretations of the game plan that underpins Trump's threat to apply new levies against trade partners at an early point in his presidency vary. One thing is more certain: unpredictability will remain part of his approach. The president elect's penchant for bilateral dealmaking and his deep suspicion of international frameworks – particularly the World Trade Organisation – add a layer of uncertainty.

While at the mercy of geopolitical gyrations, international investors and exporters can take measures to prepare for disruption. Through scenario planning, policy tracking and consistent stakeholder engagement, business leaders should be in a better position to anticipate and respond to global and regional shocks, including trade wars.

People's Republic enemy number one

Trump's tough policy approach to China is one of many pillars that support his America First and Make America Great Again political slogans and policies. While the president elect has made noise over the last few weeks about China's role in illegal immigration and the illegal drugs trade, he is also irked by the US's trade deficit with the People's Republic. The trade imbalance is captured in the visual below.

Taking a no-nonsense, confrontational approach towards the US's chief global rival additionally aligns with Trump's focus on projecting strength. His threat to impose an additional tariff of 10% on Chinese goods, on top of his threat of tariffs as high as 60%, speaks volumes.



Trump's readiness to lock horns with Beijing is nothing new. It was evident during his first term in office. In July 2018, Trump launched a trade war with the People's Republic. This led to the adoption of US tariffs on Chinese goods worth USD550 billion, and China retaliating with its own tariffs on US goods worth USD185 billion. A January 2020 trade deal between the Trump administration and Beijing – in which the US agreed to relax some tariffs in exchange for China buying more US exports – ultimately failed.

The president elect's selection of China hawks for senior cabinet posts confirms his intended posture towards Beijing. Incoming national security advisor Mike Waltz, secretary of state nominee Marco Rubio, and CIA director-to-be John Ratcliffe don't mince their words about how serious a strategic threat China is to United States. They are all tugging in the same direction.

Some observers hope that Trump's stance on China will be softened by such figures as treasury secretary appointee Scott Bessent. This thinking should be treated with a degree of caution, however. Wall Street regards the veteran hedge fund manager as a champion of stability for financial markets, though his working relationship with Trump has yet to be seriously tested. Bessent stated in October that he believed Trump wants to "escalate to de-escalate" on tariffs.

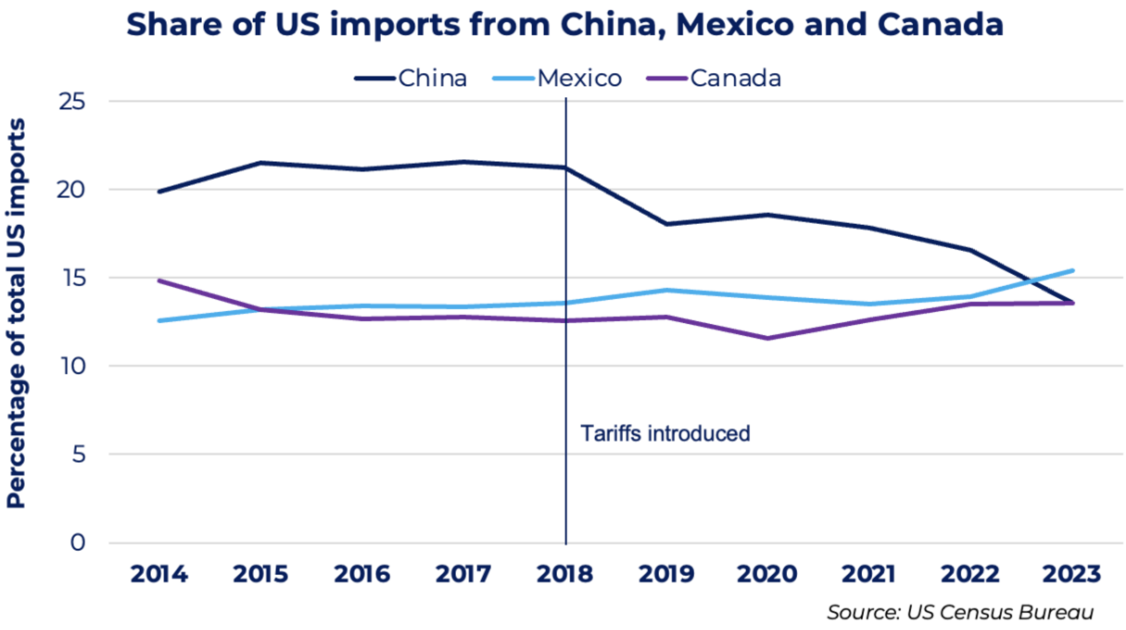
Elon Musk, the incoming co-head of a yet-to-be-unveiled Department of Government Efficiency and owner of Tesla, is another key figure to watch. Musk, who is regularly seen by Trump's side, should in theory at least oppose stringent tariffs on Chinese car component imports, as these would hit Tesla manufacturing in the United States. But the multi-billionaire stands to gain from import restrictions on cheap Chinese electric vehicles and will likely make the case for an automotive component import carve-out. Trump after all granted tariff exemptions to Apple during his first term.

Trump set his sights on other 'offenders'

Though representing the biggest target, China is not the single focus of Trump's tariff agenda. In addition to China, Trump has threatened to slap fellow Brics countries India, Brazil, South Africa, Ethiopia, Egypt and the UAE with a 100% tariff if they move ahead to create a new currency as an alternative to the US dollar. It is not clear how Brics countries Russia and Iran would be impacted in view of the US sanctions they already face.

Non-Brics Asian jurisdictions likewise worry about Trump's protectionist bent. South Korea, Vietnam, Cambodia, Malaysia, Thailand, and Taiwan enjoy trade surpluses with the US and are preoccupied with the prospect of Trump applying a universal tariff of 10% or more on their exports. Team Trump knows full well that Chinese companies re-route their supply chains through most of these jurisdictions to access the US market.

Other jurisdictions in the Americas are also in Trump's crosshairs, with Mexico standing out. Trump has threatened to impose a 25% tariff on Mexican imports to the US on the first day of his presidency if the government doesn't "stop the onslaught of criminals," illegal migrants and drugs coming into the US. The president elect has also threatened to impose tariffs of 200% or more on cars imported from Mexico, where Japanese, Chinese and German manufacturers make vehicles and export across the northern border.



Canada is in a similar boat, sitting alongside Mexico and China as a priority target. Like Mexico, Trump has threatened to introduce a 25% tariff on all goods coming from Canada to force the Canadian authorities to tackle illegal migration and the flow of drugs across the shared frontier. While 75% of Canadian exports go to the US, Canada buys more from its southern neighbour than China, France, the UK and Japan combined.

Trump is clearly aggrieved by the EU's mammoth trade surplus with the US, which came to €158 billion in 2023. German automotive exports to the US have been a particular sore point for the president elect. In a November interview with Italian daily Corriere della Sera, former German Chancellor Angela Merkel said that Trump was obsessed with the number of German cars in Manhattan and pledged to impose biting tariffs on the German auto manufacturing industry if he were to become president.

EU exporters are unsurprisingly using the limited time they have before Trump enters the White House in January 2025 to front-load cross-Atlantic shipments. This includes Italian producers of olive oil and cheeses, many of whom are reportedly rushing to fill warehouses and export to the US.

Even the United Kingdom, which has long pointed to its special relationship with the US, is in the firing line. Trump has not exempted the UK from his threat to impose tariffs on all overseas imports. Britain's pharmaceuticals, electrical, fishing, petroleum and mining sectors may all suffer. The value of the UK's global exports could decline by over 2.6% in the event Trump imposes a 20% tariff on the UK and other trade partners, a study by the Sussex's Centre for Inclusive Trade Policy (CITP) shows.

Trade partners hoping for give-and-take but ready to retaliate

Trump's tough talk on tariffs may be a tactic to achieve the best outcome for the US in trade negotiations. But his threat to impose tariffs on China, Mexico and Canada on day one of his presidency does not suggest leniency. The president elect may believe that if he follows through on his threat, his team will be taken seriously by all trade partners, thereby maximising US leverage in all trade relationships. The adoption of blanket tariffs could thus be used as a hard-ball negotiation tactic and precursor to exemptions.

Trade partners might do well to hand Trump a quick win. For instance, if Mexico, China and Canada take new measures to tackle illegal migration and stymie the flow of fentanyl into the US, Trump could take credit for a big success at an early point in his presidency. This might moderate his appetite to impose high tariffs on these jurisdictions.

While sustaining its openness to dialogue with the incoming Trump administration, Beijing appears for now at least to be pursuing a different tack. The Chinese government has shifted from taking a wait-and-see approach to swift retaliatory action. Earlier this month, Beijing banned the export of gallium, germanium, antimony and superhard materials – used for semiconductor manufacturing and military applications. Chinese authorities also say they will adopt stricter controls on graphite exports. This action comes shortly after the Biden administration banned the export to China of advanced high bandwidth memory (HBM) chips and imposed greater restrictions on the export of critical semiconductor manufacturing tools.

Apart from export controls, the Chinese government can retaliate against the US with its own tariffs and enterprise blacklisting. Beijing has previously threatened to add US clothing company PVH – which owns brands Olga, True & Co, Warner's, Tommy Hilfiger and Calvin Klein – to its 'unreliable' list. This could effectively end the company's access to China. The list of US companies lined up for China's 'unreliable' classification may well expand over the coming months.

The EU faces some of the same tough decisions as China. It would prefer to negotiate with the Trump administration and reach an agreement than enter a potential, 'no winners' cycle of escalatory retaliation. It has a range of carrots at its disposal to help bring about a deal, which Trump could present as a win. These include buying more US-produced products and commodities, including LNG and defence equipment, as suggested by ECB chief Christine Lagarde. Brussels may also consider reducing the 10% tariff it applies on US passenger cars and its 11.3% tariff on US agricultural imports. Suspending plans to slap the US with billions of USD in addition tariffs next March might also help soften Trump's hawkish bent. But if negotiations fail, the EU is ready to toughen its own protectionist regime against the US.

The EU's approach is likely to be similar to that of the UK from more than one perspective. While London will seek to avoid a trade war, it has ammunition at its disposal if negotiations collapse. Following Brexit, London carried over tariffs on US goods – including Levi's, Harley Davidson and Jack Daniel's – that were applied in response to the tariffs Trump imposed on European steel during his first term. The tariffs were effectively suspended, but not fully disbanded, by the UK in 2022. The British government could activate them swiftly should Trump refuse to agree to a mutually acceptable deal.

Too much solidarity with US against China could backfire

Perhaps the biggest lever in negotiations for the EU, UK and other trade partners will be taking real and meaningful steps to reduce trade and commercial ties with China. This includes in the intellectual property space which Beijing may seek to leverage for military applications. This approach would be risky, however. By currying favour with Washington, trade partners could find themselves at the receiving end of Chinese import controls, sanctions and other penalties.

The potential cost is not lost on such US trade partners as the UK and EU. China is the UK's fifth largest trade partner, and the British government trails most of its G7 counterparts in imposing tariffs on the People's Republic. While the EU has trade defence tariffs and anti-subsidy tariffs in place against Chinses electric vehicles, Chinese products are highly integrated into many EU supply chains. It is no coincidence that China classifies as the EU's second largest trading partner for goods following the United States.

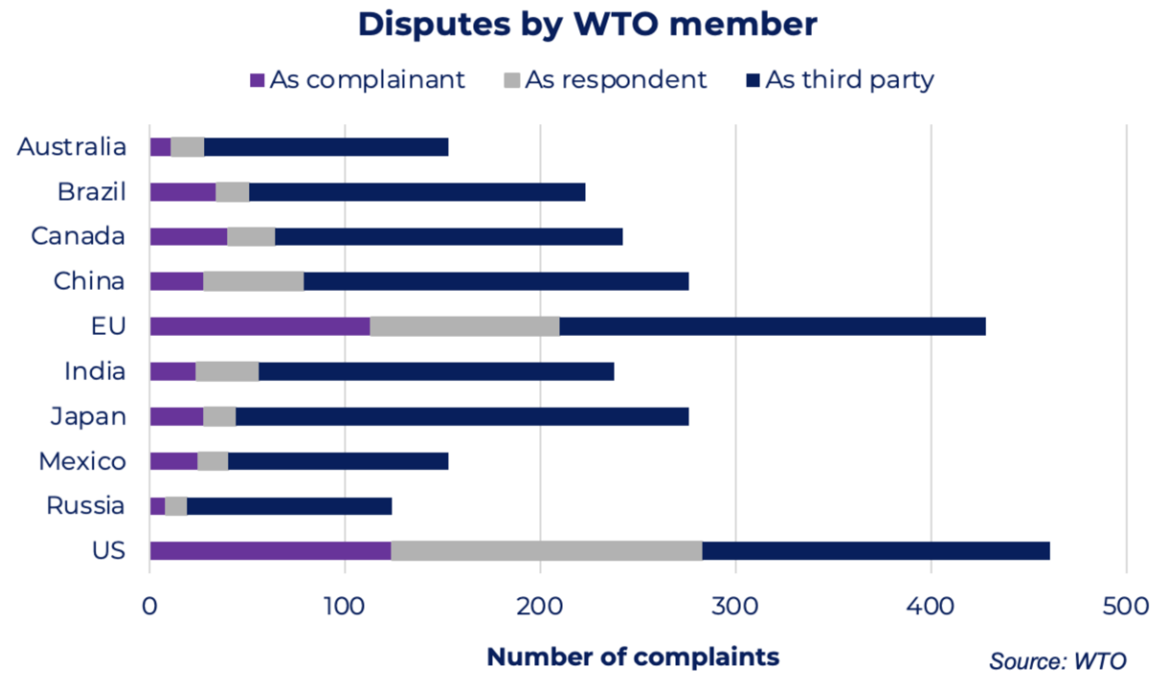
A more fractured global trade environment?

Whether Trump's protectionism precipitates a limited or full-blown trade war is at this point anyone's guess. But his presidency heightens the risk of an even more fragmented and unpredictable global trade environment.

Trump's longstanding gripe that the WTO unfairly punishes US interests means that he has little inclination to play by its rules. During his first term Trump repeatedly threatened to withdraw from the organisation. While the Obama administration was the first to start blocking the reappointment of judges to the WTO's appellate body, Trump intensified this trend. During his first term in office Trump blocked all new appointments to the body, which hears appeals against decisions by the WTO's dispute settlement panels.

Even regional trade deals are fair game for Trump. Imposing tough tariffs on Mexico and Canada would violate the USMCA free-trade agreement, which was conceived during Trump's first term in office. Robert Lighthizer – a prominent trade advisor to Trump – reportedly told Canadian business leaders earlier this year that "no deal is forever."

It would be wrong, however, to attribute the unravelling over time of the rules-based system of international trade solely to the United States. China is another chief perpetrator, given its track record of weaponised trade and commerce against geopolitical rivals and trade partners. China and the US are the two countries that have been involved in most trade disputes, but they do not stand alone. This is captured in the visual below.



Winners and losers of Trump tariffs

It is too early to determine precisely which jurisdictions will benefit from a full-blown trade war, a more modest, tit-for-tat but controlled retaliation, and a partial reconfiguration of the international trade landscape. That said, many of the jurisdictions that benefited from the trade war that kicked off between the US and China in 2018 may be in a position to do so again. This is notwithstanding the risk that these countries will be slapped with US tariffs if they serve as a back-door entry point for China into the US market.

Those jurisdictions that benefited most from import substitution by the US and China in 2018 and 2019 include Vietnam, Chile, Malaysia, Argentina, Hong Kong, Mexico, Korea (South), Singapore, Brazil, and Canada.

Countries in the Gulf region could emerge as some of the biggest beneficiaries from intensified US-China geopolitical friction, a tit-for-tat trade war and broader decoupling. Beijing will likely work with Riyadh and Abu Dhabi to further expand collaboration and investment in a range of growing sectors, including digital infrastructure, emerging technologies, renewable energy and electric vehicle production.

However, Gulf leaders may increasingly find themselves wedged uncomfortably between Washington and Beijing. Saudi Arabia and the UAE have, for the most part, successfully juggled relations between the US (their biggest security provider) and China (their biggest energy client) and avoided having to decisively pick one side. Both the Emiratis and Saudis have used China as a strong card when dealing with Western governments and investors. But sustaining this approach may become increasingly difficult, especially if tensions between Beijing and Washington reach a new high.

As is the case with jurisdictions, it is premature to provide a full list of sectors that are likely to be adversely impacted by Trump-induced, escalating trade tensions. A tariff war risks inflating costs even for the US industries that Trump aims to protect. A spike in intermediary good import costs will force manufacturers to shoulder the cost themselves or increase sale prices, thereby propelling inflation.

Some of the sectors and industries that are likely to be directly affected by new US tariffs or impacted by retaliatory action from trade partners include automotive manufacturing, agriculture, semi-conductors, electric appliances, luxury goods, critical minerals and soybeans, from a longer list.

Mitigating the impact of trade-related geopolitical shocks

A key question is what investors and exporters can do to be prepared – as far as is possible – for a low-level or more serious trade war. An obvious starting point is to carefully assess company supply chains and exposure to jurisdictions that are likely to be slapped with new tariffs by Trump and governments that are forced to respond.

Identifying alternative, less exposed jurisdictions - to source from and ship to - should be a top priority for investors and exporters. "To make a judgement over the extent to which the relationship between the US and China will deteriorate further is actually rather difficult. What you can do is diversify your risks a bit," former British ambassador and corporate executive David Landsman told us.

This should go hand in hand with consistent information-collection on the thinking and strategies of key influencers and policy makers in Washington, Brussels, Beijing, London, and other capitals. The exercise should extend beyond senior officials and advisors in the bureaucracy to include private sector behemoths and C-suites who straddle both worlds, with Elon Musk being the most obvious example. Getting an accurate understanding of the types of carrots and sticks being used or held in reserve during government-to-government trade negotiations will help investors and exporters get a better sense of possible outcomes.

Companies should also plan for both likely and unlikely scenarios. Scenario planning will allow management to have a clear and defined plan of action in place to mitigate – to the extent possible – against damaging protectionist policies. Having a range of contingencies and responses laid out is particularly important given Trump's expected pursuit of a tough, mercantilist approach to trade.

Scenario planning should focus on tangible, measurable, and meaningful impacts. "To make scenario planning useful the exercise needs to relate to cash flow, hiring and CAPEX. You really need to take it to the next level, which is rare." Witold Henisz, Vice Dean and Faculty Director of the ESG Initiative at Wharton's Management Department told us. "Usually those people who have great skills in facilitating don't necessarily have financial acumen and wherewithal to connect that to the systems that drive decision making within a company."

In sum, the need for exporters and investors to acquire a better understanding of today's complex and dynamic geopolitical environment has peaked with Trump entering the White House. The next four years promise to test relations between chief geopolitical rivals and long-standing partners alike.

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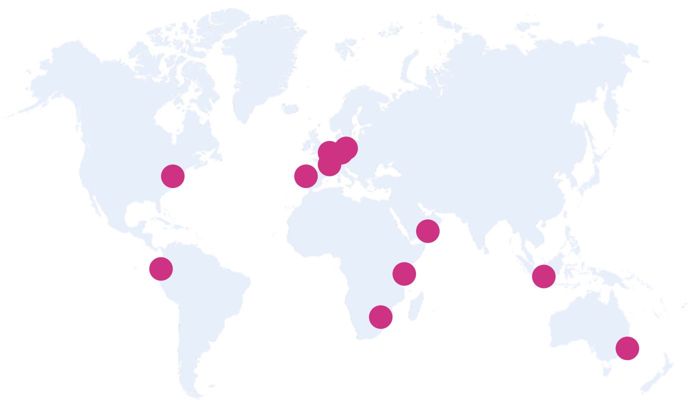

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