Isolation day: the geopolitical impact of Trump's tariffs on the world

Focusing on Asia as US risk premiums could potentially increase

By the Asian Equity Team
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"Shock and awe" intended

When news broke of Donald Trump's resounding victory at the November 2024 US presidential elections, many countries and businesses girded themselves for another round of trade wars.

But this time, the 47th US president upped the ante from his previous term by imposing across-the-board tariffs on friends and foes alike. The Republican party's majority in both the US House of Representatives and Senate helped to ensure that Trump would have near-unchecked power, leading to such policy extremes.

In light of these developments, we see markets as the remaining check and balance to hold the current administration's actions to account in the immediate term. As would be expected, Trump's tariffs roiled global stock markets. We therefore expect risk premiums for US assets to remain elevated for some time. Prior to the outcome of the US elections, we had explored the likely implications of a second Trump presidency and potential implications for portfolio companies in "If Trump wins: uncertainties and opportunities from an Asian equity perspective".

Similarly, from a global perspective, the pronounced market volatility suggests that it will be hazardous to sell following large declines and to buy after major upturns unless we have greater conviction that concrete steps are being taken towards de-escalation. Energy and commodities also took a hit as the ongoing trade disputes raised doubts over future demand. We expect crude oil prices to remain lower for longer though other commodities may be more economically sensitive and thus, volatile.

In our view, Trump's re-escalation of the tariff wars will only exacerbate the slowdown in global growth and may potentially plunge the US into recession unless his administration significantly reverses course with key trading partners including China, the European Union (EU), Canada and Mexico.

Another factor which could prevent an impending US downturn is intervention by the Federal Reserve (Fed). However, the Fed faces a very tough task, as rising inflation poses a risk that could make it challenging for it to further reduce interest rates.

China in the crosshairs

Although seemingly indiscriminate, the so-called "Liberation Day" tariffs primarily targeted China. We believe that Washington will maintain this approach even if it rolls back punitive measures, such as with the surprise 90-day reciprocal tariff reprieve announced by the White House, for all countries apart from China.

The chaos caused by Trump's unpredictable actions may seem surreal, almost like events from a reality TV show. Nonetheless, we believe he is still a businessman at heart with deal-making as his main objective.

The ability of all countries to weather the US tariffs hinges on sound policy decisions, supportive domestic demand, capacity to stimulate the economy via monetary and fiscal means and the ability to negotiate concessions with the Trump administration by increasing purchases of US goods or investment. We think this last point may help countries to secure a bigger share of the export manufacturing market to the US over time if balanced correctly. The country with the most potential in this regard is India, which also stands to benefit from a sustained drop in energy prices.

Most countries in Asia will likely try and hold discussions with the Trump administration. To date, over 75 countries have sought to strike a deal with the White House.

Given Trump's preference to conduct one-on-one talks, we feel it would be prudent for the Association of Southeast Asian Nations (ASEAN) to negotiate as a bloc for more favourable terms as opposed to a country-by-country basis. For potential guidance ASEAN can look at the EU, which has banded together even more closely amid current developments.

In the context of Asia excluding Japan, although countries that are part of the "China plus one" risk diversification strategy were also hit with tariffs to varying degrees, most of them are in the process of negotiating trade agreements with the White House. We believe that they could potentially be well-positioned to benefit from subsequent lowered duties as well as the accelerating trend of diversifying supply chains away from China.

Meanwhile, the Philippines' services and agriculture-focused economy means that the reciprocal tariffs, which mainly penalise manufacturing hubs in Trump's quest to bring such jobs back to the US, will have less of a negative impact on the Philippines.

And finally, while India is yet to officially respond to the sweeping US tariffs, we believe that its economy, driven more domestic consumption, puts it in a stronger position to negotiate a more favourable trade agreement with Trump compared to countries more heavily reliant on exports.

Sino resolution

China, however, is not having any of it. Compared to Trump's first term in office, Beijing is hitting back more forcefully with tit-for-tat tariffs having learned the hard way that any signs of weakness will certainly be exploited. With neither Trump nor Chinese President Xi Jinping likely to back down, we believe China's actions must be accompanied by corresponding domestic support packages to prevent Chinese assets from suffering collateral damage. Further restrictions on investments in China or the US could be on the cards should tensions escalate. US Treasury Secretary Scott Bessent raised the possibility of delisting Chinese companies from local stock exchanges following the tariffs announcements. Beijing had also earlier ordered the National Development and Reform Commission to halt approvals for Chinese firms aiming to invest in the US.

Government officials have said China is ready to lower interest rates and relax the reserve requirement ratio to stimulate the economy in the face of rising trade tensions with the US. In a planned emergency meeting of high-level economic officials, we expect the authorities to redouble efforts to bolster consumption, artificial intelligence (AI) and energy infrastructure and focus on localising industries such as medical devices.

Initial measures to boost domestic consumption are expected to include the streamlining of duty-free purchases by inbound tourists, which could benefit duty free names. The measures could also include a plan to ramp up health-related consumption though fitness and sports initiatives and the promotion of high-quality agricultural products. These are likely to be just the beginning of a series of policies aimed at supporting domestic demand.

Manufacturing mayhem

At a sectoral level, pharmaceutical and semiconductor imports are currently not subject to US reciprocal tariffs. However, Trump is threatening to revoke these exemptions as part of a wider national security agenda. Chinese companies in these industries are the likely targets of future measures.

In the broader manufacturing space, we view flexibility in production as necessary for supply chain resilience as per Apple's decision to produce more iPhones in India in a shift away from China. Nevertheless, committing to longer-term manufacturing capital expenditure decisions poses significant challenges under current conditions.

A new world order born of fundamental change

Trump's unprecedented actions have torn down the established global trade order as the US seeks to structurally cut its deficit and bring back manufacturing jobs, while China has been making attempts to shift away from an export-led economy towards consumption-driven growth. The 90-day tariff moratorium may provide nations some time to assess the optimal route to navigate these US tariffs. However, the risk of further escalation is very real, given that the world's two largest economies are adamant about not appearing weak in the eyes of the other. Regardless of who gains the upper hand in the end, all countries will need to chart a new course into the proverbial unknown.

Volatility typically brings both risk and opportunities. Significant fundamental changes have been set in motion and will lead to long-term, sustainable investment opportunities in the days and months ahead. Cutting through the noise and bluster to identify longer term investment opportunities is what excites us. Over the last 15 years, US equities and assets have been the biggest beneficiary of global portfolio flows. However, if US risk premiums are expected to remain elevated for an extended period, investors are likely to ask, "Where else should I reallocate my capital to"? We would not rule out large parts of Asia.

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