

9 November 2016

# Flash Comment

## What Trump means for China

- Immigration, China and arrogance in the political establishment were at the centre of Donald Trump's campaign to become the US president. **One might thus fear that punishing China could be one of the main aims of Trump's policy** in the White House. A rise in protectionism could hurt Chinese exports, as the US is the destination of close to 20% of Chinese exports.
- However, **there will be some mitigating factors**.
  - First, a **fiscal boost to US growth** seems increasingly likely. More US growth would benefit demand from China.
  - Second, while an increase in tariffs on imports is likely, **Trump has to be careful how much he goes down the protectionist path**. China would be likely to retaliate in such a scenario and US importers from China would be hurt by higher duties on imports. For example, iPhones and other electronic products that are assembled in China could suddenly become more expensive. If production is moved to the US instead, it would also make the products more expensive.
  - Third, **China can let the market weaken the CNY** further by simply not intervening to dampen the depreciation of CNY. As this kind of depreciation would be driven by markets rather than due to intervention, it would be hard to get global support for calling China a currency manipulator.
  - Fourth, **China has significant leverage to the US in the USD1.2trn portfolio of US treasury securities** it holds following many years of accumulation (for comparison, the Fed holds USD2.3trn of US treasuries). Should China choose to sell out of this portfolio in a rapid fashion, it could push up US yields significantly.

Finally, **China holds a trump card in the near-monopoly of rare earth minerals**, with an estimated 95% of rare earth mining. Rare earth is used to manufacture everything from electric vehicles, missiles, wind turbines and mobile phones. China used this weapon against Japan in 2010, when a Chinese fishing boat captain was detained in disputed waters. At the same time, China reduced export quotas temporarily, leading to a price spike in 2011. While mining could be increased elsewhere if China were to put a quota on exports, this would take time.

**Trump already struck a milder tone towards the world in his acceptance speech than during the campaign** as he said: *'I want to tell the world community that while we will always put America's interests first, we will deal fairly with everyone, with everyone... All people and all other nations. We will seek common ground, not hostility; partnership, not conflict'*. Exactly what 'deal fairly' means only time will tell but his rhetoric has softened quite a bit in this area already.

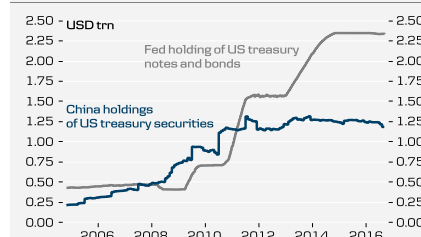
**It is still too early to evaluate what it means for China** – and the world – that Donald Trump will soon be in the White House. However, while his rhetoric has been tough on China, there is a limit to how far he can go down the protectionist path. At the same time, China would benefit from stronger US growth on the back of an expected fiscal boost in the US

### Chinese exports to the US



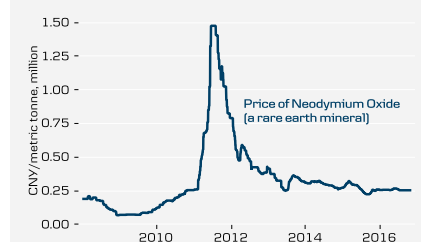
Source: Macrobond Financial

### China holds a large portfolio of treasuries



Source: Macrobond Financial

### Rare earth price spiked in 2011 in response to lower export quota



Source: Macrobond Financial

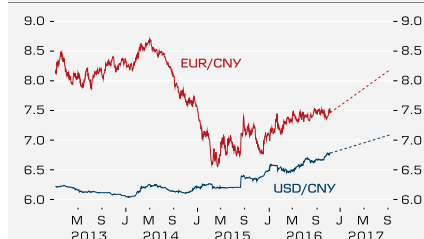
#### Chief Analyst

Allan von Mehren  
+45 45 12 80 55  
alvo@danskebank.dk

## Market reaction

- The **knee-jerk reaction in Chinese offshore stocks was a sharp sell-off** in tandem with other markets, while the onshore market was only slightly lower. However, offshore stocks closed before the rebound in European time and we believe they are likely to catch up when Asian stock markets open again.
- **The currency movements overnight in USD/CNY very much reflected the development in the broad USD index.** The CNY strengthened versus the USD initially, as the USD saw broad-based weakness. However, the CNY has weakened again as the USD gained pace over the day. **We do not see any scope for changing our CNY forecast and will await more information on Trump's policies before we make any changes to our view.** However, if anything, the election of Trump supports the case for more weakening of the CNY and we continue to recommend hedging receivables in CNY. We also still see a short CNH trade as a good hedge against financial risks in China.

### Chinese currency set to weaken - Trump or not



Source: Macrobond Financial

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