VICTIMS OF A LOOMING TRADE WAR

The election of Donald Trump has not triggered any major financial tensions in the main emerging markets. Nevertheless, the dollar has strengthened, which should delay the easing of monetary policies. More worryingly, emerging economies will be the direct or collateral victims of the trade war promised by the incoming United States administration. They will face a double shock: a sharp slowdown in global trade and the re-routing of Chinese exports. The first shock is bound to be recessionary or even inflationary. The impact of the second is not clear cut as it hinges on the types of Chinese exports (complementary or competing) and, most of all, on their link with direct investment.

The election of Donald Trump has darkened the outlook for emerging countries. In the very short term, the impact is mainly financial. Since 4 November, the exchange rates of the main emerging countries have depreciated by a median of 1.5% against the dollar, with Central European currencies the hardest hit, in line with the euro's 2.8% depreciation against the dollar, the Chilean and Mexican pesos (both -2.7%), the Thai baht (-3.1%) and the South African rand (-3.6%). Since October, portfolio investment flows from non-residents to the main emerging countries have dried up, with the exception of a few countries that have continued to attract bond investors. However, government bond yields in local currency and CDS spreads have remained stable. If they remain at this level, currency depreciations are unlikely to accelerate inflation again on a long-term basis. But they could delay the easing of monetary policies.

PROTECTIONIST SPIRAL: A GLOBAL RECESSIONARY EFFECT

More worrying in the short to medium term, the announced increased protectionism in the United States and the risk of retaliatory measures from China and the European Union are reducing the prospects for global growth, and therefore for emerging countries, via the negative impact on international trade. The Trump administration is planning to raise the existing import taxes by 10 percentage points on all products imported from all countries except China, and by 60 percentage points on Chinese products. According to the CEPII, a French center for research and expertise on the world economy[1], if other countries were to apply equivalent import taxes in return[2], the recessionary impact by 2030 (compared with a scenario without increases in tariffs) would be -3.3% on global exports and -0.5% on global GDP. China and the US would obviously be hardest hit with a 1.3% contraction of their GDP. According to a study published by the Peterson Institute for International Economics (PIIE)[3] using a different methodology[4] the negative impact on the US GDP (assuming retaliation by other countries as well) would be in the -0.9%/-1.3% range[5]. The impact would be -1.2% for China (in the China-specific scenario). In the CEPII study, Canada and Mexico, protected by the USMCA, would benefit greatly from the improved price competitiveness of their exports. In the PIIE study, it would be the opposite; the two countries would suffer more from the increase in tariffs than the other countries since they would be hit harder given their large commercial links with the US.

For the rest of the world, the CEPII simulation concludes that the impact would be negative but limited. The impact on India's GDP would be lower than 0.5%. In the PIIE study, against all odds, the impact of countries' GDP is even slightly positive, despite the overall inflationary impact. The authors do not provide explanations in their article. Compared with the CEPII study, the negative impact of protectionism on world trade seems underestimated in our view. The fact remains that a trade war will have a recessionary effect for all countries (to a lesser extent, perhaps, for Canada and Mexico).

RE-ROUTING OF CHINESE EXPORTS: MIXED EFFECTS ...

The fact remains that a trade war triggered by the Trump administration will have a recessionary impact for emerging countries (except, perhaps and to a lesser extent, for Mexico). In addition to this, there are the more specific effects of i/ the re-routing of Chinese exports, independently of the re-routing caused by the trade war with the United States (which is at the core of the CEPII model), as a means of supporting growth held back by domestic demand ii/ the redeployment of Chinese direct investment to circumvent the rise in American import taxes, or simply that of emerging countries themselves in order to protect their domestic markets (as in the case of Brazil, Thailand and Turkey, which are trying to attract Chinese investment in order to protect their domestic electric-vehicle market).

These more specific effects may intensify the overall recessionary effect of a trade war or, on the contrary, mitigate it in the case of direct investment.

The re-routing of exports has been underway since 2018, when American taxes on Chinese products were first raised. As a result, China's share of exports to the United States has fallen from 19% to 14%, while, at the same time, exports to emerging Asia have risen by the same proportion, from 21% to 25%, with Vietnam in particular seeing its share rise from 3.2% to 4.5%. Emerging Asia is the only emerging region which has seen this share increase significantly over the 2017-2024 period. In the other regions, however, there is one exception: Mexico. Mexico's share of China's exports is still low, at 2.5%, but, as with Vietnam, Chinese exports there have grown very strongly (by a factor of 2.5 since 2017).

1 Antoine Bouët & alii « Le prix du protectionnisme de Donald Trump » - La lettre du CEPII - Novembre 2024.
2 Except for Canada and Mexico as the authors assume that these two countries would not face tariff increases under the USMCA.
3 McKibbin & alii : « The international economic implications of a second Trump presidency » - PIIE working paper - September 2024.
4 In the CEPII study, the authors use a multi country multi sector dynamic computable general equilibrium model, mainly designed to simulate commercial policies. A growth model is conjointly used to simulate main macroeconomic variables like GDP, inflation etc. In the PIIE study, the simulation is based on a standard modern international model which is widely used in central banks, international institutions, government agencies for economic and monetary policy evaluation.
5 The authors simulated 2 scenarii: the first one with a universal +10pp increase applied to all countries including China and the second China-specific one with +60pp increase on Chinese products and 0 for other countries' products. As a first estimation, one can add the two impacts even if the upper bound is slightly overestimated.

Mexico and Vietnam are key examples of the re-routing of Chinese exports with the aim of circumventing American taxes and sanctions (in the case of Mexico) and/or simply expanding the export network (in the case of Vietnam, for both reasons). For both these countries, the re-routing of Chinese exports is not negative as it has been accompanied by an increase in FDI. Indeed, Chinese exports are not necessarily in direct competition with locally produced goods, but help to expand the recipient country's production capacity and export base by becoming part of value chains. According to the OECD, both these countries also have the highest Chinese value-added content in their exports (measured by the countries' backward participation index with respect to China) among the main emerging countries.

There is one reservation, however; the re-routing of Chinese exports may create a dependency on imports of "Made in China" products. For emerging countries as a whole, the share of products imported from China that account for more than 50% of total imports rose from 15% in 2019 to 20% in 2022 (this share is stable for developed countries at around 8%).

… MORE FAVORABLE TO ASIAN COUNTRIES THAN CENTRAL EUROPEAN COUNTRIES & TÜRKIYE

Which regions and countries would be most affected by the re-routing of Chinese exports? If we take, as a first step, the share of imports from the trading partner (in this case China) in the total imports for finished manufactured products (where Chinese competition is potentially the strongest), Asian countries are the most exposed (with the share ranging from 28% for Malaysia to 48% for Indonesia). On the other hand, these are the countries with the highest backward participation indexes, which means that a significant proportion of imported Chinese products are complementary (as embedded into value chains) rather than competing. For Central European countries and Turkey, the situation is the other way around. The share of Chinese imports is lower than for Asian countries (ranging from 9% for Romania to 27% for the Czech Republic), but so are the backward participation indexes. What's more, Europe, the main destination for their exports, is already a major outlet for Chinese exports, and for products that are a priori competitors (household appliances, cars). In addition, unlike China, these countries have experienced a sharp rise in real wages and have therefore lost out in terms of cost competitiveness. However, Hungary and even the Czech Republic could do well, as their backward participation index is as high as that of some Asian countries, and Chinese direct investment in both these countries is part of a long-term strategy to gain a foothold in the European market. In the other regions, Latin America, Africa and the Middle East, the re-routing of Chinese exports is likely to lead Chinese companies to strengthen their position mainly in the Brazilian market. Finally, Morocco's manufactured exports and, to a lesser extent, those of South Africa (which account for 40% of its total exports) will also be competing with Chinese products.

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