"TEAM TRUMP" ASIA PIVOT: PRESIDENTIAL LEADERSHIP

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"Team Trump" demonstrated exemplary global economic leadership skills at last week's summit between President Donald Trump and China's president, Xi Jinping. Most importantly, both leaders agreed to a concrete agenda of dialogue and engagement: At the working level, both nations committed to a 100-day plan to address bilateral trade issues, with progress overseen by the two presidents directly, and at the top level, President Trump accepted President Xi's invitation for a follow-up bilateral summit in China sometime later this year.

All said, both leaders went out of their way to seek common ground and work toward credible solutions, rather than—as was widely expected before the meeting—merely agreeing to disagree. The new U.S.-China bilateral relationship is off to a pragmatic and forward-looking start, in our view. This is good news for global risk asset markets in general, and Japanese equities in particular: The risk of a trade and/or currency war coming to Asia has come down significantly, in our view.

However, as we pointed out in last week's discussion about the U.S.-China-Japan dynamics, the U.S.-China presidential summit was just the first step in a series of events that will shape investor confidence in the future opportunities and prospects for the world's most dynamic economic region, Asia-Pacific. Next comes April 14, when the U.S. Treasury is due to publish its report on currency manipulation, and then we get a visit by U.S. Vice President Mike Pence and Commerce Secretary Wilbur Ross to Tokyo for the first U.S.-Japan economic, trade and finance framework talks during the week of April 17.

A return of true "risk on" requires evidence of coordinated policy leadership from America, with the Treasury Department, the Commerce Department and the White House demonstrating a unified and coordinated approach. For example, it would be alarming to see China accused of currency manipulation without immediate reference to the newly agreed-on U.S.-China 100-day plan as a forum to work things out. Ditto for the yen and the U.S.-Japan bilateral forum. The more professional and coordinated U.S. trade and investment policy leadership gets, the less distracted will risk takers be by the "chattering classes." Both Washington and Tokyo are working hard to create a possible blueprint on future U.S.-Japan bilateral economic, trade and investment relations. In my personal view, the Team Trump Asia pivot between April 6 and April 21 marks the first real test of what the new U.S. administration is capable of.

From the U.S.-China-Japan Triangle to Asia-Pacific

Here in Tokyo, the success of the U.S.-China summit was greeted with relief. Yes, there is an understanding of the symbolism inherent in the fact that the U.S.-China bilateral framework talks will be overseen by the two presidents personally while, in contrast, the U.S.-Japan bilateral talks are led by the two vice presidents. At the core of this lies not only the fact that both Prime Minister Shinzo Abe and President Trump already have a much deeper relationship of not just personal trust but also national codependence: The U.S.-Japan security alliance is a bedrock that allows economic and trade relations to be viewed as more of a technical problem between the two nations, rather than a fundamental one. In contrast, the U.S.-China security and defense relationship is much less well defined, with both countries' ambitions perhaps more competitive than complementary. "Team Abe" understands that the greater complexity of the U.S.-China relationship does require oversight at the highest level because it is more controversial and requires greater political capital commitment.

Here, it is important to stress how pivotal a smooth U.S.-China trade relationship is to the future prosperity of all of Asia-Pacific. Competition between China and the rest of Asia is intense. Specifically, export competition is extremely fierce, with almost 80% of Asia ex-China exports competing head-to-head in the U.S. market against made-in-China products (see the table below). Even for made-in-Japan products, about 65% of exports compete head-to-head against those made in China, with the lack of direct competition in the car and car parts markets the principal reason Japan is relatively low compared to the rest of Asia. Make no mistake—China's position in global export markets is not an unassailable monopoly.

Who Is Afraid of China?

% of country's exports that compete head-to-head with made-in-China products in the U.S.			
	1996	2006	2016
Japan	8%	28%	65%
Korea	28%	49%	72%
Taiwan	35%	69%	87%
Philippines	46%	76%	81%
Thailand	48%	77%	86%
Indonesia	56%	67%	78%

WisdomTree Japan Calculations based on UNCTAD trade statistics (12/31/16).

The key implications are twofold, in our view. First of all, a breakdown of U.S.-China free trade would almost certainly trigger a currency war, with China most likely forced to compensate for potential adverse tariffs by debasing its currency. Not doing so would risk market-share loss as Asian suppliers could move in quickly.

Second, the U.S. administration starts the 100-day plan negotiations from a position of relative strength. For America, there are plenty of alternative suppliers to made in China. For China, the almost certain loss of exports would likely force rising unemployment, which in turn could undermine leadership credentials for the Communist Party in general, and frictions between local governments and central government in particular.

The fact that President Xi himself is directly supervising progress on the 100-day plan underscores that failure is not an option for China, in our view.

In our view, the conditions for a "risk-on" trigger from the removal of policy uncertainty in Asia are beginning to fall into place. Whether these developments in Asia have any bearing on other regions in general, Europe in particular, remains to be seen. Unlike U.S.-Japan and now U.S.-China, a credible path toward bilateral engagement in Europe appears unlikely before we know who will be ruling in Europe's strongest powers, Germany and France.

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