SINGALLIANCE

Letter n°73

Protectionist pressures and the risk for stock market valuations (1).

"***Commerce is a perpetual and peaceful war of wits and industry among all nations***" ***Colbert*** in "Letters, instructions, memoirs".

- ***The drivers and successes of globalisation***:

Over the last twenty to thirty years, globalisation has been fuelled by low-cost raw materials and driven by the United States, the world's leading power with more than a quarter of world consumption, the EU, the world's leading trading partner and China, the world's factory.

Relocations were numerous and international trade grew faster than GDP.

Globalisation has greatly benefited emerging countries and has reduced the number of poor people from 1.8 billion in 1990 to 650 million in 2018, but it is causing discontent among the Western middle classes.

- ***Hindered multilateralism***:

Blockages are becoming more frequent at the United Nations. The United States, distrustful of international law, has not ratified the Convention on the Rights of the Child, the Convention on Human Rights or the ICC. As for China, it advocates multilateralism but its market remains protected.

A certain number of treaties, such as the NPT (Non-Proliferation Treaty), are subject to infringements and, among the recent treaties, the ICC (International Criminal Court) of 1998 has a disappointing record because it mainly involves Africans and has few resources. The climate convention also has a lacklustre record because it does not provide for any real commitment and the humanitarian law convention on anti-personnel mines has not organised any verification measures. At the WTO, the 164 members have not made any progress since Doha in 2001.

There are still some twenty conventions in force, including the UN Charter, the 1967 Outer Space Treaty and the Law of the Sea, but there are few multilateral negotiations underway.

In order to better understand these protectionist seeds and the impact on margins and stock market valuations, we will take two approaches: trade and industrial.

From a trade perspective:

The globalisation of trade in the history of the last century has not been linear and the rate of openness of economies only returned to the 1914 level in the 1970s.

International trade as a percentage of world GDP rose from 31% in 1975 to 61% in 2008 and has since declined but remains at 57% of world GDP in 2021.

In order to assess the evolution of trade from a commercial perspective, let us look at recent changes in international trade, then focus on bilateral trade between the United States and China, and finally look at the trend towards the regionalisation of trade

- ***Changes in international trade***: 3 downward trends.

Slower growth in international trade:

While trade growth before 2008 was double that of global GDP, since then it has been just in line.

Today, we measure the increased exposure of companies to global public opinion in the fight against forced labour and environmental protection.

The second trend is a decrease in the number of foreign workers:

Following the Covid crisis and the sometimes prolonged closure of borders, many Asian countries have seen expatriates leave, for example in Australia, where the number of foreign workers has fallen from 500,000 to 90,000, and also in Singapore and Hong Kong.

The third trend is an increase in border protection measures or relocation incentives:

In developed countries, the theme of reindustrialisation is prevalent. It is a question of recreating skilled jobs for middle classes revolted by wage stagnation. It is also a question of combating industrial desertification in certain regions. Finally, it is a question of reducing dependence on foreign countries.

- ***US-China trade developments and implications***:

The US is working to reduce its dependence on China but progress is slow. Between 1990 and 2015, China's share of global manufactured exports rose from 2.8% to 18.5% according to Gordon Hanson.

Topical is the ambivalence between political rhetoric and economic reality, between the Trump and then Biden measures and the 20% growth in trade between the US and China from 2019 to 2022.

In 2022, trade with China totalled $690 billion, an increase of 6.3% in one year despite the tension between the two countries and despite the sanctions, and the US deficit reached over $380 billion, 13% of US foreign trade. The tariffs brought in $260 billion in revenue for the federal government.

US imports from China accounted for 22% of the total in 2017 but (still) 16.5% in 2022. After the sanctions, imports of goods taxed at 25% fell by a fifth, as did those taxed at 7.5%. In contrast, the share of untaxed goods from China increased by 50% between July 2018 and August 2022.

US FDI (foreign direct investment) to China+Hong Kong maintained around 25% of US investment in Asia between 2008 and 2021, but FDI to Singapore rose from 21% to 38%.

And, similarly, there has been an increase in purchases from other Asian countries.

The recent US decision to block semiconductor sales to China particularly affects Yangtze Memory Tech and Hua Hong Semiconductor and, according to ***Roubini***, in a world increasingly dependent on semiconductors, World War 3 began in October with the US decision to ban sales of certain chips to China. In November, Chinese imports of semiconductors fell by 40% year-on-year from $4 to $2.3 billion.

At the same time, the US is offering subsidies for local production of electronic components, imports from Mexico have doubled since 2008 to $400 billion and purchases from Vietnam have risen from $10 billion in 2007 to $120 billion in 2022.

Between 2017 and 2022, imports from Vietnam increased by more than 170%, those from Taiwan by 120%, those from Bangladesh and Thailand by 80%, and those from Indonesia and India by 75%.

Thus, Asia excluding China now accounts for 24.8% of imports, compared with just under 21% in 2017, while Europe (27+ Great Britain) is stable at 19%.

- ***The regionalisation of trade***: 2 examples.

Trade between Russia and China:

Between 2014 and 2022, trade between the two countries increased from $95 billion to $190 billion, and in 2022 alone it grew by 30%. By sector, China buys less agricultural products from the US and more from Russia.

The growing role of ASEAN countries:

The ten members have a population of 680 million, 3.5% of the world's GDP, and above all 7.7% of world exports. FDI is increasing in Indonesia, Malaysia and Singapore.

ASEAN countries are benefiting from the two-point decline in US imports from China. A similar shift can be seen with Japan. In 2012, 75% of textile imports came from China, today it is 58%. There is a political reason for this and also lower costs in Bangladesh or Vietnam.

From an industrial point of view: 3 developments are worth noting.

Today, governments and companies are worried, suspecting, speculating, sensing hidden agendas, and fearing an embargo on the sale of technological components in the case of China, and on the supply of rare earths in the case of the West. Thus, each actor is changing its strategy.

In this environment, after having noted the universal nature of the quest for sovereignty, we will analyse the evolution in developed and emerging countries.

- ***The quest for sovereignty***:

Politics is taking over economics, the quest for sovereignty over trade integration. According to the United Nations, more than 100 countries have recently adopted strategies to strengthen the industry, and within the G7, many countries are focusing on robotization and artificial intelligence. Overall, subsidies have increased from 0.6% of GDP in 2016 to 2% in 2020, or $1.1 trillion.

In some sectors, some countries are closing their borders and thus exposing themselves to retaliation in other sectors. Independence is the word, as if everyone fears a new iron curtain. Some are working to relocate productions deemed sensitive. And so, in technology, agricultural production and healthcare, Chinese, American and European discourses have a similar tone.

Of all the countries, the most determined seem to be the Americans because among the $280 billion plan to revive the semiconductor sector, the $400 billion IRA plan and the $1.2 trillion infrastructure plan, nearly $2 trillion should be invested over the next ten years.

- ***Developments in developed countries***:

Western countries retain many advantages - financial resources, quality infrastructure, a well-trained workforce, technological leadership - and they still represent the world's largest consumer market.

Within developed countries, disadvantaged or declining regions are expected to benefit from increased investment in infrastructure.

The relocation and regionalisation of trade make it possible to create or strengthen attractive regional areas (qualified personnel and infrastructure). This is not immediate, but the EU could benefit from it as it is studying the launch of new common policies.

The European Commission estimates that €350 billion is needed by 2030 to promote a high-tech industry in the EU and, given the sums available, would need a balance of €100 billion. This includes making government aid and tax incentives for green technologies more flexible. A European sovereign fund for innovation is under discussion which, in addition to renewable energies, would finance disruptive innovations, AI, robotics, biotech and quantum computing.

We are talking about industrial policies here, but let us keep in mind the dominance of services in developed economies, around 70% of GDP. In other words, reindustrialisation will hardly change the potential economic growth rate because the share of manufacturing industry in Europe has fallen from 18% of GDP to 15% between 2000 and 2021 and is around 10% in the southern countries, including France and excluding Italy, and 20% in the northern countries.

Energy prices are a variable of competitiveness, but the sectors are variously impacted. Chemicals is obviously the sector most affected by the rise in energy prices and activity has fallen by 14% in 2022, metals, also, -7% and paper, -6%. However, according to Allianz, overall, energy represents only 1.5% of the costs of industrial production.

- ***Developments in China and emerging countries***:

In emerging countries, the trend towards promoting national champions is similar.

In China, in the automotive sector, foreign manufacturers, which were still dominant two years ago with 60% of sales, have fallen to 43% in 2022 and, with the promotion of electric cars, Chinese manufacturers will extend their advantage as 8 out of 10 electric cars sold in China are Chinese.

In distribution and cosmetics, Chinese companies are moving upmarket, and China is increasingly showing national preference. The big international brands, e.g. H&M, Zara, Adidas, are holding on to the Chinese market but are affected.

India, like China, is focusing on 14 sectors and offering $26 billion in aid to attract investment.

In conclusion, in the policies pursued by the governments, we can discern 3 trends and 2 reasons not to believe in protectionism:

- ***Three trends:***

Firstly, the ***concern to preserve national independence***, i.e. the control or even blocking of foreign investors, especially if they are Chinese and intend to take control of a particular technological company.

Secondly, the ***decision*** of certain countries, first and foremost the United States, ***to block certain exports*** to certain countries such as China or Russia.

Finally, in parallel with these relocation policies, there has been a ***fall in the amount of FDI***. These represented 5.3% of world GDP in 2007 but only 2.3% in 2020.

- ***Two reasons not to believe in protectionism:***

It is true that free trade, contrary to belief, does not guarantee against the risk of war, e.g. in 1914, a time of vast opening up of countries, and cannot be used as an argument in the fight against protectionism:

The evidence of free trade: a simple observation, the richest countries in terms of GDP/capita, Switzerland, Singapore, the Netherlands... are also the most open to the world.

The false trial of globalisation: the vast majority of industrial jobs lost in Western countries are the result of technological progress, not globalisation. According to McKinsey, only 20% of the 5.8m US manufacturing jobs lost between 2000 and 2010 were the result of offshoring.

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