

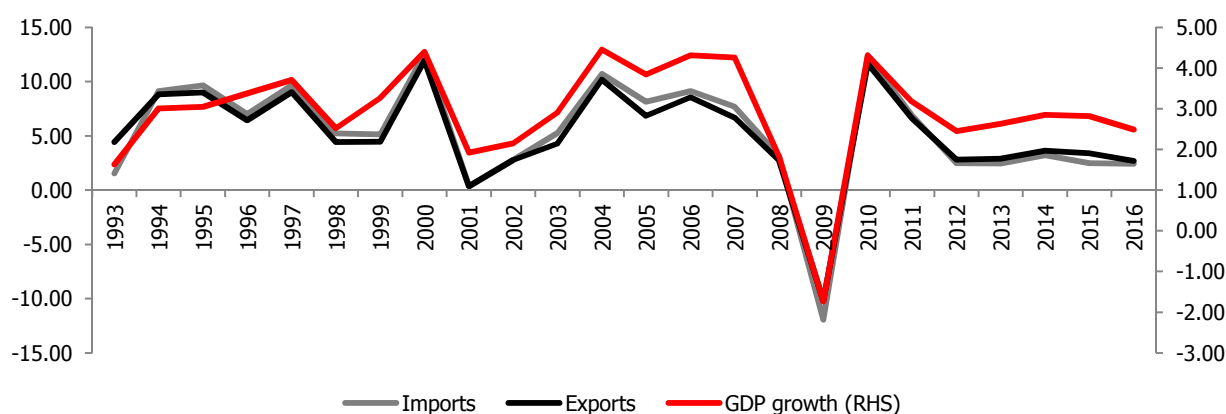
ECONOMIC REPORT | External Trade Sector

US Tariff Measures (Part 1):

A Political Order Rather Than Economical

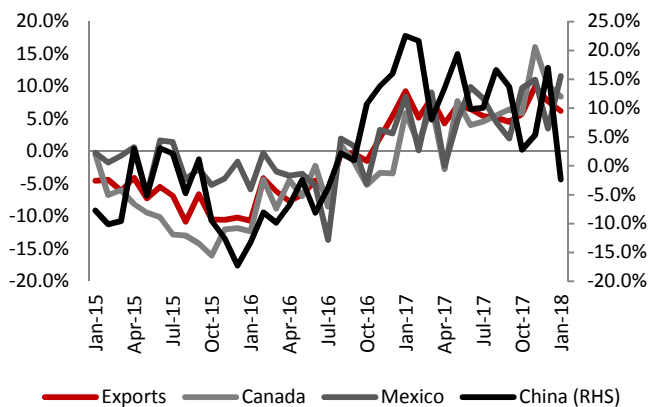
Slowdown in global performances. International exports and imports for the past few years reflect a slowdown in the global economy. Exports and imports in 2016 grew however at a softer pace by 2.68% and 2.42% respectively partially buoyed by easing economic activity globally. In 1Q17, trade indicators such as exports orders increased, signalling stronger trade growth for the year. Trade has high potential to reinforce global economic growth if the movement of goods and services across borders remains clear. However, the presence of uncertainties such as Trump’s protectionism moves weigh on the outcomes.

Chart 1: Global: Imports & Exports Growth vs Economic Growth (%)



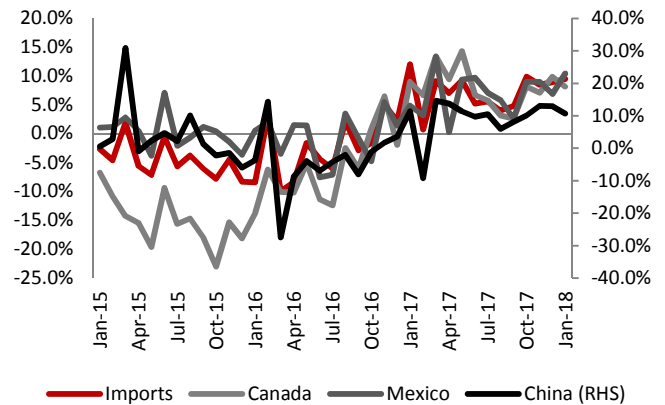
2017 was a blessing year for Trump. Economic performances in the US, developed and emerging markets were on the upside amid of improved global demand, better recovery in commodity prices, sanguine business confidences and receding protectionism threats. Henceforth, most economies across the globe recorded solid pace in each external trade activity in 2017. As Trump entered the White House in Jan-17, he enjoyed the upswing rise of the US economy as well as global trade performances. Looking at 2018, external trade activities across the globe are expected to moderate particularly due to unfavorable base effects, continuous geopolitical risks and growing protectionism threats. The recent tariff hikes on imported solar panel, washer, aluminum and steel are examples of protectionist policies under Trump’s administration.

Chart 2: USA's Exports Destination Performances (YoY%)



Source: CEIC, MIDFR

Chart 3: USA's Imports Destination Performances (YoY%)



Source: CEIC, MIDFR

Tariff threats by the US. Tracking back Trump's first year in office since Jan-17, he did not make significant progress on his trade-related moves except for withdrawing US from TPPA. However, Trump gave it a kick-start in 2018 after he imposed steep tariffs on solar panels and washers which start off with 20% and 30% tariff respectively. Subsequently, he imposed another steep tariff on imported steel and aluminium by 25% and 10% respectively which took effect on March 23. While EU and some other countries were temporarily exempted from this tariff, China remained on target. Lately, Trump signed a memorandum that would witness additional tariffs worth up to \$60 billion in Chinese imports.

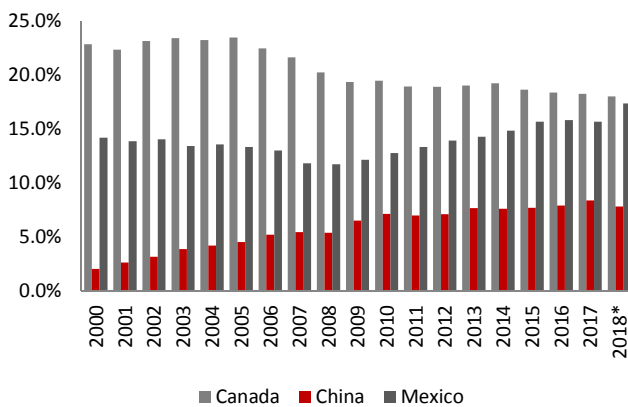
Protectionism spark fears of trade war. The continuous protectionism moves by Trump have provoked trade wars, escalating global tensions. Trade war is a circumstance in which countries retaliate against each other's trade usually by imposing trade barriers such as tariffs and quotas. Among others, China has started to retaliate over Trump's decisions, fuelling global worries of an all-out trade war between the two largest economies in the world. China announced to impose tariffs on 128 US products, including California wine and almonds which amount to \$3 billion, just enough to indicate their seriousness in this matter. On the other hand, EU warned it will hit back with 25% tariff on US goods including motorcycles, bourbon and denim jeans worth \$3.5 billion if the exemption from recent steel and aluminium tariffs have not been made permanent.

Historical evidences showed unfavourable effects. Previous trade wars in US history had shown the folly of protectionism. The Smooth-Hawley Act passed by Congress in 1930 despite economists' disapproval was blamed for deepening the Great Depression as it added economic strain to countries. The act which imposed tariffs up to 50% was initiated to protect American farmers however broadened as other sectors followed. Subsequently, other countries retaliated by also increasing their tariffs which eventually caused world trade to decline severely as demands collapsed. Besides that, Bush's steel tariffs in 2002 didn't work as well as the cost of the policy outweighed its benefits in terms of aggregate GDP (declined by \$30.4 million) and employment (lost around 200k jobs).

Tariff hikes may translate into rise in inflationary pressure. According to the latest Dallas Fed Manufacturing Index, the index went down to 4-month low at 21.4 points in Mar-18 amid of new steel tariff hikes. The protectionist move pushes indirectly increase in production for manufacturers in Texas. Consequently, further

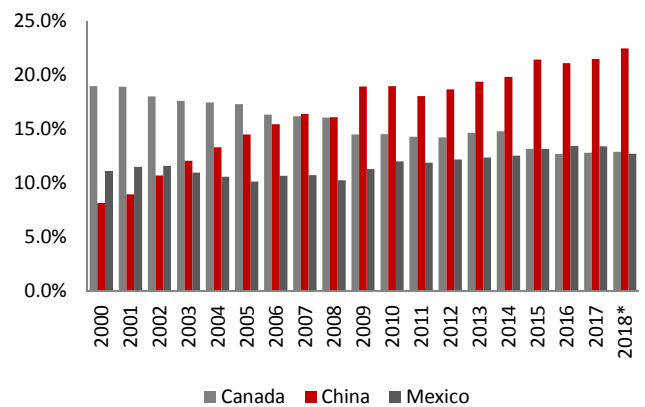
tariff hikes will push up inflationary pressure and hence impede business and consumer confidences in the economy. In addition, trade war with Canada, China and Mexico will have negative repercussion on the US economy due to external trade contributions. Exports to Canada, China and Mexico constitute about 43.3% of total exports while imports from these economies hold about 48.2% in Jan-18. Moving forward, we view the Trump's administration will not aggressively hike the tariff and non-tariff measures in the future. The protectionist moves are more political rather than economical.

Chart 4: USA's exports share by destination (%)



Source: CEIC, MIDFR

Chart 5: USA's imports share by destination (%)

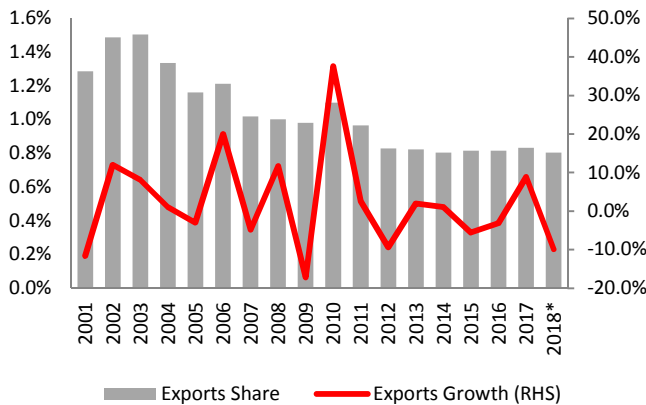


Source: CEIC, MIDFR

Impacts are minimal to China. The latest US steel and aluminium tariffs will possibly hit global trade activities more than it affects China if it was directed to that country. Approximately 94% of US imports of steel products from China are already subject to special tariffs in the past trade restrictions. Hence, the recent 25% tariff would not have significant impacts on China compared to other US allies which face only trivial tariffs earlier. On top of that, China had already reduced steel exports to the US due to strong domestic demand and US anti-dumping duties. On the other hand, aluminium exports are relatively small to be compared with China's total exports. Meanwhile, Trump's tariff is likely to cause unintended consequences to the US. For instance, the steel & aluminium tariff is expected to help steel & aluminium makers however at the expense of the duo's users. Many US industries particularly automotive will be affected as the tariff will lead to higher prices in the US and reduce its global competitiveness.

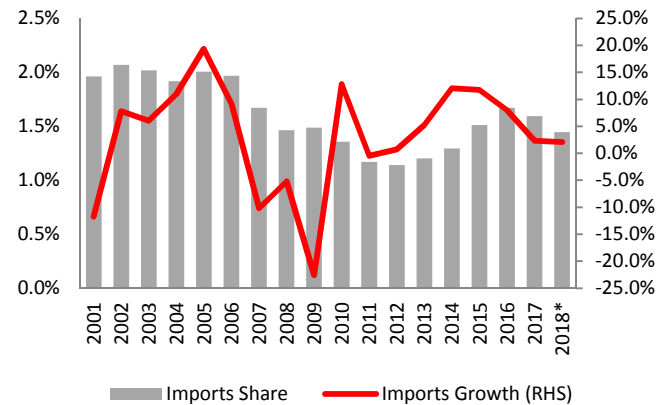
External demand from the US to dampen in 2018. Apart of high base effects, further protectionist moves by Trump's administration will possibly hit global trade activities as well as exports demand on Malaysia's external trade performance in 2018. Direct exports to the US constitutes of 9% of Malaysia's total outbound shipments. More than half of the exports are E&E products and other manufactured goods. With the steep tariffs, we view the demand on manufactured goods especially products relating to washers, solar panels, aluminium and steel will drag down Malaysia's exports to the US. We forecast Malaysia's exports growth to the US will decelerate to 3%-5% this year as compared to 11.8%yoy in 2017.

Chart 6: USA-to-Malaysia Exports Performance



Source: CEIC, MIDFR

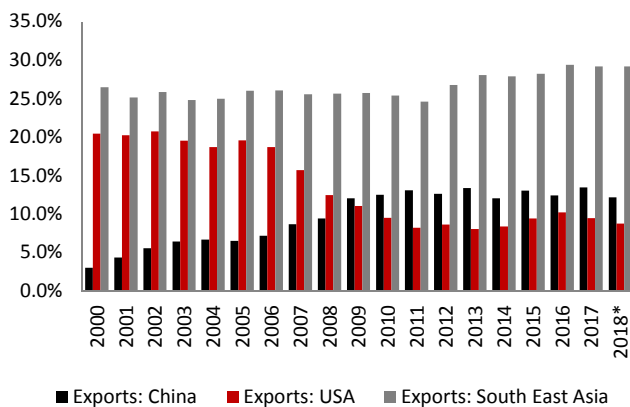
Chart 7: USA-from-Malaysia Imports Performance



Source: CEIC, MIDFR

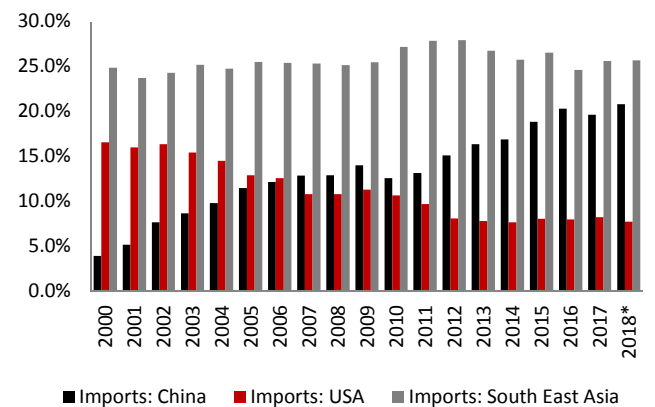
Shares of US are declining. For exports performance, demands from Southeast Asia remain prominent for Malaysia as its share holds above 25% since 2012. Plus, China’s shares have increase on steady trends, averaging 12.7% during post-GFC whereas shares of the US have declined since 2005 from 19.6% to 8.8% in Jan-18. On the other hand, imports share of the US had similar downturn directions since early 2000s while imports share of China rose to a record high of 20.8% during the first month of 2018. Therefore, we foresee the recent tariff hikes by the US will have minimal impacts on Malaysia’s external trade performances given that both exports and imports shares of the US have been on declining trends for more than a decade. Nevertheless, the impacts would be indirect hitting Malaysia’s other trading partners such as Singapore, China and South Korea.

Chart 8: Malaysia’s Exports Share by Destination (%)



Source: DOSM, MIDFR

Chart 9: Malaysia’s Imports Share by Destination (%)

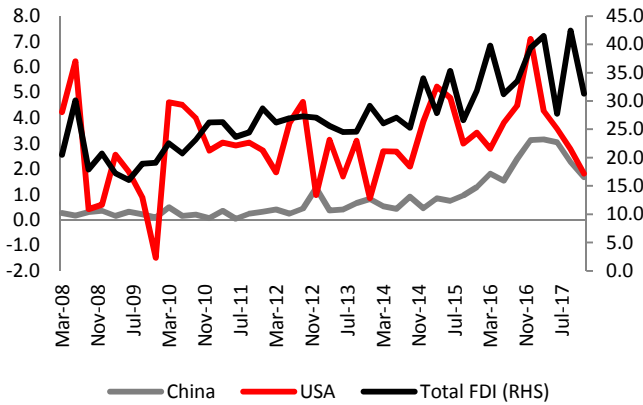


Source: CEIC, MIDFR

Impacts of USA’s investments reallocation are minimal. As mentioned during the presidential election, Trump indirectly urges US-based companies to reallocate from overseas back to the US. Hence, the imposition of the steep tariffs may have significant pull-effects on US-based companies to operate and manufacture in the US. Based on our observation, US capital investment in Malaysia recorded at RM 1.4 billion in 2016, a decline from RM 4.15 billion in the previous year. Referring to the FDI inflows database, the US contributes less than 9% to Malaysia’s investment activity. As of 2017, we noticed FDI inflows by the US have been on falling trends for 4-consecutive quarters. The consecutive falls were in tandem with Trump’s protectionism moves since he was inaugurated as the 45th President of the US in January 2017. Henceforth, we firmly believe the impacts of steep

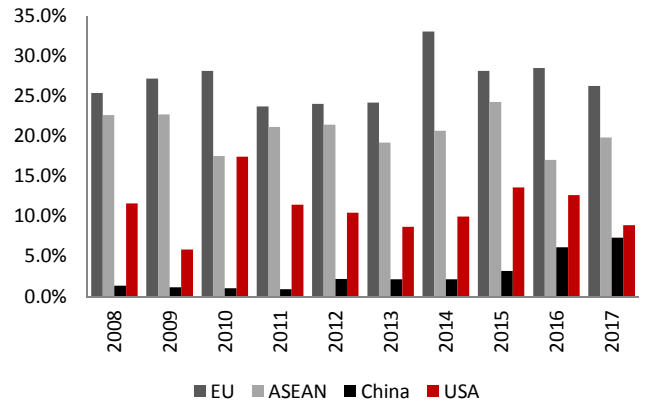
tariffs imposition would not have significant changes on Malaysia's overall investment flows due to its small contributions.

Chart 10: FDI Performances (RM Billion)



Source: CEIC, MIDFR

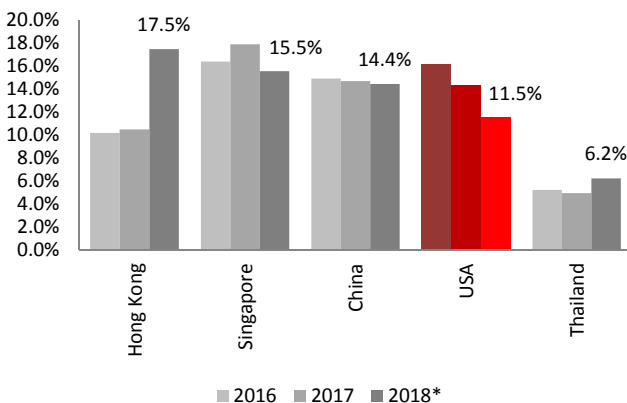
Chart 11: FDI Share by Destination (%)



Source: CEIC, MIDFR

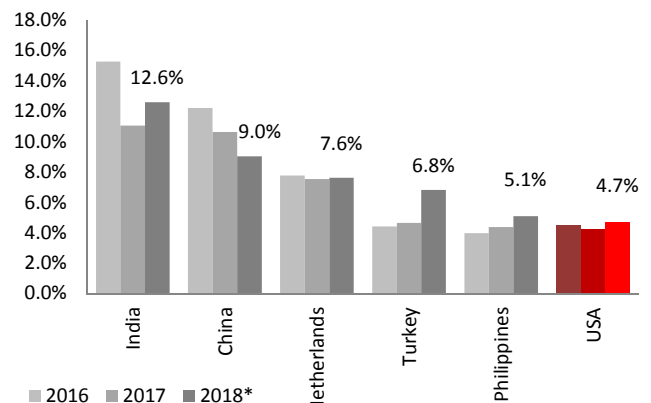
Protectionism threat remains as global downside risks. As mentioned in our previous thematic report, Trump's administration is expected to impose tariff hike on steel and aluminium industries. As promised by Trump, "Make America Great Again" campaign is to attract US-based companies to relocate to the US and providing more jobs to the local Americans. Therefore, we foresee further protectionism moves to be made by the US government in order to 'protect' its economy. On the other hand, such moves would spur market uncertainties, drop in business confidence, affect commodity prices and to the extent could drag down global growth in the medium term.

Chart 12: Malaysia's E&E Exports Share by Destination (%)



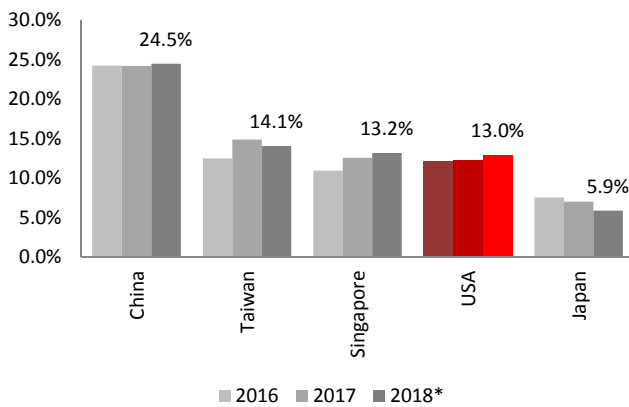
Source: CEIC, MIDFR
*As of Jan-18

Chart 13: Palm-Oil Exports Share by Destination (%)



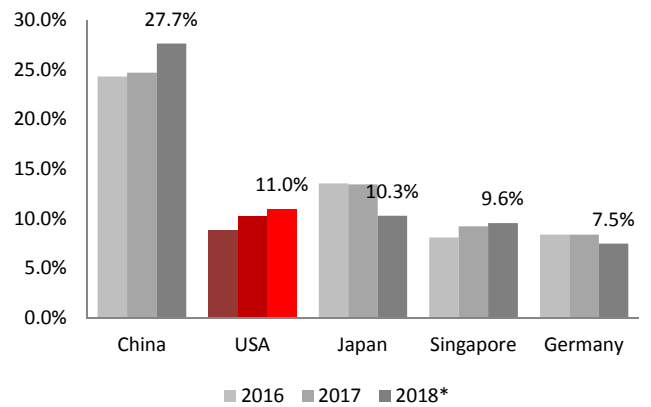
Source: CEIC, MIDFR
*As of Jan-18

Chart 14: Malaysia's E&E Imports Share by Destination (%)



Source: CEIC, MIDFR
*As of Jan-18

Chart 15: Machinery Imports Share by Destination (%)



Source: CEIC, MIDFR
*As of Jan-18

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