

TRUMP AS BREXIT+++ OPPORTUNITY OR THREAT FOR KOREA?

Op Ed by Dr Rory Knight



OM

Dr Rory Knight, is Chairman of Oxford Metrica and a member of the Board of the Templeton Foundations. He was formerly Dean of Templeton, Oxford University's business college.

Prior to that Dr Knight was the vize-direktor at the Schweizerische Nationalbank (SNB) the Swiss central bank.

JOONGANG
SUNDAY

JoongAng Sunday is the Sunday edition of the leading Korean language daily newspaper JoongAng Ilbo. It is one of the three biggest newspapers in South Korea. The paper also publishes an English edition, Korea JoongAng Daily, in alliance with the International New York Times.

The election of Donald Trump hard on the heels of the Brexit referendum represents a seismic event of major proportions in the world political order. It heralds a tsunami of change certain to surge out to other countries in Europe and beyond.

Commentators in the English-speaking world identify disaffection among the working classes and consequent rejection of the globalisation created by political elites as the root cause in both cases. They predict a dystopian world order, with an inward-looking America forsaking its international obligations with attendant increases in uncertainty, heightened political risk and a stagnating world economy as tariff conflicts stifle world trade.

It is true that the Brexit referendum result and the outcome of the US election - both of which utterly confounded pollsters and traditional expectations - represent a protest against ruling elites. Both countries appear to be seeking to free themselves from perceived burdens: that of world protector in the US and that of European Union membership in Britain. In the former the "America First" rhetoric identifies globalisation; trade deals such as NAFTA, TPP and TTIP; security agreements such as NATO, the US-Japan Security treaty and the commitment to Korea's

security as too costly to bear. In the latter, loss of sovereignty and the cost of membership of the EU are seen as unacceptable burdens.

Pax Americana No Longer

In the twenty seven years since the fall of the Berlin Wall, the world order has been based on a *Pax Americana* that has supported the free flow of capital, goods and people. The process has led to a globalisation of markets which has lifted many out of poverty around the world. The result is a considerably more interdependent world. The engine for the world economy is the consumption expenditure of the top billion mainly concentrated in North America, Western Europe and Japan and fuelled by the growth in China.

Most economies, whether developed or developing, have been pre-eminently dependent on the US economy. A renewed, rejuvenated American economy is therefore a desirable, and indeed vital, contributor to a flourishing world economy.

All of this will be upended if the new US President follows up on his campaign threats. He has branded China a "currency manipulator" and threatened to retaliate with tariffs of 45% on Chinese imports; to withdraw from

the WTO, NAFTA, TPP and the putative trade deal with the EU known as TTIP; and to renege on the US commitments to NATO, the Japan-US Security Treaty and the security arrangements with Korea. Taken together, these represent a seriously scary scenario. Such extreme protectionism would represent a major lurch in the global political power balance and the world economy resulting not just in the stagnation of international trade and a world-wide recession but political instabilities echoing the 1930s.

“In the twenty seven years since the fall of the Berlin Wall, the world order has been based on a Pax Americana”

None of this is in America's interest, and for that reason alone an extreme "America First" outcome is unlikely. If there was any chance of this happening world markets would have

been in meltdown since the election. In fact the opposite has occurred. Markets have reached new highs.

Although the record of businessmen as president has not been good, a Trump presidency could deliver some economic benefits. Firstly, his aim to invest in infrastructure seems reasonable. Anyone who has travelled in the US will agree that massive reinvestment is overdue. Secondly, his reducing corporate taxes will be highly stimulatory. Thirdly, cutting back on regulation, particularly in financial markets, will boost the US as a financial centre. Together, these three policies will revitalise the exhausted policy of quantitative easing and low interest rates.

“Mr Trump is more deal maker than ideologue, and the US under his leadership will be keen to trade if with a protectionist bias.”

Mr Trump is more deal maker than ideologue, and the US under his leadership will be keen to trade if with a protectionist bias. Many nations and especially the UK outside of the EU as an outward looking nation could benefit from a Trump presidency.

Significant economic challenges remain, however. The budget deficit and government debt cast a dark shadow over any recovery. It is difficult to see how a combined policy of investment and tax cuts could be achieved without budget deficit spending financed by debt. There is continuing doubt as to whether China

will continue financing the US debt. Under such circumstances the dollar is likely to weaken, its fall further fuelled by attendant inflation and the reduction in foreign trade as a component of GDP. *In extremis* the dollar as a weakening volatile currency subject to increasing country risk could even be toppled from its position as the world's reserve currency. And replacements would be hard to find. Successor candidates such as the Renminbi bring with them their own challenges.

So there are considerable risks in both the near and mid-term. Even if Mr Trump does not carry out all his many threats, his fundamental instincts are protectionist, and any tariff barriers he introduces are likely to dampen world trade. The brunt will be borne by the emerging markets. These markets, which have not been performing well, were on the verge of a period of renewed growth. This could come to naught if barriers to trade are erected. Fortunately Korea is not exposed to the same level of risk as it enjoys a competitive position with an advanced set of products and services on offer to the world. However, its dependence on US trade remains considerable, and therefore the drive to diversify Korea's trade base is becoming an increasingly urgent priority.

Bilateralism: the New Face of Globalisation

The idea that globalisation has resulted in a considerable income disparity between and within countries is gaining increasing traction despite the indisputable fact that globalisation lifted many millions out of poverty. Brexit and the Trump reflect a reaction. However to assume that globalisation has been derailed is utterly mistaken. There will be change, and many of the trade blocks such as the EU, ASEAN and NAFTA are likely to be considerably diluted in the new world order. Trade treaties between individual countries and regional blocks are likely to be under pressure to be renegotiated or scrapped, the WTO itself may see change.

Globalisation is not necessarily to be achieved through a world dominated by a few regional trading blocks or indeed a one state world economy. The existence of regional trading blocks are themselves blockages to globalisation and these “clumps” are likely to disappear. One view of the new order is bi-lateral trading arrangements between individual nation states operating under modified WTO rules rather than clumsy regional trade areas. The advantage of the bi-lateral approach is that each arrangement is *sui generis* and tailor made to the strengths of the partners and not distorted by the compromises inevitable when negotiating with a multi-state block such as the EU.

Korea's Future Looks Bright

Korea is the economic miracle of our lifetimes. It has flourished since 1953 and has been the beneficiary of the liberal world order that has prevailed in this period. It is now a developed nation with a well-educated young work force and a technologically advanced economy. It has throughout its history had to deal with powerful neighbours and it will need to summon all these skills as the landscape changes.

In the political arena a likely rapprochement between Russia and the US in combination with potential trade friction between China and the US will present Korea challenges, especially if the US loosens its commitments to the security of Japan and Korea. Security will loom large for Korean policy makers and broadening its relationships in the region makes sense. Ensuring energy supplies is another challenge for Korea which will no doubt be a priority.

Korean investors have hitherto been able to enjoy the benefits of international diversification by investing in their own international businesses such as Samsung, LG, Hyundai and others. Korean pension funds might now consider their ex-

posures and seek diversification with increased foreign investing. Similarly, medium to small size firms such as those listed on Kosdaq are likely to benefit from seeking to expand their customer and investor bases internationally. The ability of smaller firms to attract the attention of international investors is crucial.

Foreign investors in Korea lay their bets on individual companies, the management of these corporations will need to demonstrate their ability to hold their competitive position and continue to add value. All attention will be on the Bank of Korea's policies on interest rates as the primary driver of foreign investors' currency exposures. It is tempting to have a weak currency to improve exports but this may cost foreign investors dear.

Notwithstanding the challenges facing Korea and despite domestic political issues its economy will adapt. This does not mean there is room for complacency. There is considerable risk for the Korean economy amid the sweeping changes to the world order. However, Korea is well placed to navigate these waters and to seize new opportunities. The fact that Mr Trump's call to the Blue House was among the first he made is an encouraging sign of Korea's position. Its policy-makers, corporations and investors are well placed to ensure the Korean economy prospers in the new world order which is not remotely as dystopian as portrayed by many.

NAFTA

North American Free Trade Agreement

NATO

North Atlantic Treaty Organisation

TPP

Trans Pacific Partnership

TTIP

Transatlantic Trade and Investment Partnership

WTO

World Trade Organisation

OXFORD METRICA

Oxford Metrica is a strategic advisory firm,
offering informed counsel to boards. Our advisory
services are anchored on evidence-based research
in risk and financial performance. Our work
includes statistical analysis and index construction
for banks and insurers, risk and performance
analytics for asset managers, due diligence
support in mergers and highly customised
services for corporate boards.