Northern Trust | Wayne Bowers: Asian Trade Deals Enter the Spotlight… But Remember the New Silk Road

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As we wait to see if US President-elect Donald Trump's domestically focused economic agenda will affect trade with Asia to the extent some are suggesting, it's hard to draw too many firm conclusions. This week we take a further look at the opportunity and uncertainty surrounding the region, and whether there is reason for a pause in world trade or a continued pivot to Asia.

The ascension of China and India continues to be one of the most important economic stories in the world. Asia is more than one third of the world's economy, with nearly 60% of humanity or 4.4 billion people, and has been the fastest growing region over the last decade. However, we have noticed a long term trend of global economic trade gravitating east away from developed markets because of the rise of the consumer wealth and increasing domestic consumption in Asia. There is the potential for the US to not ratify the Trans-Pacific Partnership which will effectively kill the 12 nation trade deal. This puts a pause on the ability of the US to pivot to Asia. Failure of this partnership would allow China a clear path towards pushing its own regional trade pact, the regional comprehensive economic partnership, linking member nations with the likes of Australia, China, India, Japan who account for one third of global growth.

In 2013, Chinese president Xi Jinping announced the trillion dollar belt and road initiative, more commonly known as the new Silk Road. The new Silk Road, once seemed to be a delusional dream for Central Asia, but now it appears more realistic and may cover 70% of the world's population, 75% of energy resources, and 70% of the global economy on the same economic trajectory. Far from being a pipeline solely to dump Chinese products west, the new Silk Road is offering Western manufactures and African agricultural mineral producers a new door into Asia's booming domestic marketplace. Uncertainty over bilateral relations comes at a time when Beijing hopes for stability as it faces daunting reform challenges, a slowing economy, and a leadership reshuffle. China faces reforming banks, paying close attention to tightening risk control and pushing forward financial regulation to improve financial stability.

Whilst the new policies have been ambitious and encouraging, implementation has proven difficult and lacking in many areas. As economic growth is slowing, China is also facing the challenge of transitioning into an innovation nation from a manufacturing center of excellence by implementing appointed technology drive. According to recent announcements, the government has set a target for research and development at 2.5% of gross domestic product by 2020, up from 2% in 2015, or approximately $365 billion. Research and development spending is forecast to surpass the US by 2020, with a clear aim by China to transform itself from an adopter or copier to an innovator and creator.

What does this mean for investors? As markets digest the news, it's important for investors to remain focused on the long term economic trends. Asia's attractiveness remains as strong today as it did yesterday, with sound fundamentals of savings, investment, and faster productivity growth, providing diversified investment opportunities. However, we expect short term continued pressure on emerging markets as investors focus on positive US growth prospects caused by potential domestic policy changes.

Medium term, investors may have significant buying opportunities in emerging markets if currency and asset values weaken without regard for growth and structural reform potential. With this in mind, we continue to support our recent asset allocation focused on increased overweight of US large cap equity and resource exposure, whilst moderately reducing our US investment grade position.