



Global Political Drivers

ABE & JOHNSON – TRUMP PUPILS

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- Sanctions campaigns are a routine political driver of investment risks since they can have globally significant economic effects unrelated to the underlying political agendas. But Japan's trade sanctions against South Korea deserve particular attention.
- There are many cases, past and present, of countries sanctioning each other; and although the economic effects can be quite powerful, they are largely local – except when the US is involved, since its economic bazookas can have impacts on global supply chains, trade and FDI.
- The Japan-South Korea spat does have such global impacts even though the US is not involved – or not directly: for this episode should be seen as heralding the proliferation of a global political risk which until now has emanated only from the US.
- This proliferation stems from both the policies and style of Donald Trump.
- By weakening the cohesion of the US alliance system, Trump's "America First" approach leaves more scope for clashes between large economies that will force investors to take notice.
- Trump's style is proving contagious. Shinzo Abe's moves against South Korea are Trump-like in their domestic political motives and tactics; and Boris Johnson has opened his Brexit campaign by taking some leaves out of the Trump playbook.

Sounds familiar?

The present dispute between Japan and South Korea amounts to a striking Global Political Driver. On both sides, the motive is purely political – rooted in intense national feelings dating back to the Japanese colonial occupation of Korea and the Second World War. The trigger lies very much in the present, and is likewise purely political.

Tokyo is setting the pace in this dispute, and made its main move earlier this month by restricting exports to South Korea of three essential chemical components for semiconductors (a core Korean industry sector) and also touchscreens. The timing is not explained by the official Japanese grievance, which has to do with by now months-old South Korean judicial and political decisions. The Japanese see these decisions as unravelling a 2015 agreement between the two countries that had sought to draw a line under the vexed question of the “comfort women” (the euphemism conventionally used to describe the women – mainly Korean, but also from some other countries – who were forced into sex slavery by the Japanese army during WWII).

Instead, the answer to the ‘why now?’ question about this Japanese trade sanction against South Korea lies in Prime Minister Shinzo Abe’s quest – successful as it turned out – for electoral advantage in the election to the upper house of the Japanese parliament held on 14 July.

That election out of the way, Abe might refrain for now from further escalation – which would take the form of a decision to remove South Korea from the so-called “White List” of friendly export destinations that do not require export permits. He may well decide to turn up the heat again in this dispute in September to distract the public ahead of the scheduled October consumption tax hike. The whole episode has shown Abe that targeting South Korea is an easy vote winner, with negligible political or economic costs. Does this sound familiar? As suggested by the title of this note, we think it does.

Sanctions that matter: No longer from the US only

The relevance of this story is not just for South Korea. Before exploring further this phenomenon of Trump’s contagious style – and its possible spread to the UK with Boris Johnson now installed this week as prime minister – we should finish reviewing this case history. As explained by our China and South Korea economist Rory Green in his [brief note](#) on this row published last week, the investment relevance of this politically charged stand-off is not limited to the adverse effect on the already struggling South Korean economy and the threat to its equity market – in turn likely to induce the government to intensify its fiscal stimulus.

There are also material implications for global supply chains in semiconductors and consumer electronics. This broader picture comprises, as one would expect, winners and losers – the global competitors of the South Korean semiconductor and OLED champions, with big non-Korean smartphone producers like Huawei and Apple also facing some disruption. The picture also has its ironies, such as the silver lining of these supply disruptions for the local losers – Samsung and SK Hynix – helping to absorb the global semiconductor inventory overhang.

Economic sanctions are of course nothing new. Reviewing this scene may, once again, seem all too familiar – though now in a more routine than topical Trump-related sense. Long before Trump came along, the daily news diet was already full of such stories – that is, countries using trade-related and financial levers to pursue political agendas against other countries. In other

words, we are simply talking about economic sanctions – long a popular instrument and nowadays ever more so. In addition to providing a topical snapshot, the table below also aims to set this political driver in proper contemporary perspective.

Disputes between countries

Motive	Action	Topical example(s)	Comment
Economic	Punitive trade/financial measures	US-China trade/tech war	(Geo)political agenda also driving the main US-China 'trade' war
PURELY POLITICAL		Trump immigration-related tariffs on Mexico Trump Iran sanctions Japan-South Korea electronics supply chain	
		Radical political action	Potential no-deal Brexit

The dominant present-day case – America’s trade and tech ‘war’ against China – stems primarily from an economic agenda rather than being motivated by pure politics. Political drivers are, of course, part of the mix. The underlying economic grievances from the loss of manufacturing jobs to (especially) China have caused social and political reactions which Trump has harvested. This ‘war’ is also fuelled by the direct (geo)political driver of the strategic tensions between the US and China. Yet the core of this struggle is being waged in the economic arena, and the fact of the belligerents being the world’s two largest economies puts this case in a different league for global investment importance compared to the more purely political cases.

Exclusively political motives can, however, lead to sanctions that have wider economic and financial market effects than just the local damage to the target country’s economy. Take the example of last month’s threat by Trump of punitive tariffs of up to 25% on Mexican imports. This move is designed to deliver his electoral promise about getting Mexico to pay for a wall to block illegal immigrants – only now in a non-literal way, by coercing Mexico to accept some variation of a “safe third country” agreement.

Mexico and Iran provide further recent examples. However anxious the AMLO administration may be in principle to find some way of accommodating Trump, entering into and then implementing any such arrangement would be extremely difficult for Mexico. The Trump threat may therefore be revived imminently – or at least by next September. That would intensify pressure on Mexico’s economy and credit fundamentals, while also devaluing and jeopardizing the USMCA (NAFTA 2.0) deal.

That Mexico episode was pushed out of the headlines last month by the still more dramatic case of Iran, coming as it did to the brink of war. Trump’s goals here lie wholly in the political and security sphere: ending the perceived threat from Iran to the security of Israel – and, albeit to a lesser extent, of America’s Gulf allies. Since the chosen means are to strangle the Iranian economy, above all by ruining its oil export trade, the economic effects are felt globally through the resulting oil price volatility. At the same time, this effect falls well short of the global shock transmitted through the US-China trade war. To return to our starting point of the Japan-South Korea spat, the economic impact seems similar in scale: this will not ‘move the needle’ on world

trade, but the repercussions will ripple through an important sector in the world economy, forcing investors to sit up and take notice.

By returning to this Japan-South Korea case after surveying the general background, the striking difference leaps out. In all other cases of globally significant economic impact, the US is in the driving seat as the world's dominant power, using its economic leverage against other countries for political reasons. Traditionally, US allies have tended to join these campaigns (although under Trump, this has become more the exception – e.g. North Korean sanctions – than the rule). In the case of the 'comfort women' dispute, however, the US is not a party; and yet the economic and market significance is comparable to the sanctions imposed by the US in a typical campaign.

Trump proliferation

Politically-driven sanctions clashes between countries not involving the US are hardly a rarity. But the economic impact of the sanctions, while often quite substantial, remains local. A good example that we have covered in our MENA service is the deep dislocation of the GCC economy caused by the Saudi-led vendetta against Qatar. Another instance re-surfaced only yesterday, when President Putin finally rescinded some residual components of the sanctions that Russia imposed on Turkey after it had shot down a Russian warplane over Syria in late 2015. The most serious measures have long since been removed, but at their height, these sanctions almost halved the two countries' bilateral goods trade (then worth \$11 billion) and wiped out most of the services trade as six million Russian tourists disappeared from Turkish beaches.

Such episodes provide another perspective that brings out the novelty of the Japan-South Korea situation. The typically sharp local economic effects of a political-sanctions episode not involving the US are supplemented in this 'comfort women' case by a broader global dimension. Here, then, is a global political driver that previously emanated only from the US but which now, thanks to Trump, is proliferating.

Trump's 'contribution' has flowed through two channels.

- The first has to do with the effect of his policies on the cohesion of the US alliance system. Sanctions battles between countries not involving the US are more likely to make themselves felt in the global economy if the countries concerned are large economies in their own right. Since sanctions affecting important economies outside the US alliance system are usually instigated by the US itself, any such economically significant sanctions exchanges by-passing the US will more often involve US allies. The likelihood of such episodes increases as Trump weakens the glue of US alliances both by his general attitude (allies seen as sponging on America) and his policies.
- Trump's style is inspiring imitators. This style is by now easily recognizable. It involves mixing things up, dialling the noise up and down, and 'art-of-the-deal' opportunism as opposed to carefully planned pursuit of clearly defined goals. The relevance of this approach to investment risks lies in the uncertainty it generates around supply chains, trade and FDI.

Contagion through policies

Looking more closely at each of these factors in turn, the Trump policies in question are not only those that most allies view negatively (such as China trade war or Iran sanctions), but also widely

welcomed initiatives such as striving for a deal with North Korea. As the existential threat from North Korea recedes, nationalism in South Korea and Japan is variously enflamed and deflected.

Abe needs an easy enemy he can periodically target to whip up support. China is too powerful to run risks with, but provoking South Korea is a safe choice. Trump's "America First" distaste for foreign entanglements weakens the traditional moderating role of the US. It seems unlikely, for instance, that the visits to Tokyo and Seoul this week by Trump's National Security Adviser John Bolton will change the dynamic of the Japan-South Korea dispute.

Turning to the UK and Brexit, this saga has deep domestic roots and does not owe its existence to the US. Trump's ideological sympathies have nevertheless made him a ringside cheerleader for Brexit. Long gone are the days when US policy would have focused on mitigating the risks to the "West" from a dispute between key allies by using its influence to push the parties towards a compromise. Instead, Trump's policies show the way: the threat of disruption to economic relations is a means to a strongly felt political goal – though in the scenario of a disorderly ("no-deal") Brexit, the UK as instigator stands to be as much self-harmed as harming.

Style contagion

We have already noted the Trump-like features of Abe's handling of the dispute with South Korea. By way of additional perspective on this, it is worth recalling the particular rapport which Abe has managed to build with Trump ever since being the first foreign leader to meet Trump in person – soon after he was elected president in November 2016 and when he was still working out of his offices in New York City's Trump Tower.

That rapport has since been cemented by the two men's shared love of golf. As the saying goes, imitation is the sincerest form of flattery. The imitation is rational in itself: Abe's Trump-style policy on South Korea is designed to get results – mainly in the form of already visible domestic political dividends. As for the flattery, this is less certain to bring benefits; but should at least buttress Japanese interests at the margin.

Changing the scene to London, Boris Johnson has started by taking leaves out of Trump's playbook. He advertised this already last year when criticizing Theresa May for what he claimed was her negotiating weakness on Brexit and comparing her unfavourably with Trump who, said Johnson, "would have gone in really hard". This is what Johnson has done with his rhetoric on Brexit during his first 48 hours in office. We may now expect him to continue this imitation by blowing alternately hot and cold – the 'cooler' passages involving negotiating overtures to the EU. Johnson's approach seems Trump-like above all in the way that he is noisily shaking things up with a view to taking best opportunistic advantage of the fall-out from that noise to attain his paramount goal of obtaining real power and longevity in office through a general election victory.

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