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Topics *Trump policies destabilizing Asian foreign exchange markets*

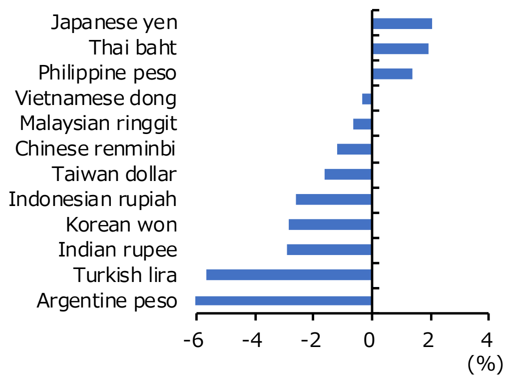
The Trump administration's policies are piling downward pressure on Asian currencies. If higher U.S. interest rates and tariff hikes substantially depress Asian economies, there is a danger that financial risks accompanied by currency declines will mount, notably in India, Indonesia and the Philippines.

■ Slides in Asian currencies against the dollar are accelerating

With U.S. President Trump deploying one new policy measure after another, uncertainty about the outlook for the world economy is growing. The impact has also rippled into financial markets, and Asian currencies are feeling the effects. Since the U.S. presidential election in November last year, many Asian currencies, notably the Indian rupee and South Korean won, have shed value against the dollar. The margins of decline have been second only to those seen with chronically fragile currencies like the Argentine peso and the Turkish lira.

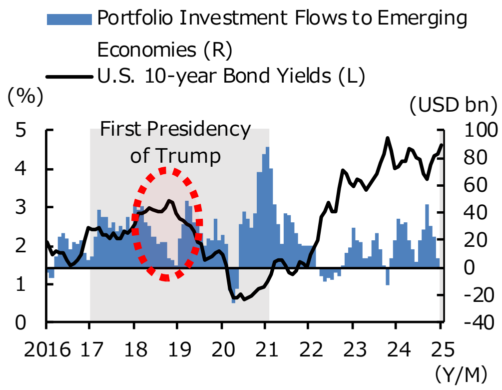
In 2018, when the first Trump administration was in power, emerging economies, including ones in Asia, were also plagued by mounting downward pressure on their currencies. At that time in the U.S., monetary policy was being tightened, and large-scale tax cuts were implemented, exacerbating concerns about fiscal risks and leading to higher U.S. interest rates and lower U.S. dollar liquidity. As a result, capital inflows to emerging economies plummeted. This time around, a sharp rise in long-term interest rates is being coupled with the possibility that Asian economies will deteriorate in the face of tariff hikes, and the currencies of emerging economies, particularly ones in Asia, could be subject to further downward pressure going forward.

<Emerging Market Currencies>
(From Nov 6, 2024 to Feb 17, 2025)



Source: JRI, based on Bloomberg L.P.

<US Long-Term Rates and Capital Flows to Emerging Economies>

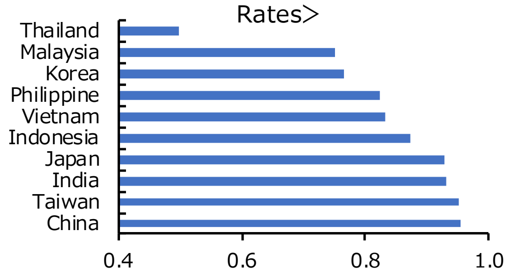


Source: JRI, based on Bloomberg L.P.and IIF

■ Trump's policies are emerging as a factor driving falls in Asian currencies

The U.S. economy is holding up well, and after the FOMC's January meeting, Fed Chair Jerome Powell said there was no need to rush to lower interest rates. Although President Trump has repeatedly said that rates need to be reduced, the tariff hikes and big tax cuts he has promised will accelerate inflation, invite an increase in government bond issuance, and apply further upside pressure to interest rates. Financial markets have priced in this outlook, and U.S. long-term interest rates are trending upward. For many Asian economies, a rise in U.S. long-term interest rates reduces the value of their currencies, because exchange rates are closely linked to the gap between U.S. and domestic interest rates. While it is unlikely that the Fed

<Correlation Coefficients between Rates Differentials with US and Exchange Rates>

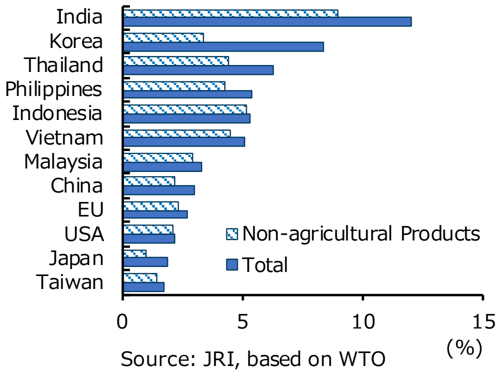


Source: JRI, based on Bloomberg L.P.
Note: Interest rates are 10-year government bond yields. Sample period is from January 2022 to January 2025.

will reverse course and start raising rates, the robust U.S. economy and fiscal risks are likely to keep pushing up U.S. long-term interest rates. Downward pressure on Asian currencies against the dollar due to interest-rate differentials is thus expected to continue into the future.

In addition, if the U.S. raises tariffs on imports from Asian countries/territories, this could also trigger falls in Asian currencies. The Trump administration has adopted a tough foreign policy stance, using tariff hikes as a negotiation card. On February 4, for example, it instituted an additional 10% duty on imports from China. Although China has certainly been at the center of discussions about tariffs, just as it was during the first Trump administration, what sets the second administration apart is its expansion of import duties beyond China to encompass other countries/territories. The U.S. imposes a 2.2% levy (trade-weighted average) on imports from "most favored nations" (MFNs), but the tariff rates applied to imports from the U.S. and other countries by many Asian countries/territories are much higher than that. President Trump has also announced the introduction of "reciprocal tariffs," i.e., subjecting trading partners to the same tariff rates that they apply to imports from the U.S., and many countries are expected to be impacted by these increased import levies.

<Tariff Rates for Most-Favoured-Nation>
(Import Value Weighted Average)



Source: JRI, based on WTO

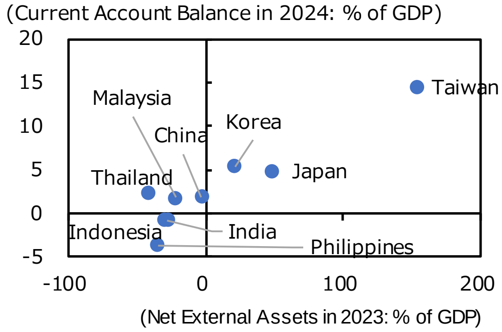
This is particularly true for India, whose high tariffs President Trump has long viewed as a problem, having cited agricultural products and motorcycles as specific examples. At a meeting between the U.S. and Indian leaders on February 13, India agreed to start negotiations to reduce its trade surplus with the U.S. Nevertheless, the U.S. undoubtedly continues to see its trade position with India as an issue, and may keep exerting pressure in various ways going forward. The U.S. is also expected to put pressure on other countries, especially ones whose trade surpluses with it have expanded substantially, such as Vietnam, and depending on the outcomes of negotiations, these countries could be slapped with higher tariffs or forced to accept imports of specific items. Such developments would likely hit the economies and trade balances of these countries, and cause downward pressure on their currencies to build.

■ Caution is required concerning financial risks in India, Indonesia, and the Philippines

Given the risk that President Trump's policies will push up U.S. long-term interest rates and that tariffs will be raised further, attention will need to be paid to exchange rate trends in emerging economies, and particularly in Asian countries/territories.

Of course, many Asian countries/territories have abundant foreign exchange reserves, so the likelihood of currency depreciation immediately leading to a major financial crisis seems low. The risk of such a development is particularly low in Taiwan, South Korea, and other countries/territories that are international net creditors and enjoy stable current account surpluses. However, vigilance is required concerning the possibility that financial risks are likely to materialize in countries/territories where external debt exceeds external assets and current account deficits are entrenched due to a lack of industries that earn foreign currency. Weaker currencies could widen their current account deficits, leading to a vicious cycle of continued currency decline. Such a development would also swell the burden of servicing external debt, which could sharply increase risks such as financial system destabilization. Within Asia, an especially close eye will need to be kept on any heightening in financial risks, particularly in India, Indonesia, and the Philippines.

<Current Account Balance and Net External Assets in Asia>



Source: JRI, based on IMF
Note: The current account balance for countries other than Japan, South Korea and Thailand is the cumulative data for January to September. Net external assets are the total of direct investment, securities investment and other investment.

(Minoru Nogimori)

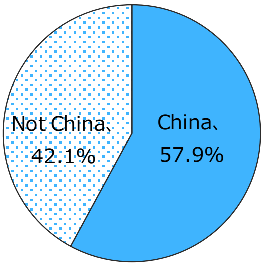
Topics *Alarm about Chinese cross-border e-commerce mounting worldwide*

Many countries are tightening controls on Chinese cross-border e-commerce. The aim seems to be to prevent the "export of deflation," i.e., cheap Chinese products flooding domestic markets, and China's economy could be adversely affected if the stricter curbs lead to a decline in exports.

■ U.S. Seeks to End De Minimis Rule Amid China’s E-Commerce Surge

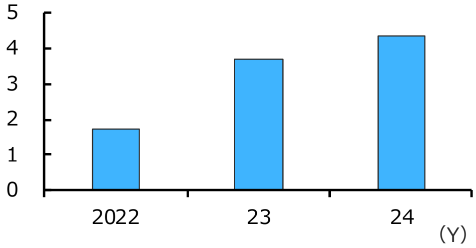
On February 1, President Trump signed an executive order imposing an additional 10% tariff on Chinese products. Simultaneously, an executive order was issued to abolish the so-called de minimis rule, which exempts low-value goods under $800 from tariffs. Ostensibly aimed at cracking down harder on trade in the illegal drug fentanyl, the move seems designed to curb the "export of deflation" from China and protect domestic industry. According to media reports, China supplies approximately 60% of the goods imported to the U.S. under the de minimis rule. Notably, more than half of these imports come from just two companies—Temu and Shein—whose low-cost online sales have surged globally.

<Origins of U.S. Imports of Low-value Goods >



Source: Prepared by JRI based on data from the U.S. Customs and Border Protection
Note: Figures are for 2021.

<Share of Low-value Goods in Chinese Exports to The U.S.>



Source: prepared by JRI based on data from China's General Administration of Customs

However, on February 5, President Trump amended the executive order on the cancellation of the de minimis rule, delaying its repeal. In response, the United States Postal Service (USPS) reversed its decision to stop accepting U.S.-bound international parcels from mainland China and Hong Kong. The postponement was due to the lack of an adequate system in the U.S. for collecting and processing tariff revenues fully and promptly, though the rule is still expected to be scrapped as soon as such a system is in place.

Estimates on the volume of Chinese low-value goods exports to the U.S. vary depending on the calculation method. China's General Administration of Customs places the share at around 4% of all U.S.-bound exports, while the U.S. Department of Commerce estimates it at 10%. Given that these figures translate to just 0.6% to 1.3% of China's total exports, any abolition of the de minimis rule in the future will only have a limited impact on Chinese exports as a whole.

Chinese cross-border e-commerce firms like Temu and Shein, however, are expected to be adversely affected. These companies have adopted a "direct shipping model," dispatching products straight from Chinese warehouses and factories to consumers overseas, mainly by air. And thanks to the de minimis rule, they have been able to sell goods at low prices and deliver them swiftly. However, if the rule is scrapped, the applicable tariffs will have to be passed through to buyers and delays in clearing customs will be inevitable, so the competitiveness of these firms is likely to be undermined.

To overcome this predicament, Chinese cross-border e-commerce platforms are focusing on transitioning to an "overseas warehousing model." Under this approach, companies pre-stock inventory in warehouses located in major cities across the U.S. and other key markets, from which goods would be sent out to local consumers. However, this transition comes with added costs for setting up and managing warehouses, and inaccurate demand forecasting could result in excess inventory. A drop in competitivenessis probably unavoidable.

■ Countries/territories other than the U.S. are also moving to tighten regulations

Regulations targeting Chinese cross-border e-commerce are being tightened not just in the U.S., but also in many other countries/territories. Earlier this year, the Vietnamese government announced that it would eliminate its VAT (value-added tax) exemption for low-value goods from February 18. Previously, goods imported by international courier were exempt from tariffs and VAT if the value was less than one million dong.

Meanwhile, on February 5, the EU announced stricter controls on imports of low-value consignments worth less than 150 euros from online sellers located outside the bloc. It also launched an investigation into Shein on suspicion of violating European consumer protection laws. According to the European Commission, consignments worth less than 150 euros shipped from outside the EU were about three times higher in 2024 than in 2022, and around 91% of them came from China.

One aim of this worldwide tightening of regulations is to prevent domestic consumer goods manufacturers from being driven out by cheap Chinese products. Another reason is security, i.e., stopping the influx of illegal or pirated goods. Looking ahead, Chinese products that can no longer be sold in the U.S. and other jurisdictions can be expected to find their way into other countries.

The Chinese government has positioned cross-border e-commerce as a "vibrant force for the development of foreign trade" and has implemented an array of support measures. These include establishing "e-commerce demonstration bases", improving logistics efficiency, and expanding tax incentives. The more the Chinese government's preferential measures for cross-border e-commerce companies prove effective, and the more cheap Chinese goods flow into other countries, the more concern there will be about China. This could lead to the trend of imposing additional tariffs and restricting trade spreading more widely across the globe.

Behind the expansion of Chinese cross-border e-commerce is China's rapidly expanding production capacity and its numerous small and medium-sized enterprises (SMEs). If the trend toward tighter regulation spreads around the world, it will be difficult for Chinese companies to maintain their export competitiveness given their strategy of leveraging low costs to sell large quantities of products at razor-thin profit margins. Exports are a key source of revenue for China, especially given the prolonged weakness in domestic demand. If export growth is curbed, SMEs will face financial pressure, potentially leading to reduced capital investment and a weaker employment environment. This, in turn, could further dampen China’s already sluggish domestic demand, amplifying economic challenges.

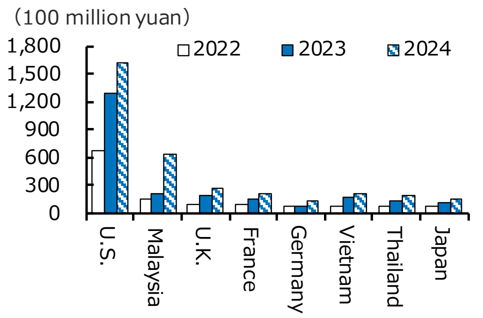
(Zijing Wu)

<Measures by Different Countries/Territories>

Date		Country/Territory	Main regulations
2021	7	EU	Abolition of VAT exemption on consignments up to 22 euros
2023	1	Singapore	Abolition of GST exemption on consignments up to 400 Singapore dollars
		Malaysia	Imposition of 10% sales tax on low-value goods up to 500 ringgit ordered online
2024	5	U.S.	Suspension of permission for multiple customs brokers to declare low-value goods electronically
	7	Thailand	Application of VAT and goods tax to low-value goods up to 1,500 baht
	8	Brazil	Abolition of import tax exemption on goods up to 50 dollars
	10	Indonesia	Blocking of Temu
	11	Japan	Review of consumption tax and tariff exemptions for low-value goods up to 10,000 yen (ongoing)
	12	Vietnam	Temporary business suspension orders for Temu and Shein
2025	1	Vietnam	Abolition of import duty and VAT exemptions on consignments up to 1,000,000 dong (from February)
	2	U.S.	Abolition of de minimis rule for imported goods under 800 dollars (temporarily postponed)
	2	EU	Proposal to abolish tariff exemption for low-value goods under 150 euros (under consideration)

Sources: Prepared by JRI based on various media reports

<Chinese Exports of Low-value Goods to Different Countries>



Source: prepared by JRI based on data from China's General Administration of Customs