

Trump Presidency: Impact on the US Economic Outlook and US Energy Policy

March 27, 2017

Agenda

- **Globalism in Retreat**
 - US election accelerated recent trends
 - Global status quo under pressure
- **Trump's Trade and Economic Policies**
 - Economic nationalism
 - Trade agreements under threat
- **US Energy and Climate Policy Under Trump**
 - Energy is central to economic message
 - Strong effort to reverse Obama's climate legacy
 - Trump team likely to favor US LNG exports
 - Shale production stabilizing, and could return to growth

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Globalism in Retreat

- **US election accelerated recent trends**
- **Global status quo under pressure**

Globalism in Retreat: Trump's Election Accelerates Recent Trends

Challenges for global cooperation

- 2016's Brexit and the election of Donald Trump are only the latest signals of a general retreat from a globalist policy orientation.
- International norms and institutions are being questioned, particularly as the United States aims to reverse course on landmark agreements, such as the Paris climate accord and Iran nuclear deal.
- The result is widespread uncertainty over previous "givens": US security policy, trade approach, and foreign relations.

Focus Issues	Developments and Implications
<ul style="list-style-type: none"> ■ Systemic Economic Risks ■ Global Trade and Financial Cooperation ■ Economic Openness 	<ul style="list-style-type: none"> ■ EU cooperation exposed during euro crisis. ■ TPP and TTIP talks have stalled; revisions to existing trade ties are possible. ■ The UK's future global trade ties are also uncertain.
<ul style="list-style-type: none"> ■ Climate Policy ■ Policy Orientation of Major Powers 	<ul style="list-style-type: none"> ■ Trump is unlikely to fulfill US climate goals, setting a low bar for other countries. ■ Populism could gain traction Europe this year.
<ul style="list-style-type: none"> ■ Great Power Relations ■ Managing Global Conflict 	<ul style="list-style-type: none"> ■ US-China relations are already in question. ■ Global security concerns range from Trump's vows to defeat Islamic State to North Korea.

Global Status Quo Under Threat: Challenges to World Order

Potential turning point in dominance of liberal democracy and capitalism

- **The events of 2016, especially the Brexit vote and Trump's election, are the latest steps in a longer historical arc.**
- **Western, liberal ideas first rise to prominence shaping the post-WWII global order, but have faced growing challenges over the past few decades.**
- In the West, lasting damage was done by the 2008-09 financial crisis. This, combined with underlying trends in demography, migration, globalization and automation, forms the basis of the current political malaise.
- With the status quo under pressure in developed Western economies, alternatives are gaining in prominence elsewhere. Authoritarian rule looks to be on the rise.

Rule-Based International Politics

- A rule-based international order, built around international institutions.
- Confidence in liberal democracy, and a vision of a growing club of democratic nations.
- Support from the United States has played a central role in promoting and defending this order, even if Washington has, at times, lost patience.

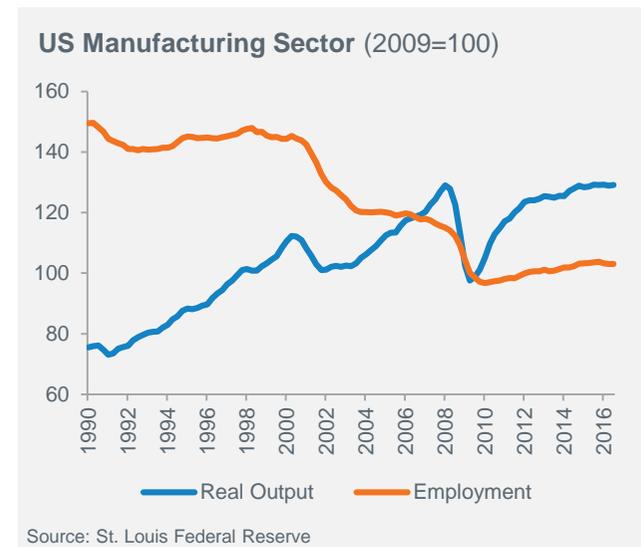
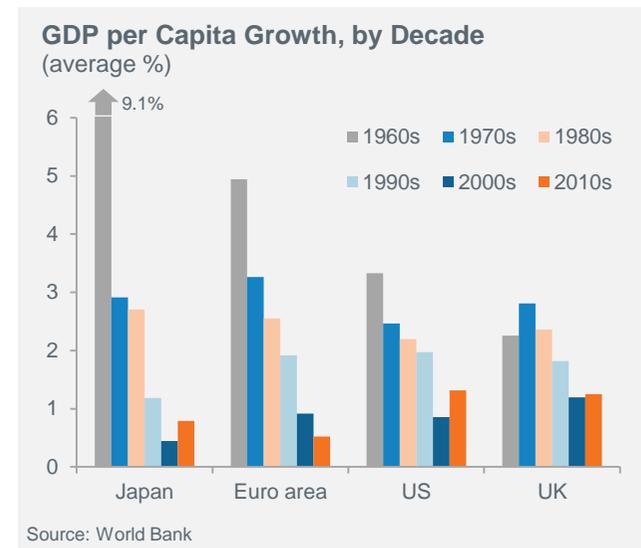
Liberal Capitalist Economics

- Characterized by free trade, globalization, technological innovation and accelerated movement of ideas and labor.
- Globalization boosted in the 1990s by free trade agreements such as NAFTA and the creation of the WTO.
- Explosive growth in China and other Asian economies has turbocharged globalization.

Global Status Quo Under Threat: Western Model Under Pressure

Advanced Western economies face growing headwinds

- Key megatrends have constrained economic growth, while contributing to political dissatisfaction and radicalization.
- The **2008-09 global economic crisis** cast a long shadow, including a weak recovery in the United States, and economic stagnation along with lingering debt crises in Europe.
- However, the economic malaise has deeper roots, starting with **demographic** change, especially in Japan and continental Europe.
- The demographic mismatch with faster-growing populations in the Middle East, Latin America and Africa is creating huge **migration** pressures.
- Concerns over immigration are part of a broader critique of **globalization** and its consequences. While adaptable, educated employees have often benefited, less-skilled manual workers have seen jobs move to cheaper overseas locations.
- Even where manufacturing has stayed in place, increased **automation** and efficiency have reduced manpower requirements (see US example to the right).
- Taken together, these trends have coalesced into a wave of widespread **dissatisfaction with mainstream politics**.



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Trump's Trade and Economic Policies

- **Economic nationalism**
- **Trade agreements under threat**

Trump's Worldview

Economic nationalism

- Trump's populist platform has resonated strongly with the white working class, who feel their identities are under attack.
 - Economic nationalism was a key theme of his campaign, and it comes across clearly in his policy priorities.
 - He seeks to reverse the damaging effects of globalization for the working class, with trade viewed as a key factor.
- Trump appeals to the nativist and xenophobic impulses of his voters by focusing on “radical Islam” and other threats coming from abroad.
 - He also has adopted an isolationist stance, with his “America First” message.
- Trump has criticized Obama's climate policy on economic nationalist grounds, and sees stepped up fossil-fuel investment as a central priority.

Trump Worldview: Guiding Ideas

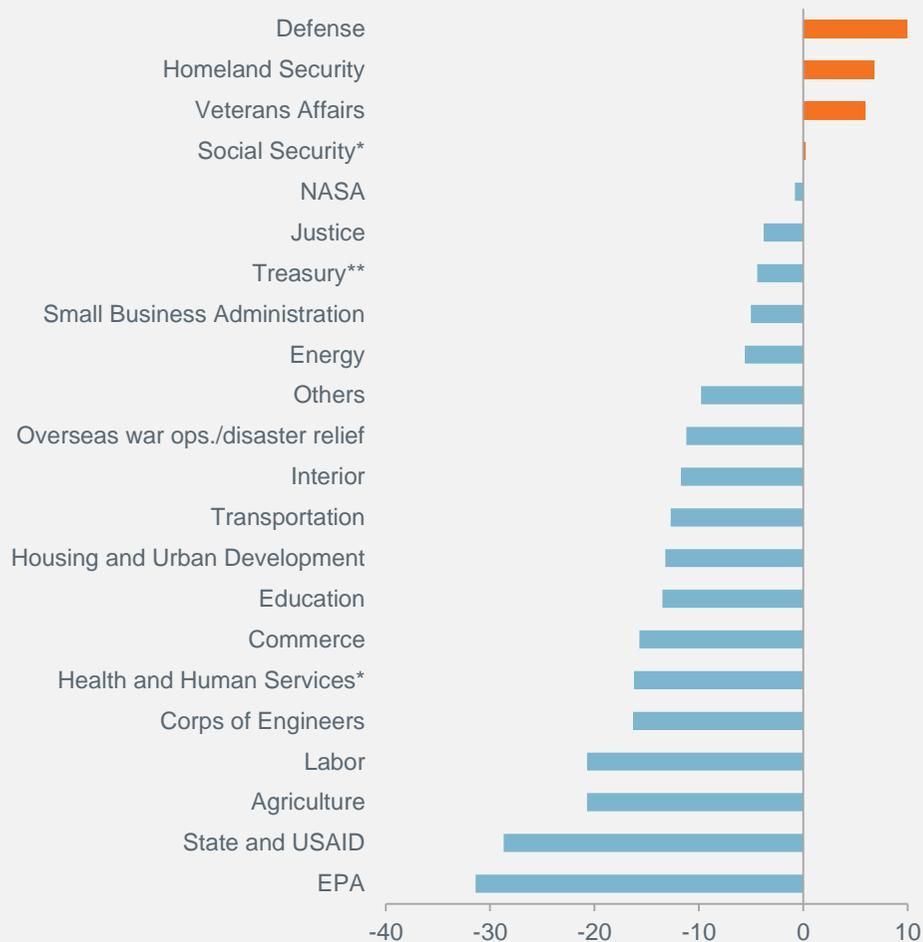


Trump is Centralizing Authority

Effort to cut funding and eliminate staff at government agencies

- Trump's first two months in office show that he is centralizing authority. He is keeping decision-making on key issues within a small circle of his family members and several close advisors.
- The White House seems determined to limit the capacity and autonomy of government agencies.
 - Trump's first budget aims for enormous cuts at the EPA, State Department and many other agencies.
 - The White House is deliberately under-staffing various departments—with many vacancies at the “under-secretary” level.
 - There are still no press secretaries at many government agencies, and no regular press briefings. This reflects Trump's efforts to freeze out, and even delegitimize, the media.
- **When a crisis occurs globally (for example a war or economic crisis), under-staffing and policy drift will make it harder to respond effectively.**

Trump's Proposed 2018 Budget
(% change from current spending)



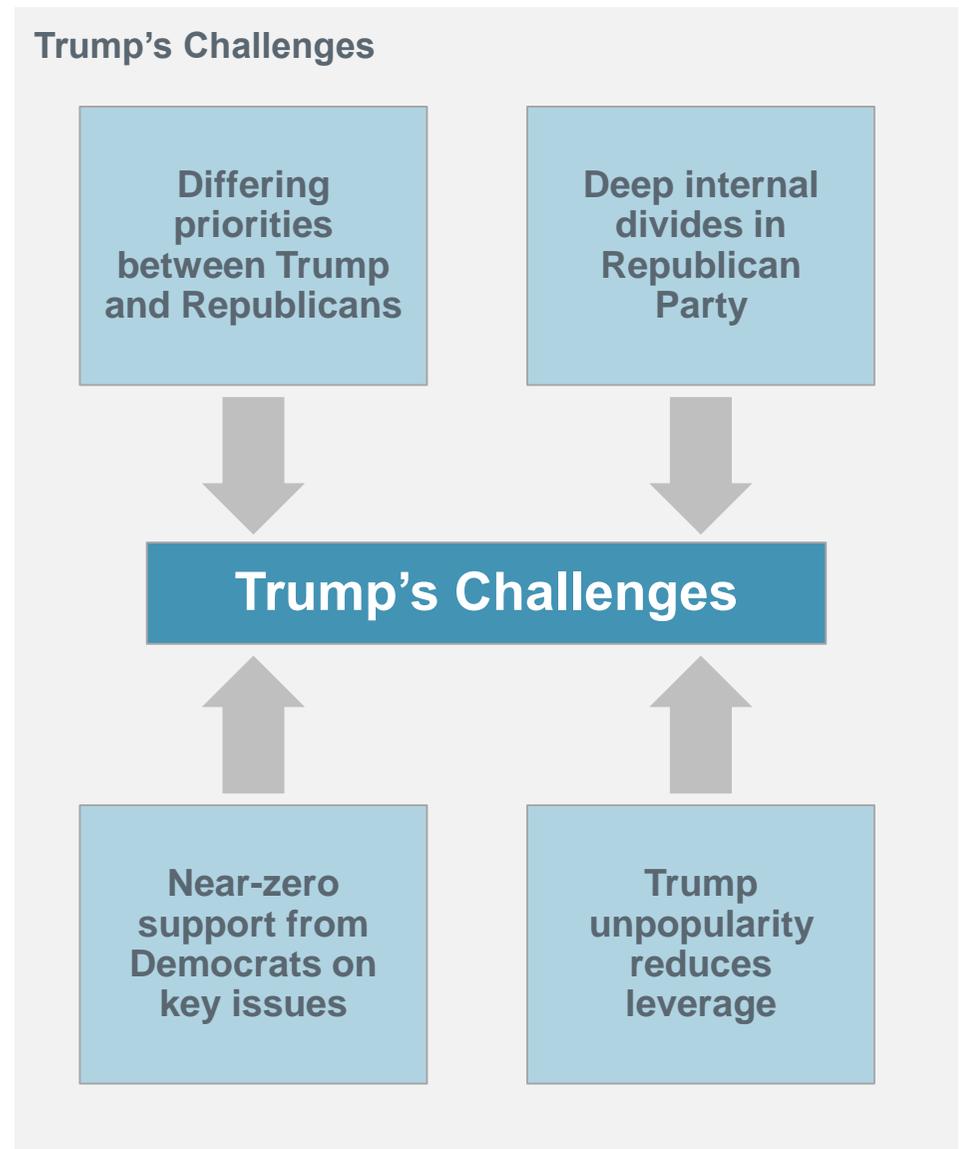
Source: Office of Management and Budget

*Does not include spending on entitlement programs **Does not include interest payments on federal debt

Trump vs. The Republicans

Trump essentially ran as a third party candidate, but must govern as a Republican

- Trump has challenged traditional Republican approaches on trade, social issues, foreign policy and many other areas. But he is constrained by the Republican agenda in Congress.
- Trump likely would prefer to focus on infrastructure, trade and jobs. Those were the issues that propelled him to the White House, and won support from working class voters.
- Instead, Republicans in Congress are embroiled in trying to reform the US health care system. This is a risky endeavor, and if the Republican health care plan turns out badly, it will diminish Trump's leverage and his momentum.
- The same could be true with tax reform.



Trump Promises Rapid Growth, but Agenda Conflicts with His Party

Infrastructure spending is a lower priority for Republicans in Congress

- Trump has promised to unleash breakneck economic growth and add 25 million jobs in the next decade.
- But his policy prescriptions favor businesses, rather than workers, signaling a continued belief in “trickle down economics.” Priorities include cutting taxes and curbing regulations, and stimulating infrastructure investment, but also challenging global supply chains through protectionist measures.

Trade Policy

- Ties many lost blue collar jobs and declining wages to expanding global trade.
- Calls for “fair” trade deals, by securing better terms for US workers and punishing violators.

Tax Policy

- Simplification of tax code, and large tax cuts for both households and firms.
- Cut top tax rate from 39.6% to 33%. Corporate tax rate would fall from 35% to 15%, and would apply to partnerships and sole proprietorships.
- No changes to Medicare or Social Security.

Infrastructure Investment

- Spur \$1 trillion in transport, water, power, and other infrastructure investment in 10 years, with aim of adding millions of jobs.
- Offer tax credits and public-private partnerships to fund plan, although key areas will fail to attract private investors.

Financial Sector Regulation

- Overhaul Dodd-Frank Law regulating banks, to limit regulations and oversight by the Federal Reserve and the Securities and Exchange Commission (SEC).
- Ease regulations for small banks and credit unions.

Trump's War on Trade

Trade policy will be a top priority for the Trump White House

- Trump campaigned on the misleading idea that he could boost the US economy and protect American jobs by renegotiating “bad” trade deals and punishing trade cheaters.
- Trump wants to encourage firms to set up manufacturing plants in the United States rather than abroad, and eliminate the trade deficit.
- His advisors have a misguided belief that trade deficits drag down growth.
 - Trade surpluses or deficits are not inherently good or bad.
 - The US maintains its trade deficit because it has a capital account surplus, due to enormous capital inflows.
- These mercantilist policies, combined with Trump's self-image as a master negotiator and deal-maker, suggest the US is serious about attempting to re-negotiate Nafta and other trade deals.
- Trump officials have attacked the trade policies of China, Mexico, Japan and Germany—four of its five largest trade partners.



Trump Worldview: Why US is “Losing” in Trade

- States with Value Added Tax (VAT) have unfair tax advantage
- Currency manipulation by China, Japan, EU
- “Cheating” under WTO rules

The Risks of Trump's Approach to Trade

More aggressive policies and shirking of rules create risk of trade wars

- Trump's proposals have signaled that Washington may discard long-established rules governing trade.
 - Proposals in Congress for “border adjusted taxes,” as well as some of Trump's proposals for “defensive tariffs,” may be illegal under WTO rules.
- China and Mexico collectively account for 30% of total trade with the United States. If a trade war erupted between the United States and “just” these two countries, the economic shockwaves would likely result in a global recession.
 - Even if a trade war is averted, a decision by Trump to step back from the US's decades-long role of promoting trade liberalization will limit medium-term global economic growth potential, and weaken US leadership on global economic policy.
- Abandoning the Trans-Pacific Partnership (TPP)—the regional trade grouping that excluded China—has opened the door for Beijing to emerge as a champion of trade liberalization.
- But replacing the United States with China—a juggernaut, but still lacking the scale of the US economy—as the engine of global trade flows could limit economic growth.

Trump's Trade Architects

- **Peter Navarro**, head of Trump's new National Trade Council, is an unorthodox economist, who was little-known before being tapped by Trump. Most of his recent writing has focused on China, which he accuses of currency manipulation and other tactics designed to boost exports and undermine trade partners.
- **Wilbur Ross**, Commerce Secretary, will play a key role in trade policy. A private equity billionaire, Ross seems an unlikely figurehead for Trump's populist economic agenda.

Some key Trump advisors, especially Navarro, seem unfazed about destabilizing the existing global trade order. Indeed, they think such a break is necessary.

Trade Agreements Under Threat

Growing obstacles to trade cooperation

Key Global Trade Initiatives Under Threat

TPP Trans-Pacific Partnership

Days after taking office, Trump issued an executive order that withdrew the US from TPP negotiations, and promised to pursue bilateral deals instead that will “promote American industry and protect American workers.” TPP was signed in February 2016 but has not been ratified by the US Congress. Asian economies may now look to the Regional Comprehensive Economic Partnership (RCEP), including China and India.

Nafta North American Free Trade Agreement

Trump has pledged “to get a better deal for American workers,” potentially including tariffs on some goods imported from Mexico and Canada. If they do not agree, Trump threatens the United States will withdraw altogether. Commerce Secretary Wilbur Ross says he wants to begin renegotiations in the coming weeks.

TTIP Transatlantic Trade and Investment Partnership

The prospects for TTIP were already dimming after a 14th round of negotiations concluded in mid-July with major differences still to be worked out. Public support for the deal has fallen with the rise of anti-trade rhetoric on both sides of the Atlantic. Trump’s election is widely seen as the death knell for TTIP.

Questions over US Role in Pacific Security

Trump questions the core tenets of Pax Americana and maritime security in Asia

- Trump's election has raised doubts over the US role in security in Asia. But even before Trump, US commitment to Asian affairs was called into question.
- The much-heralded "pivot to Asia" under Barack Obama failed to translate into concrete policies.
- During his campaign, Trump criticized large US troop deployments in South Korea and Japan, suggesting that Asian states need to do more to ensure their own security.
- He has signaled that Washington is less committed to providing global goods, including maritime security.
- The US-Japan alliance has anchored the regional security framework for decades, but a reduced US commitment to Japanese security is a possibility.
- **Freer US-Japan trade may be stifled. But Trump's market orientation and vows to cut regulations favor US oil and gas output and exports. This could support Japanese energy security goals, including diversified supplies and pricing.**

Energy Security in Asia: The Washington-Beijing Rivalry

- There is a tendency to view Pacific security issues as a zero-sum competition between Washington and Beijing.
- It is quite possible that the Trump administration will end up following a path of greater confrontation with China in trade and security matters, raising the risk of escalations in the East China Sea and South China Sea.
- But if Pax Americana in the Pacific appears to be eroding over the medium to longer term, the Asian states may find they need to work much more closely on energy security issues.

03

US Energy and Climate Policy Under Trump

- Energy is central to economic message
- Strong effort to reverse Obama's climate legacy
- Trump team likely to favor US LNG exports
- Shale production stabilizing, and could return to growth

Energy Sector is Central to Trump's Economic Message

Oil and gas companies have a strong ally in the White House

- Trump is much more sympathetic to fossil-fuel industries than the Obama administration. He can also expect support for his agenda from a Republican-majority Congress.
 - Democrat and environmentalist opposition is likely to flare up externally.
 - Fierce hostility can be expected on the ground, and in the courts, in opposition to activity such as drilling and pipeline construction.
- Market forces drove the last decade's domestic boom (and subsequent bust) first in gas and then oil, and also lie behind the demise of coal. The industry has been a victim of its own success.
- Trump's suggested reforms may allow the US hydrocarbon sector to cut costs and boost output, but in so doing will likely add to the abundance in the global opportunity set.
- **The main challenge for the oil and gas industry in the US today is economics, not access or excessive regulations.**

Climate Policy Reversal

- Trump wants to reverse Obama-era initiatives, and end or undermine the Paris Agreement and Climate Action Plan, while weakening the EPA.

Regulatory Rollback

- Trump has vowed to roll back regulations. But in reality, the federal government does not pose many obstacles to access, and states regulate most unconventional activity.

Infrastructure Approvals

- Trump signed an executive order to speed up Keystone XL and has backed the controversial Dakota Access pipeline.

Opening Federal Areas

- Trump has limited ability to open new federal areas (offshore the East Coast and Alaska, for example) until the next five-year OCS plan (2022-2027).

Climate Policy: Reversal of Obama Agenda

Congress expected to support broad attack on regulating emissions

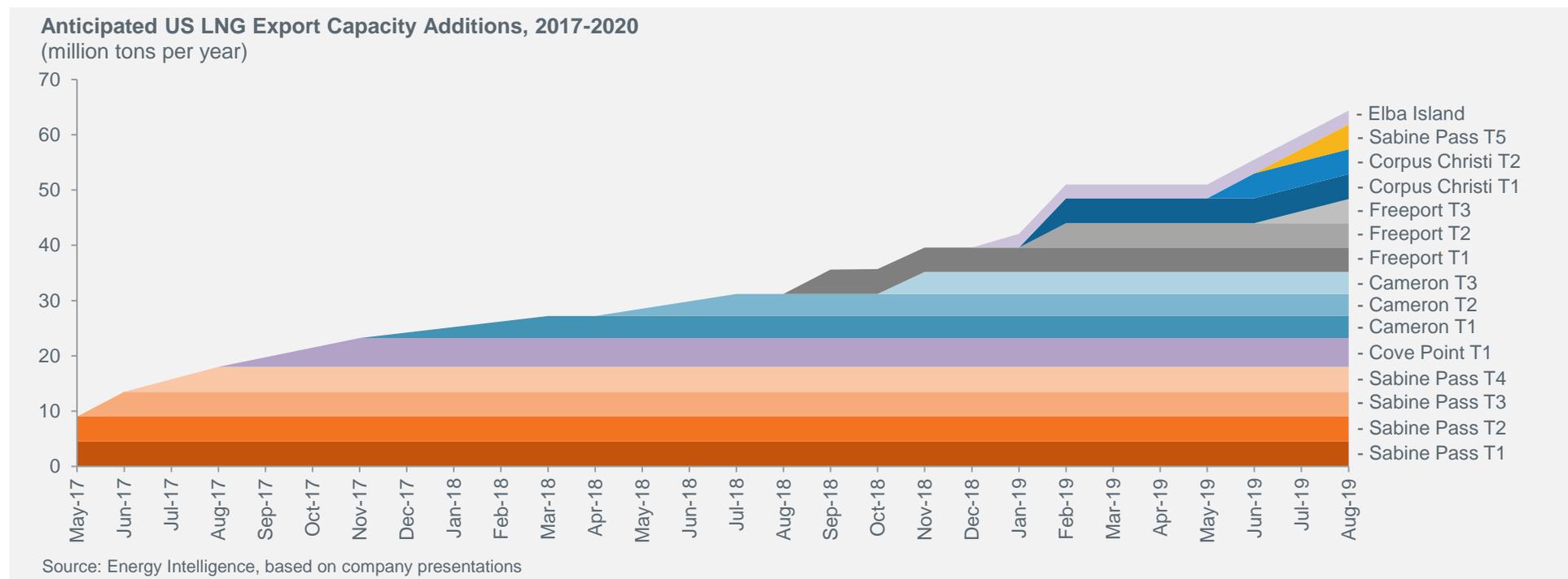
- **It is clear that Trump intends to reverse course on Obama-era climate measures. In these aims he is very likely to enjoy the support and encouragement of Republicans in Congress.**
- Trump is likely to focus on what he dislikes about climate policy: excessive regulation imposed by bureaucrats at home (especially the Environmental Protection Agency, or EPA) and abroad (under the Paris Agreement).
 - Trump wants the EPA to play a much narrower role in environmental protection.
 - His stated desire to withdraw from the Paris Agreement reflects his mistrust of international agreements and bodies.
- Republicans in Congress have largely opposed efforts to restrict emissions, and Congress may even push for harder, faster action than the White House.

Issue	Possible Actions
Paris Agreement	<ul style="list-style-type: none"> ▪ Trump has promised to “cancel” the Paris Agreement on Climate Change. ▪ The US will likely refuse to participate and implement its pledges, and will cut funding for decarbonization programs.
EPA Powers	<ul style="list-style-type: none"> ▪ Trump’s budget proposal would cut EPA funding by 31%, eliminating funding for nearly all climate research and energy efficiency programs. ▪ The new EPA head is a climate change skeptic, who sued the agency numerous times.
Clean Power Plan	<ul style="list-style-type: none"> ▪ Trump and congressional Republicans are largely united in their opposition to Obama’s Clean Power Plan (CPP), which governs power-sector emissions. ▪ Trump’s proposed budget would eliminate the EPA’s funding for CPP implementation.
CAFE Standards	<ul style="list-style-type: none"> ▪ CAFE standards, governing emissions for cars and light trucks, are due to tighten (to 54.5 mpg by 2022-2025). But a recent White House decision gave the EPA a chance to review this target until 2018.

US LNG Exports: Political Support Should Remain Strong

General pro-export policies apply to the oil and gas sector as well

- The Trump administration seems unlikely to block efforts to export more US LNG. Trump, and Energy Secretary Rick Perry, both have a pro-industry outlook, and certainly seem to favor exports.
- It is possible that the Department of Energy (DOE) could move back to a “conditional approval” process for LNG exports to non-FTA countries.
- One potential challenge in the near term is staffing at the Federal Energy Regulatory Commission (FERC). Normally there are up to five commissioners, but at present there are only two. They do not have quorum to issue final decisions.



Tax Reform Could Have Deep Impact on Refiners

But support for the proposed “border adjustment” tax seems to be weak

- Proposals for a “border adjustment” tax could have a major impact on the oil sector. For US refiners, imported crude would become more expensive, but exports of refined products would be exempt from taxes.
 - The goal is to reduce US crude imports, and to provide more incentives for domestic production.
 - Those refineries that cannot export refined products will probably have to pass on the higher costs to their customers. So presumably, US pump prices will rise.
- Backing for this border adjustment tax in Congress appears to be fairly weak. Trump has not yet committed to support it.

Impact of a “Border Adjustment Tax” on US Refiners

*More
disadvantaged*

- **East coast and West Coast refiners** are dependent on crude imports
- **Mid-continent refiners** expanded coking capacity several years ago, and cannot export

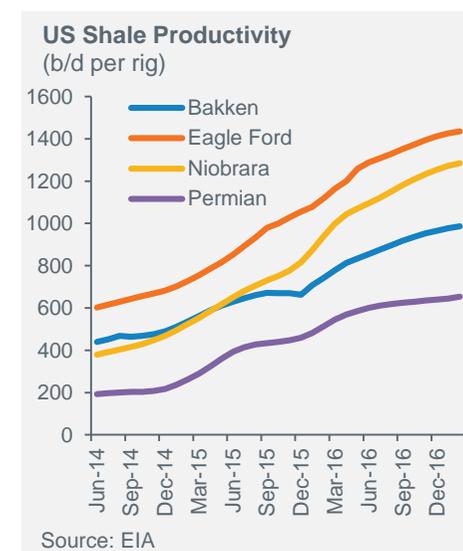
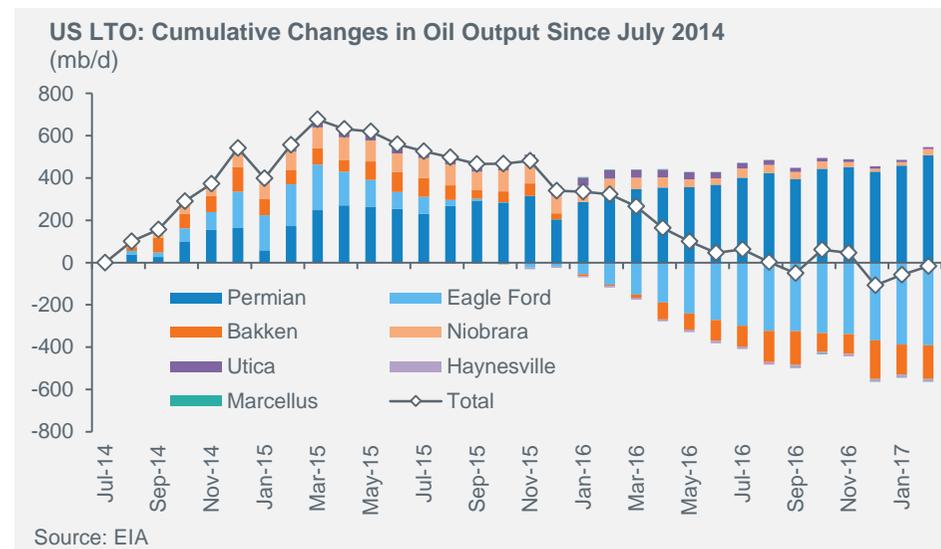
*Better able to
adjust*

- **Gulf Coast refiners** with coking capacity are optimized to import heavy crude from countries like Venezuela, Mexico and the Middle East.
- But the Gulf Coast refiners have more options: better access to domestically produced crude, and lots of export capacity.

US Shale: Production Begins to Stabilize

US output begins to stabilize due to the prolific Permian Basin and increasing rig efficiency

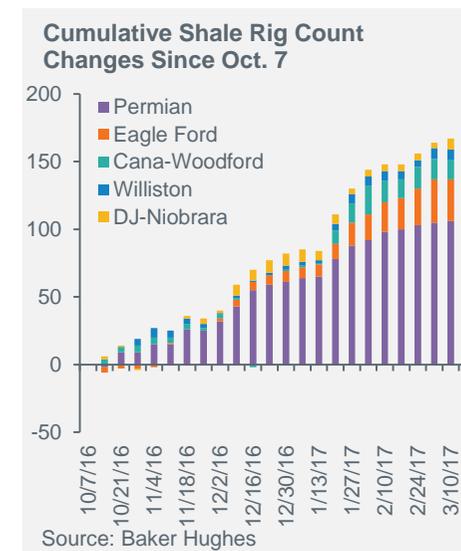
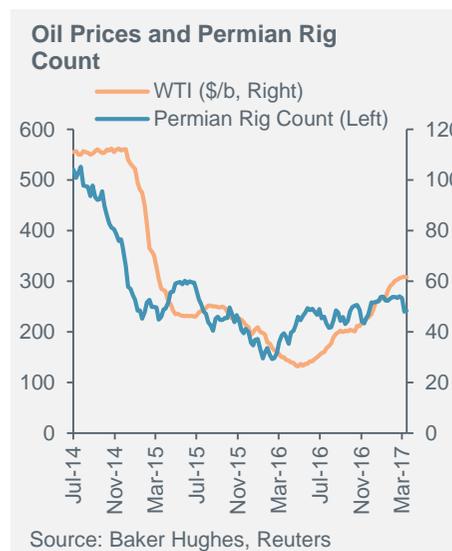
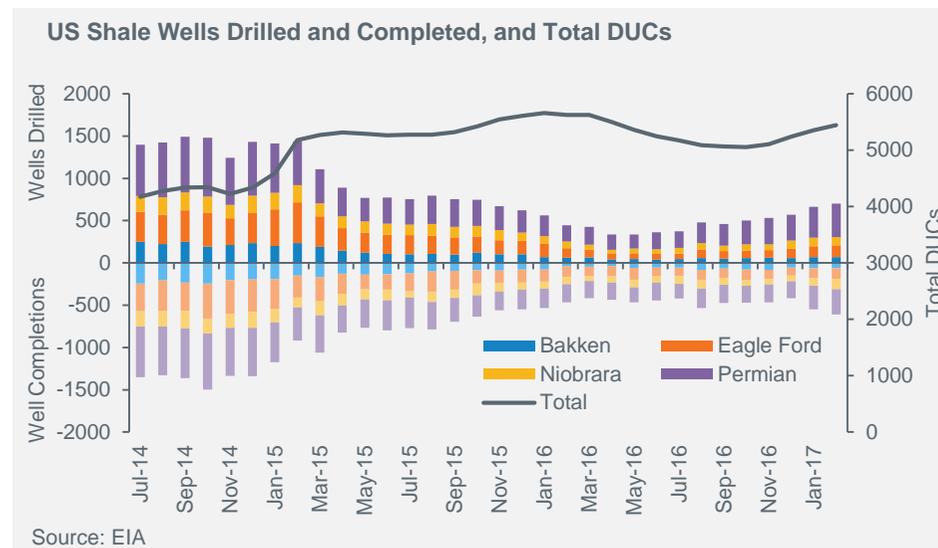
- US shale production has stabilized and activity is beginning to increase—but in response to prices rather than policies.
- Opec's action to manage markets provided an opportunity for producers to hedge forward production.
 - Project economics in the Permian have held up despite the price pressure.
 - But the increase in January price levels was sufficient to support increased activity in all basins.
- Soaring productivity rates per rig and plummeting costs have played a key role. Increases in efficiency reflect using the best crews on the best rigs, but also durable measures such as increasing the use of proppants and sand.
- The completion of drilled but uncompleted wells (DUCs) has also helped to mitigate declines, especially in the Bakken and the Eagle Ford.



US Shale: On the Cusp of a Return to Growth

Conditions appear ripe for shale to return to growth in 2017 at current price levels

- Looking forward, US shale production appears to be on the precipice of a return to growth in 2017, even at current or near current price levels.
- Permian growth looks to build upon its recent strong performance.
- Activity in other basins is likely to increase, but should remain muted compared to the production boom in 2011-2014.
- US shale production for 2017 will be largely immune to any further price pressure, should oil prices continue to weaken.
 - Project economics have improved more significantly than in other E&P play types.
 - Hedging of future production guarantees companies minimum needed returns.
- The inventory of drilled but uncompleted wells (DUCs) provides further room for production growth at current price levels.



The Americas

270 Madison Avenue, Suite 302
New York, NY 10016
Tel: +1 212 532 1112

1401 K Street, NW, Suite 1000
Washington, D.C. 20005
T: 1 202 662 0700

808 Travis Street, Suite 1014
Houston, TX 77002
T: 1 713 222 9700

Europe & Africa

7 Down Street, 3rd Floor
London W1J 7AJ, UK
T: 44 (0)20 7518 2200

Chaussée de la Hulpe 120
1000 Brussels, Belgium
T: 32 (0)2 663 18 00

Daev pereulok 20, Office 509
107045 Moscow, Russia
T: +7 495 604 8279/78/77

Middle East & Asia-Pacific

15A Temple Street, #02-01
Singapore 058562
Tel: +65 6538 0363

Dubai Media City
Al Thuraya Tower 2 - 1907
P.O. Box 502803
Dubai - UAE
Tel: +971 4 364 2607/2608

1st floor, Freij Bldg, Sodeco
President Elias Sarkis Street
Beirut, Lebanon
T: +961 1 614282 & 3