The Washington Post
January 5, 2018

Global economy untilted by Trump

by David J. Lynch

President Trump had been in the White House for just three weeks when the analysts at Fitch Ratings in London decided that he was a threat to the global economy.

Nearly a decade after the Great Recession, factories worldwide were finally humming. But the president's repeated musings about a trade war with China, and perhaps Mexico and Canada, too, coupled with plans to limit immigration and shatter diplomatic norms, "raised the prospect of sudden, unanticipated changes in U.S. policies with potential global implications," James McCormack, Fitch's managing director for government debt, told investors.

The Bank of England and several economists sounded similar alarms, while one hedge fund manager, Matthew Barkoff of Carlson Capital in Dallas, warned clients that Trump might trigger "a global depression."

Instead, 2017 turned out to be the global economy's best year since 2010, according to the International Monetary Fund, and 2018 looks even better. On Thursday, the Dow Jones industrial average continued a record-breaking run by topping 25,000 for the first time, underscoring the gathering global boom. This year, every major economy — the United States, the European Union, Japan and China — is expected to grow.

That sunny consensus, shared by Wall Street banks and Washington think tanks, shows that Trump's unorthodox governing style is having only a limited impact, though the U.S. accounts for one-quarter of the $80 trillion global economy.

Trump's impact on economic fortunes has been eclipsed by the actions of major central banks, which flooded markets with trillions of dollars in easy money. Investors and corporate executives also have learned to cope with an unpredictable president, often by ignoring his most provocative statements. Earlier this week, when Trump tweeted that his "Nuclear Button" was larger than North Korean leader Kim Jong Un's, Asian markets yawned.

“We’re all obsessed with Trump. We want to see the world through Trump,” said Ruchir Sharma, chief global strategist at Morgan Stanley Investment Management in New York. “But the effect that politics has on economics is a bit limited because of the very strong institutional structures in the United States, in contrast to the emerging markets . . . where you have to pay more attention to the political noise.”

Economics dominated politics last year outside the United States, too. In Europe, fears that ascendant populism in Britain, Poland, and Hungary would destabilize the E.U. proved exaggerated. And in Asia, prosperity surged despite rising tensions on the Korean Peninsula.

The key to the global recovery from the 2007-2008 recession has been the extraordinary monetary policy support from central banks in the United States, E.U., Britain and Japan, economists say. Those four central banks almost quadrupled their holdings of government securities, measured as a share of gross domestic product, in a bid to lower borrowing costs and stimulate economic activity, according to the IMF.

In the United States alone, the Federal Reserve increased its balance sheet to $4.5 trillion from a pre-crisis peak of $925 billion.

That ocean of money sloshing around the world was powerful enough to drown out the most incendiary presidential tweet. “The significant power of central banks’ easy money is able to dominate the negative effect of what’s going on on the political stage, not only in the U.S. but in Japan and elsewhere,” said Torsten Slok, chief international economist at Deutsche Bank.

Still, the contrast between Trump’s inflammatory rhetoric and the placid economic scene is striking.

The president has attacked companies such as Boeing and General Motors on Twitter and threatened to upend a 70-year-old global trading system. Yet business confidence is up and trade grew last year by an estimated 3.6 percent, faster than under President Barack Obama, according to the World Trade Organization.

So far, Trump’s most potentially disruptive policies, such as slapping tariffs on Chinese imports or tearing up the North American Free Trade Agreement, remain only threats. Instead, Trump’s signature economic initiatives — a $1.5 trillion tax cut and efforts to curb regulation — are expected to extend the U.S. expansion past its ninth anniversary in June.

“For all the unconventional nature of his approach to the office, when you look at what he’s done on economic policy, a lot of it has been pretty conventional,” said Stephen Stanley, chief economist at Amherst Pierpont Securities. “People have come to the realization that it’s safe to just go about your business.”

As a candidate, the former reality-television star accused China of “raping” the United States and vowed to retaliate with sweeping tariffs. Yet through the first 10 months of 2017, the United States imported $32 billion more Chinese goods, from electronics to steel, than during the same period one year earlier, according to the U.S. Census Bureau.

“In China, many business leaders have discounted Trump’s comments and are focusing on his actions,” said Andrew Collier, managing director of Orient Capital Research in Hong Kong. “Chinese businessmen are accustomed to handling changing political circumstances and are adept at changing tack when the wind shifts.”

Thanks to a supportive monetary cushion, markets have remained unruffled amid serial White House controversies. The CBOE Volatility Index, or VIX, a measure of market volatility, hovers at roughly half its long-term average. Uncertainty over economic policy also is well below typical levels over the past quarter-century, according to a separate measure developed by a trio of economists from Stanford University, the University of Chicago and Northwestern University.

This is not the environment that many analysts anticipated amid the shock of Trump’s November 2016 election win. As the votes were still being counted, economist Paul Krugman, a New York Times columnist, warned of “a regime that will be ignorant of economic policy and hostile to any effort to make it work,” adding that “we are very probably looking at a global recession, with no end in sight.”

By early February, the Fitch team responsible for evaluating government bond markets had seen enough to conclude that “the Trump administration represents a risk to international economic conditions and global sovereign credit fundamentals.”

McCormack, a veteran analyst who previously had worked for Goldman Sachs, highlighted the danger of “disruptive changes to trade relations, diminished international capital flows, limits on migration . . . and confrontational exchanges between policymakers.”

Today, McCormack says that Fitch’s concern that the president would disrupt government bond markets in his attempt to reshape trade policy is “unchanged.”

Trump’s focus on bilateral trade deficits as evidence that the United States is being mistreated by other countries “runs counter to the basic tenets of trade theory and practice,” McCormack said this week via email.

The worries that some voiced about Trump last year may prove to have been premature rather than wrong.

Though Krugman acknowledged in a New Year’s Day column that he erred with his dire forecast last year, he wrote that the economic calm “probably” will not last.

In a report Thursday, Holger Schmieding, chief economist for Berenberg Bank in Hamburg, said the economic outlook at the beginning of a year has rarely been this positive.

But he cautioned that investors “need to watch the erratic behaviour and protectionist leanings” of the U.S. president.

Talks aimed at renegotiating NAFTA are stalled, raising the risk of a collapse. Tariffs on various Chinese imports are expected within weeks. And the president retains his preference for unilateral action rather than patient diplomacy.

As Trump enters his second year in the Oval Office, some foreign executives are acting on concerns that the president may finally erect barriers against countries that sell more to the United States than they buy. The United States ran a $68 billion trade deficit with Japan last year, and Japanese companies such as Toyota and Daikin have stepped up investments in U.S.-based research, production and distribution centers, said Jesper Koll, head of Japan operations for WisdomTree Investments in Tokyo.

“Corporate executives are leaving nothing to chance,” he said. “These investments are triggered by fears that the gates are going to close.”

James McGregor, APCO Worldwide’s chairman for greater China, said business leaders in Beijing continue to eye the American president warily. “The instability of Trump definitely has everybody worried,” McGregor said. “This country is focused on stability and predictability. Neither are hallmarks of the United States right now.”

There are other reasons for skepticism about the rosy global forecasts, notably the gradual end to the easy-money policies that supported growth. The Federal Reserve has begun raising interest rates, in a bid to prevent inflation from rising past its 2 percent annual target, and is beginning to shrink its holdings of government securities. The European Central Bank is reducing its asset purchases by half, starting this month.

Forecasters expect the world’s major economies to continue powering ahead even as the monetary spigot is gradually tightened. But these central-bank maneuvers will ripple through bond and stock markets, affecting asset prices and potentially rattling economies and presidents.

“The political problems we were worrying about a year ago have not gone away,” said economist George Magnus of Oxford University. “They may just manifest themselves later than we expected.”

David J. Lynch is a staff writer on the financial desk who joined the Post in November 2017 after working for the Financial Times, Bloomberg News and USA TODAY.