The Rooster in the Hen house?

The new President's priority – Repeal of Obama care

President Trump may well undertake all manner of **policies to assist the 60%** of the US population who are relatively low-skilled and who got him elected. However, these policies are all measures that will only help in the short term, while they will eventually weaken the US economy and exacerbate the situation of "middle America" over the long term. Speaker Paul Ryan's assessment is that tax reform probably will have to wait until at least the spring; while infrastructure spending bills could well get pushed through, the actual work will be months away, if not longer. Therefore, repealing Obamacare has taken priority for the Republican leadership.

Rules and Regs for the new President

It is vital that the 45th President, in spite of being a great disrupter, should focus on the following. First, in principle, a president should not concentrate too much power in a small group of people. Second, he must resist too great an overlap between policy and politics; thirdly, he must build a broad consensus across party divides. Finally, the information channels into the White House must not be constrained, as a myopic view is extremely dangerous for the leader of the "free world". After all, a president cannot do everything by executive order. **He has to work with Congress** to push through the more complicated legislative items, and in doing so ultimately he will encounter the infamous swamp of DC and its special interest groups that dominate the process that retards/drives law-making.

An historical perspective

Economic history shows that, if countries start shielding themselves artificially against foreign competition, their international position will crumble progressively and they will actually become increasingly less competitive. Consequently, the living standard will decrease rather than increase in the long run. History also shows that interventions (both verbally and on the currency spot market) can never push currency rates up or down for a sustained period. Capital flows are and will always be the determining factor, unless the fundamentals change − i.e. higher or lower interest rates.

So, in the current case the dollar exchange rate may be kept low for a while or even be pushed down, but if this leads to even higher US interest rates, the dollar exchange rate will ultimately still increase. Reality is that while the central banks of the EU, Japan and China all took covert actions to **depreciate their currencies** during the second half of 2016, the Fed has struck back by attempting to restrain market interest-rate expectations. For those of us who remember the US – USSR crises of the 1960s, it's important to remind the younger generations that "Cold Wars" are not fought in open battle but through clandestine actions and words.

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The US – China situation

Concerns are growing in global financial markets over the speed at which China is depleting its foreign reserves (overall holdings fell by a record $188 billion last year), as ammunition to defend the currency and staunch capital outflows. Some analysts fear a heavy and sustained drain on reserves could ultimately force China to devalue the yuan. Analysts and **Chinese investors** as a result expect downward pressure on the yuan to be unrelenting, especially if the US continues to raise interest rates, which would likely trigger fresh capital outflows from EM emerging economies such as China and test its enhanced capital controls.

Historically, US officials have at least given lip service to America's "strong dollar policy." It appears, as with many other long-standing political norms, Trump has kicked this one into touch. The new US administration of President Donald Trump appears to be less likely to tolerate USD dollar strength, despite the fact that the cornerstones of his policies speak to a strong USD, and will therefore be much more likely to resort to the policies of protectionism.

Troubling times for the West

Peter Navarro, Head of the White House National Trade Council, in a Financial Times interview stated that Germany's excessive surplus is a sign of a "grossly undervalued" currency. These accusations, highlighted by Trump's top trade adviser, that Germany is manipulating currency markets may well be partially valid, but the rhetoric is deeply disturbing. Given this macro backdrop, countries like China and Russia are moving to fill the political/ trade vacuum, given the rise of populist protectionist policies; they are seeking out opportunities for political, military, and economic gains at the expense of the West. One could argue there are plenty of political reasons why the markets should be really nervous and reflect this in increased volatility.

The 'new' significance of US-China mutual dependence

The markets, however, appear to be oblivious to the fact that the western political and economic model is under structural pressure. This is not surprising given that the post-modern PC "Politically Correct" establishment, without doubt tends to destabilise the status of institutions, traditions, and customs; thus creating a vacuum and giving rise to the **social revolution that is currently fermenting.** This developing global Cultural Revolution has been masked by the stealthy advance of post-modern populist authoritarianism, which has all but destroyed the social compact embraced by the West, post the Second World War.

Therefore it is clear that in a world that is rejecting multilateral deals and embracing bilateralism, never have the US and Chinese economies been more interdependent than they are today. Neither has the value of the bilateral trade and investment relationship been greater. Nor has the current precarious state of the global economy required "harmony" between the United States and China more than it does now. Yet, the election of Donald J. Trump, on a platform of nationalism and protectionism, has evoked the possibility of a "new" cold war; therefore, never have we seen the planets so perfectly aligned for relationships to descend into a debilitating trade war and/or a currency war.

In conclusion why should SA investors care?

Choppy seas ahead?

We believe that the Trump policies will eventually increase the debt/GDP ratio until it becomes 'an albatross around the neck of the US economy'. It will also unfortunately imply less demand for commodities, as Trump's fiscally-driven infrastructure development generally requires relatively fewer commodities than a real estate development boom will. Further, the global economy is heading into a period of major event-driven risks such as the uncertainty about the path of Fed rate hikes; increased political risks with Brexit's Article 50 to be signed in March; and with elections in the Netherlands, France, and Germany.

The effect of China's problems on South Africa

Of much more concern to South African investors is the potential for Sino-American tensions (trade wars), which will reinforce the ongoing de-globalisation debate. If the top two global economies are at geopolitical loggerheads, they are more likely to see their geopolitical tensions spill over into the economic sphere. These geopolitical tensions will compound internal **economic pressures in China** resulting from rampant credit expansion, misallocation of capital, excessive money printing, and capital outflows. Excess money seeking a home inside China's closed markets creates investment bubbles; the country has seen everything from real estate to stocks to bonds to soy beans and iron ore balloon in price − which will ultimately deflate.

Renewed Chinese growth concerns, given this back- ground, are also likely to weigh on sentiment, given that 60% of our mining exports go to Asia. Stronger commodity prices have kept South African financial assets resilient over the past year. However, as the Chinese property cycle matures and monetary conditions tighten, the impending slowdown in China will send ripples across global commodity markets and commodity-dependent economies, and will likely tip South African GDP growth into negative territory in 2017.

Emerging Market concerns on the horizon

As a major consumer of our commodities/exports, China's economic health is vital to South Africa. The current calm is deceiving, since economic and security tensions will eventually rise to the surface again; likely in a more disruptive way than ever before. China and the U.S. will not be able to prevent economic tensions from spilling over into broader strategic tensions. All of the above lend support to a strong USD, the anti-globalisation pulse, which is ultimately bad news for the shares of global companies and the EM Emerging Markets who have benefited tremendously from the steady dismantling of barriers to the free flow of goods, capital and labour.

Mark Huxter – February 2017