

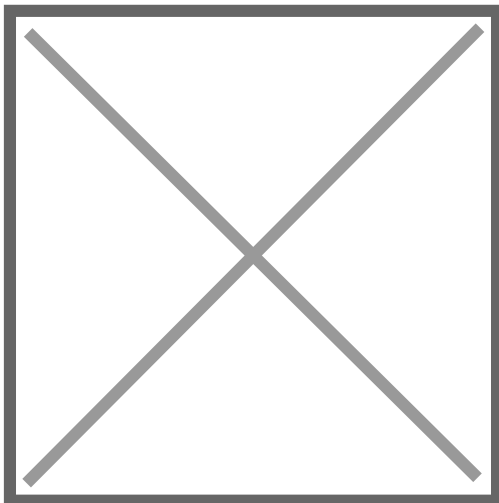
Trump, trade and unintended consequences

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The US, under Donald Trump, is turning protectionist. And the President's plan to restrict imports will see the country's external balance of trade deficit as evidence of "a war that is easy to win." Here at Tacit we believe that, like most of his policymaking, it's his "base" that will largely bear the costs.

According to data compiled by the World Bank, in 2011 the share of trade in global GDP was approximately 60%. Paul Krugman, the noted US economist who won the Nobel prize for his work on international trade economics, estimates that on a worst-case basis, President Trump will roll that figure back by 70% to around 25% of world GDP.

Trade imbalances are not a function of specific products but of deeper macro-economic forces. In this case the fundamental cause of the US external deficit is that America saves too little and spends too much. In addition, projected investment exceeds projected savings.



The gap is filled by a shortfall on the trade account and a surplus on the capital account. The surplus consists mostly of Chinese holdings of US Treasuries.

The way we suggest dealing with the US financial imbalance would be to develop fiscal policies that encourage saving. Otherwise you're getting involved in destructive bilateral trade wars. Currently we believe Trump's policymaking is both flawed and inconsistent.

It's fair to say that the US economy has recovered from the global financial crisis. It has full employment close to capacity. Yet, whilst railing against the "bad, very bad US trade deals" the President has signed off on a \$1 trillion tax-cutting economic stimulus which will boost domestic US demand.

As David Loevinger, former senior co-ordinator for China affairs at the US Treasury put it:

"Tariffs won't have much impact on the trade balance. As long as US demand is rising, we're going to be importing from somebody."

Higher tariffs will impose costs on all of us in terms of reduced competitiveness, smaller choice and lower efficiency. This leads to less innovation, higher inflation and in all probability higher interest rates. In the end, tariffs distribute resources from domestic consumers to domestic producers.

Global growth will be hit by American protectionism but in the short-term the impact will be slight although it does depend on the scale and duration of new tariff barriers.

The key factor to watch is the Federal Reserve. Tariff barriers and financial stimulus will push US inflation higher. 'The Fed' will want to raise rates but Trump almost certainly will resist.

Amongst all the risks posed by this contradictory policy framework is not only global trade but independence of the Federal Reserve itself. Any lack of autonomy would prove most damaging to asset prices. And any suggestion that the Federal Reserve would no longer be independent of government would lead to a severe repricing of assets around the world. Fiscal consequences may be unintended, but in the real world they can be avoided.

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