THE ECONOMIC CONSEQUENCES OF MR TRUMP, AND OTHER GEO-POLITICAL RISKS FOR AUSTRALIA

PRESENTATION TO THE CHAMBER OF COMMERCE & INDUSTRY OF WESTERN AUSTRALIA'S LIGHTHOUSE LEADERSHIP SERIES LUNCHEON

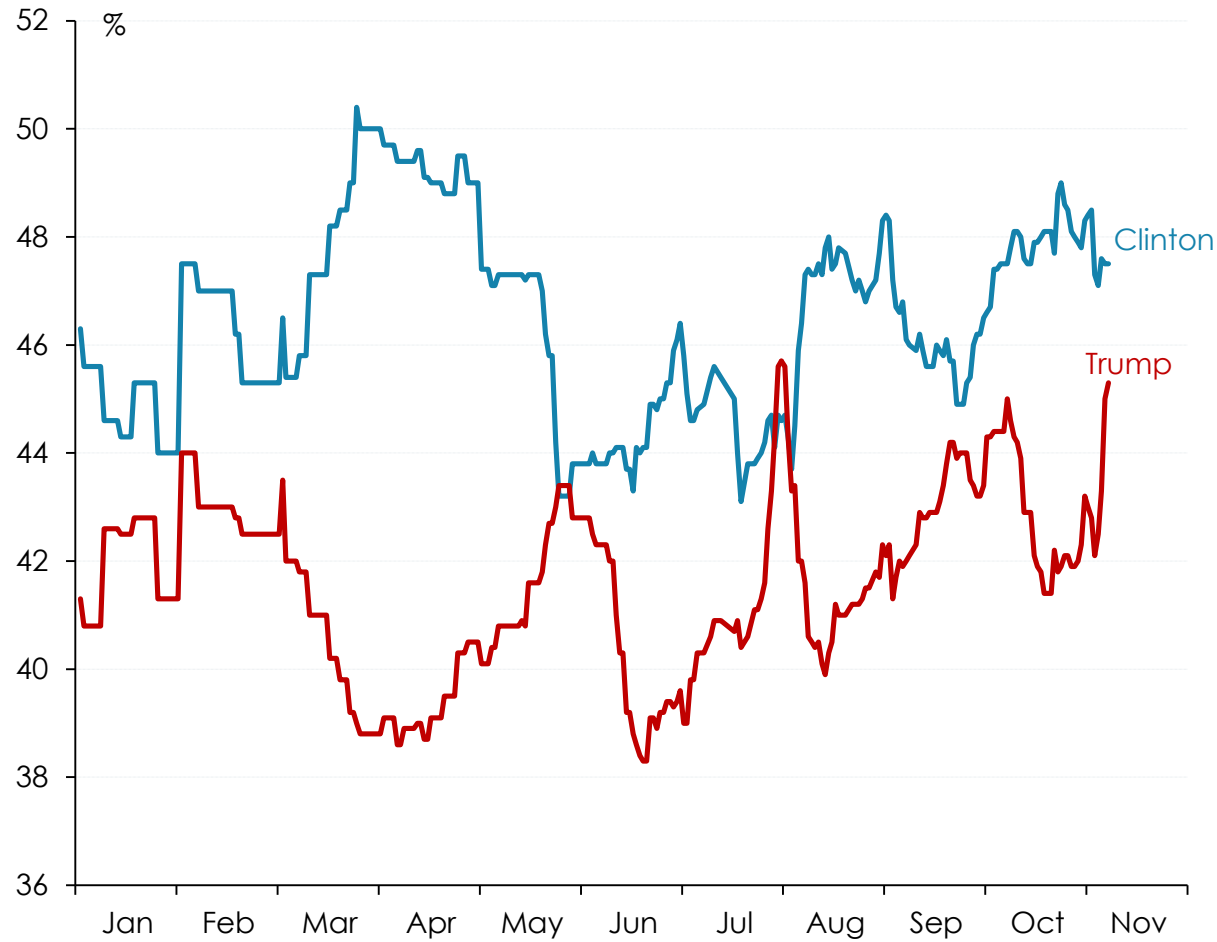### HYATT REGENCY HOTEL, PERTH – 2ND NOVEMBER 2016

bettercallsaul.com.au

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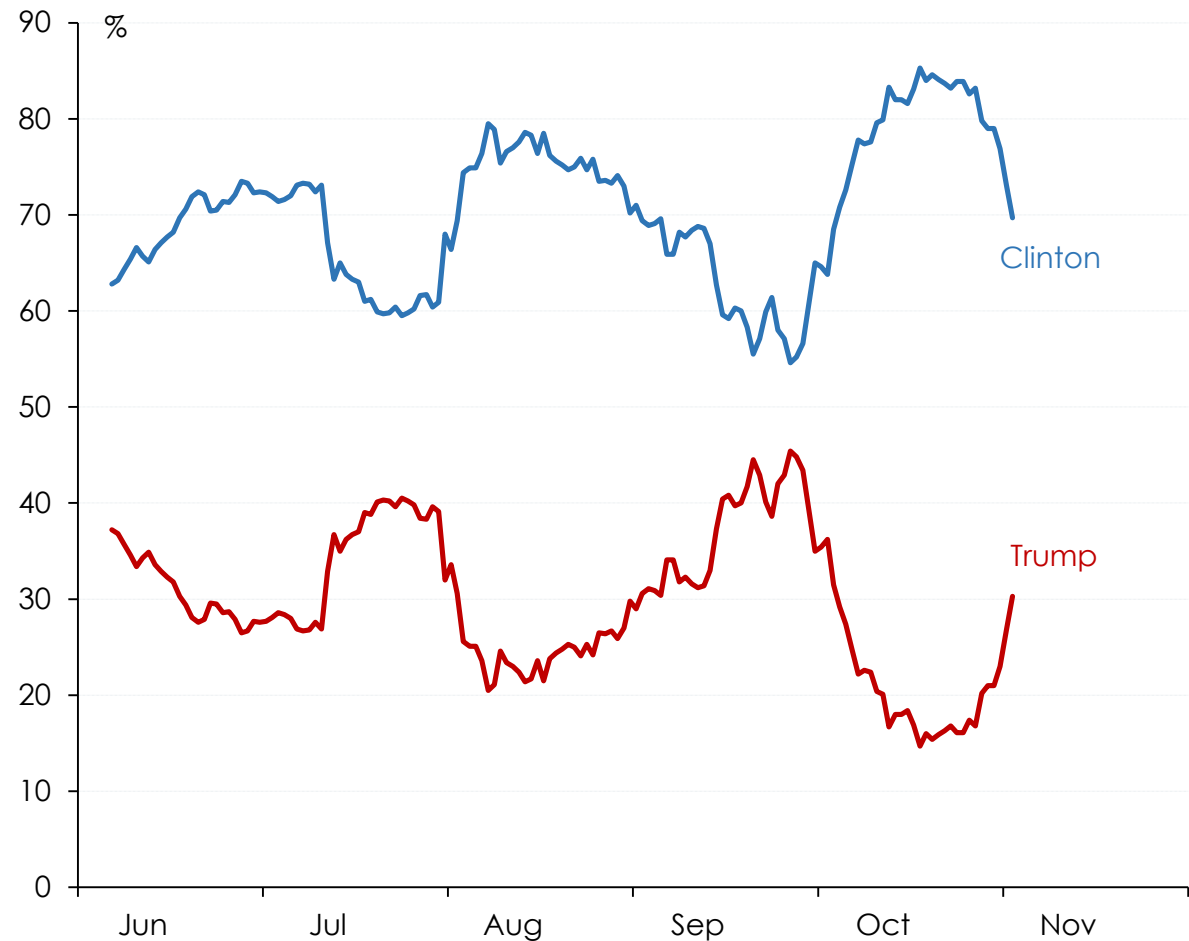Will America switch from 'Yes we can'…   … to 'I alone can' ?

Opinion polls and statistical models still suggest that Hillary Clinton will be the 45th President of the United States – albeit by a narrowing margin

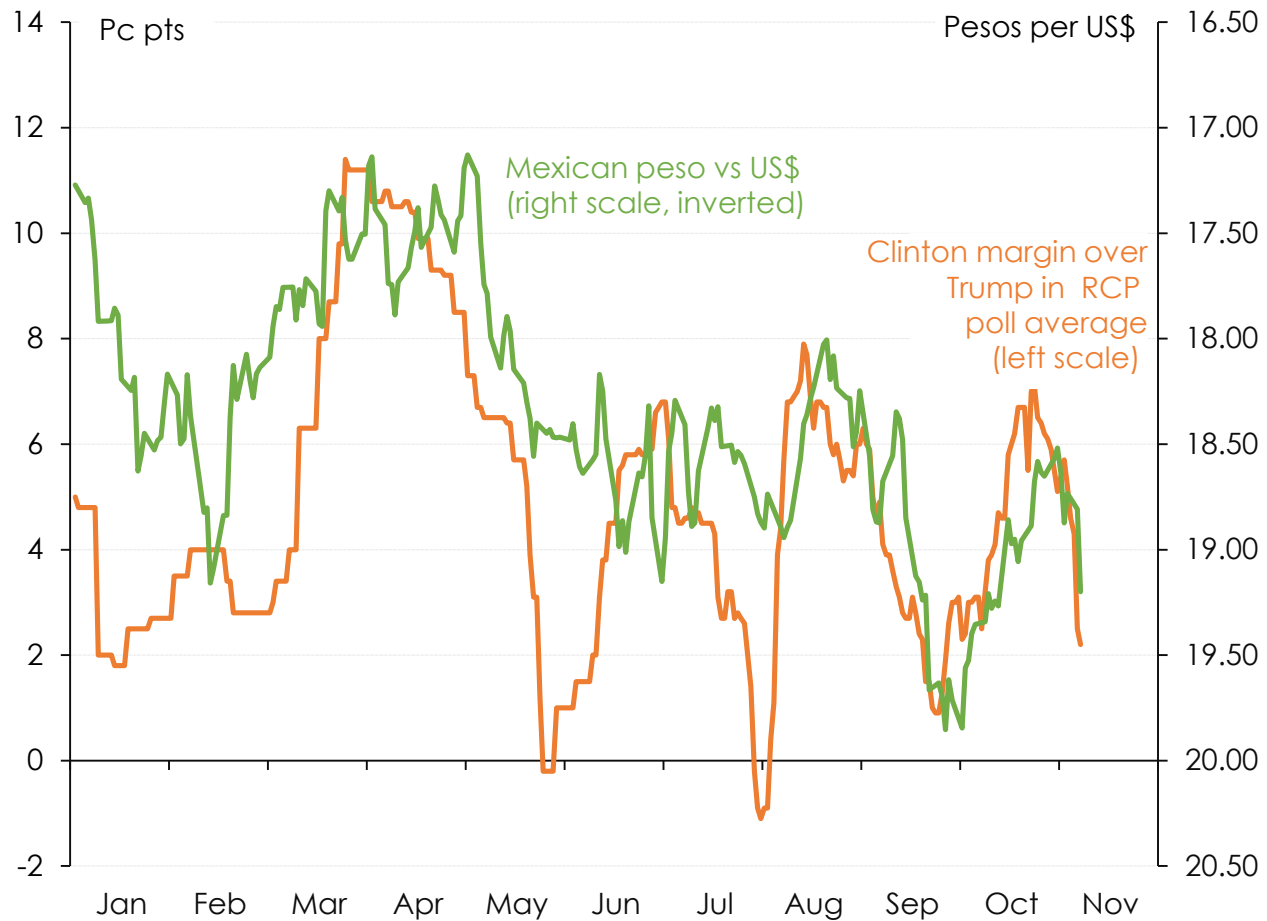## Presidential election voting intentions – average of seven major opinion polls

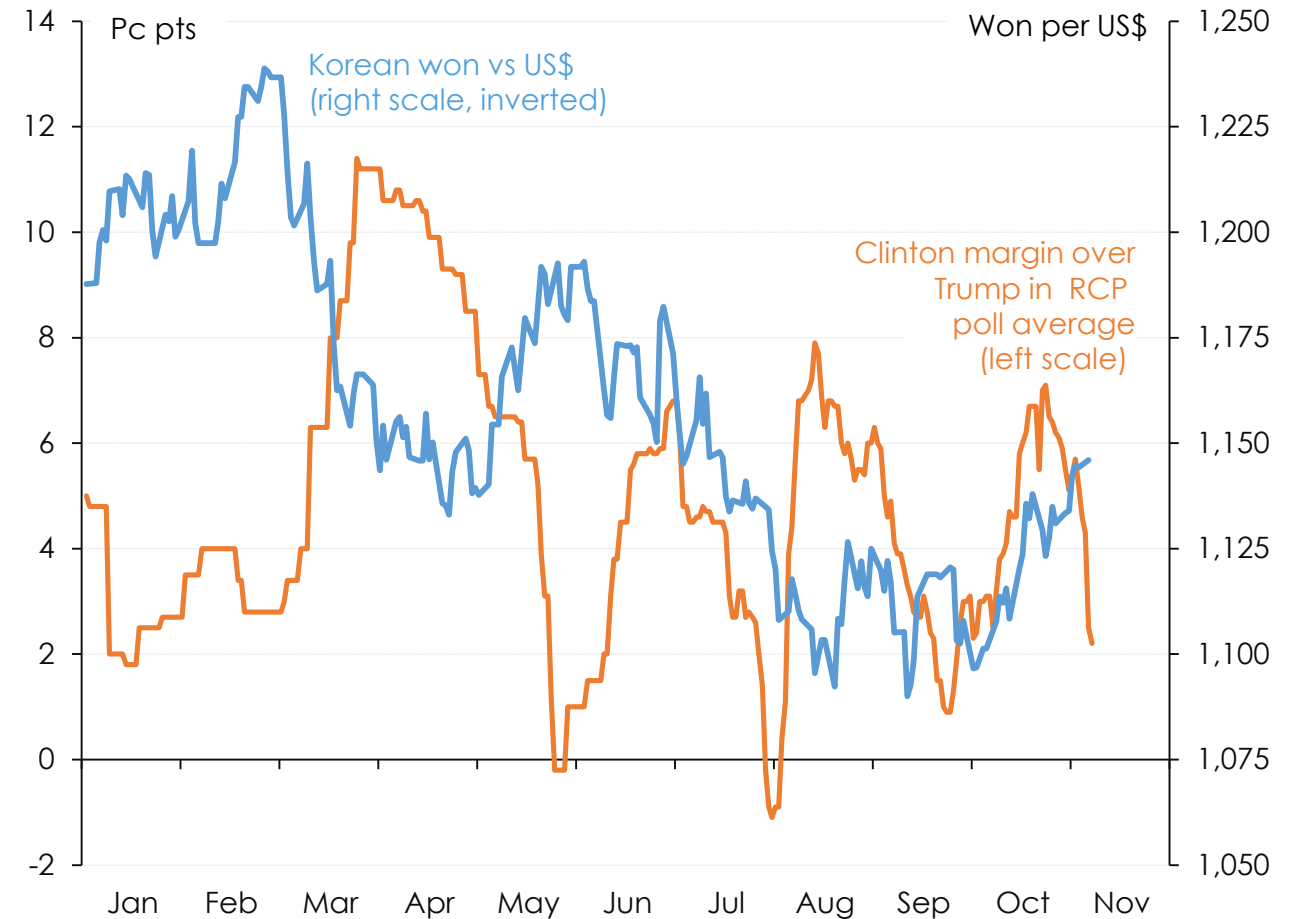## Nate Silver estimate of probability of each candidate winning Presidency

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Financial markets also expect Clinton to win

Clinton's lead over Trump in opinion polls and the Mexican peso

Pc pts

Pesos per US$

- Mexican peso vs US$ (right scale, inverted)
- Clinton margin over Trump in RCP poll average (left scale)

Left axis: 14, 12, 10, 8, 6, 4, 2, 0, -2

Right axis: 16.50, 17.00, 17.50, 18.00, 18.50, 19.00, 19.50, 20.00, 20.50

Months: Jan, Feb, Mar, Apr, May, Jun, Jul, Aug, Sep, Oct, Nov

Clinton's lead over Trump in opinion polls and the Korean won

Pc pts

Won per US$

- Korean won vs US$ (right scale, inverted)
- Clinton margin over Trump in RCP poll average (left scale)

Left axis: 14, 12, 10, 8, 6, 4, 2, 0, -2

Right axis: 1,250, 1,225, 1,200, 1,175, 1,150, 1,125, 1,100, 1,075, 1,050

Months: Jan, Feb, Mar, Apr, May, Jun, Jul, Aug, Sep, Oct, Nov
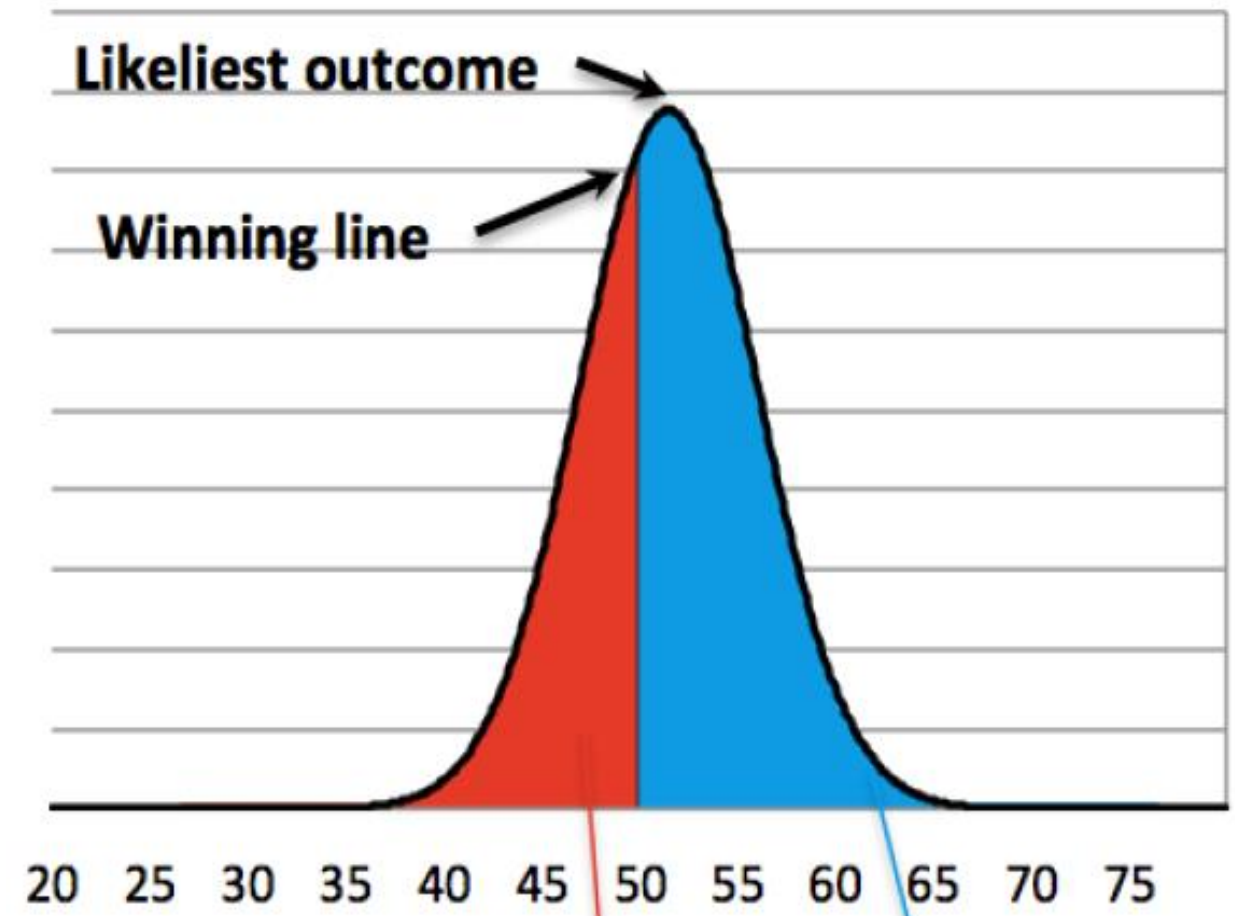
Sources: RealClearPolitics; Thomson Reuters Datastream.

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Polls, models and markets can all be wrong

UK opinion polls in the lead-up to the 'Brexit' referendum on 23rd June

Assessed probability of 'Remain' vs 'Leave' as at 21st June
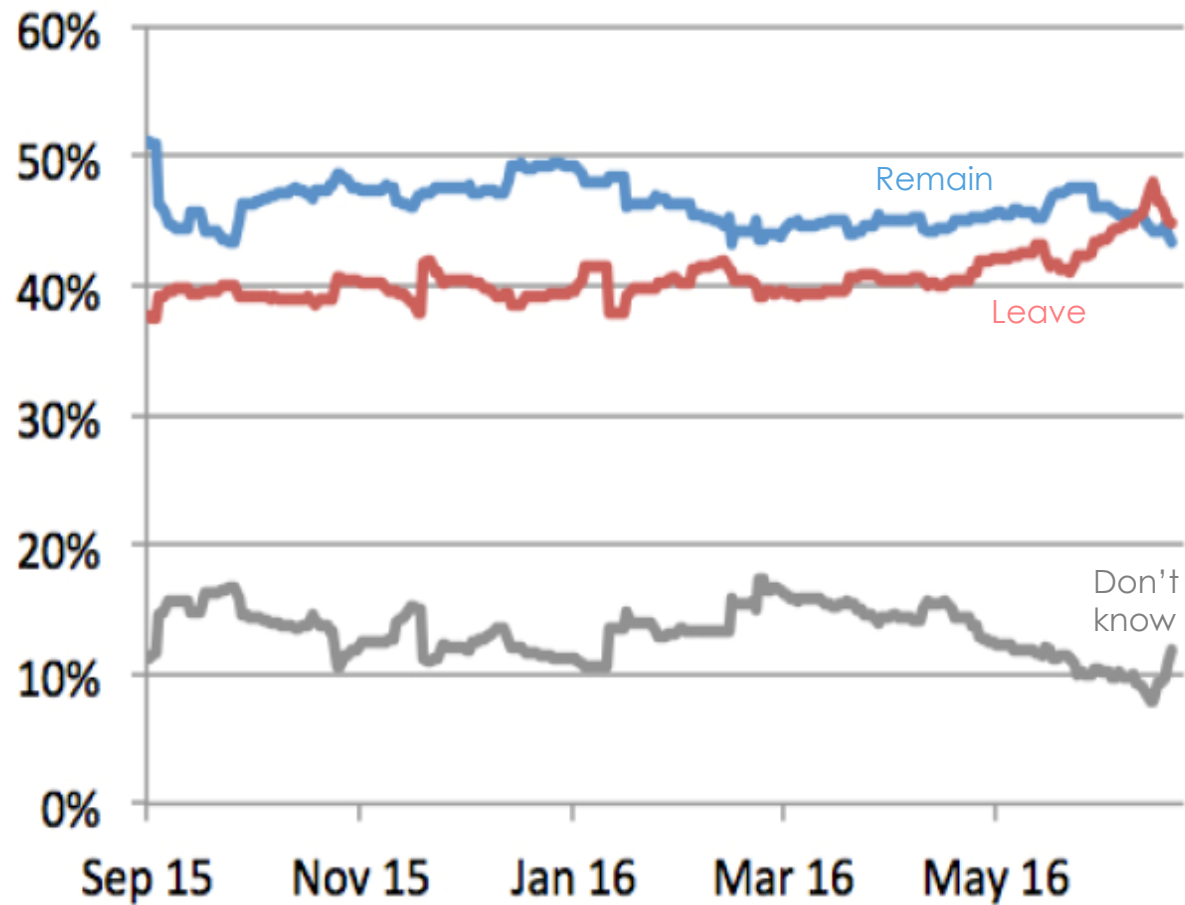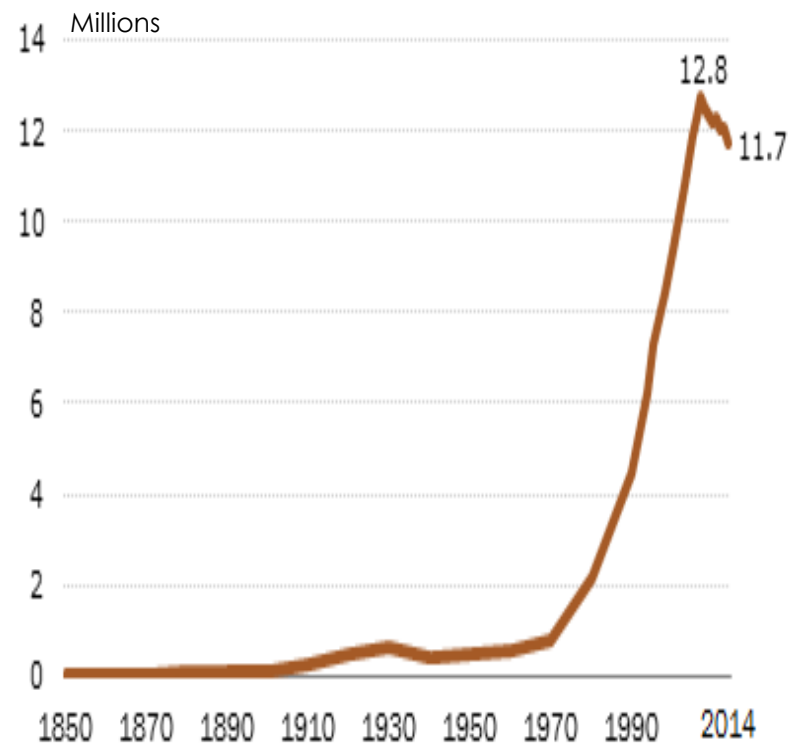

Source: Number Cruncher Politics.

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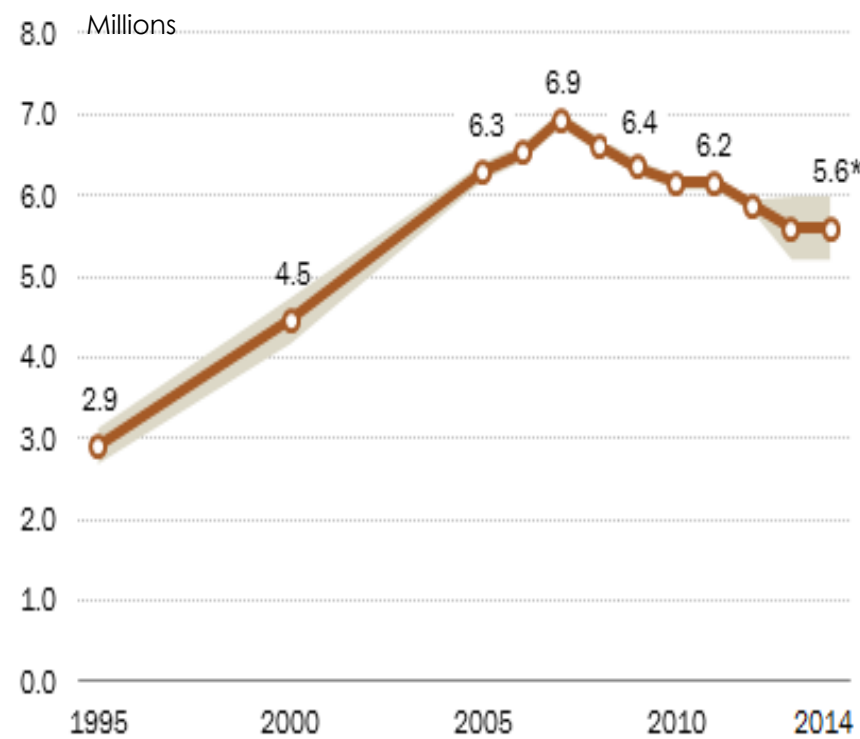# What to expect from a Trump Administration – in Donald Trump's own words

❑ "Nobody knows the system better than me, which is why I alone can fix it"

❑ "We must immediately suspend immigration from any nation that has been compromised by terrorism until such time as proven vetting mechanisms have been put in place"

❑ "We are going to build a great border wall to stop illegal immigration, to stop the gangs and the violence, and to stop the drugs from pouring into our communities"

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Actually, more people have been moving from the US to Mexico than the other way round since the financial crisis
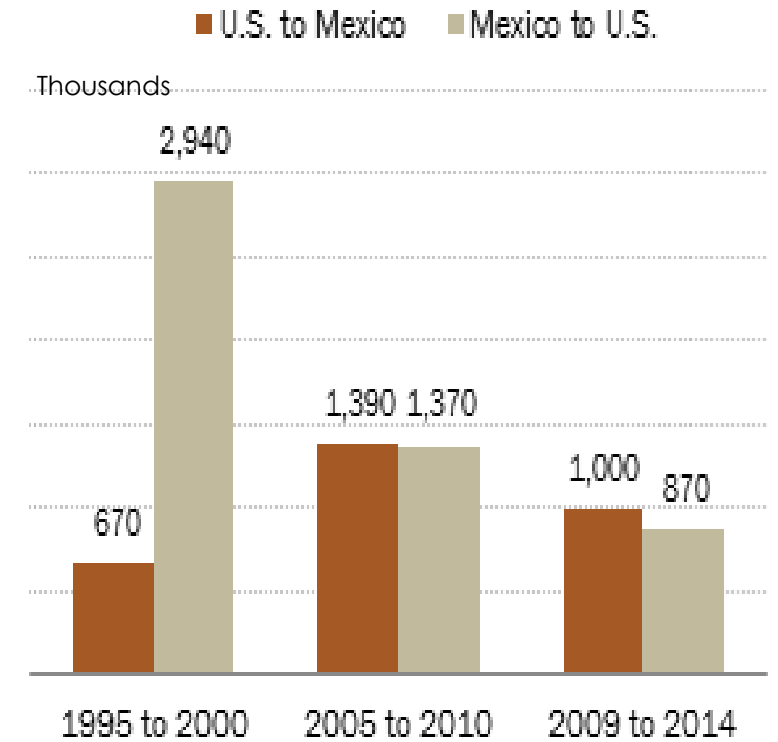
Mexican immigrant population in the US

Millions

12.8	
11.7	

(x-axis: 1850, 1870, 1890, 1910, 1930, 1950, 1970, 1990, 2014)
(y-axis: 0, 2, 4, 6, 8, 10, 12, 14)

Mexican unauthorized population in the US

Millions

2.9, 4.5, 6.3, 6.9, 6.4, 6.2, 5.6*

(x-axis: 1995, 2000, 2005, 2010, 2014)
(y-axis: 0.0, 1.0, 2.0, 3.0, 4.0, 5.0, 6.0, 7.0, 8.0)

Immigration between the US and Mexico

■ U.S. to Mexico   ■ Mexico to U.S.

Thousands

	1995 to 2000	2005 to 2010	2009 to 2014
U.S. to Mexico	670	1,390	1,000
Mexico to U.S.	2,940	1,370	870

"I will present the facts plainly and honestly … We will honour the American people with the truth, and nothing else"
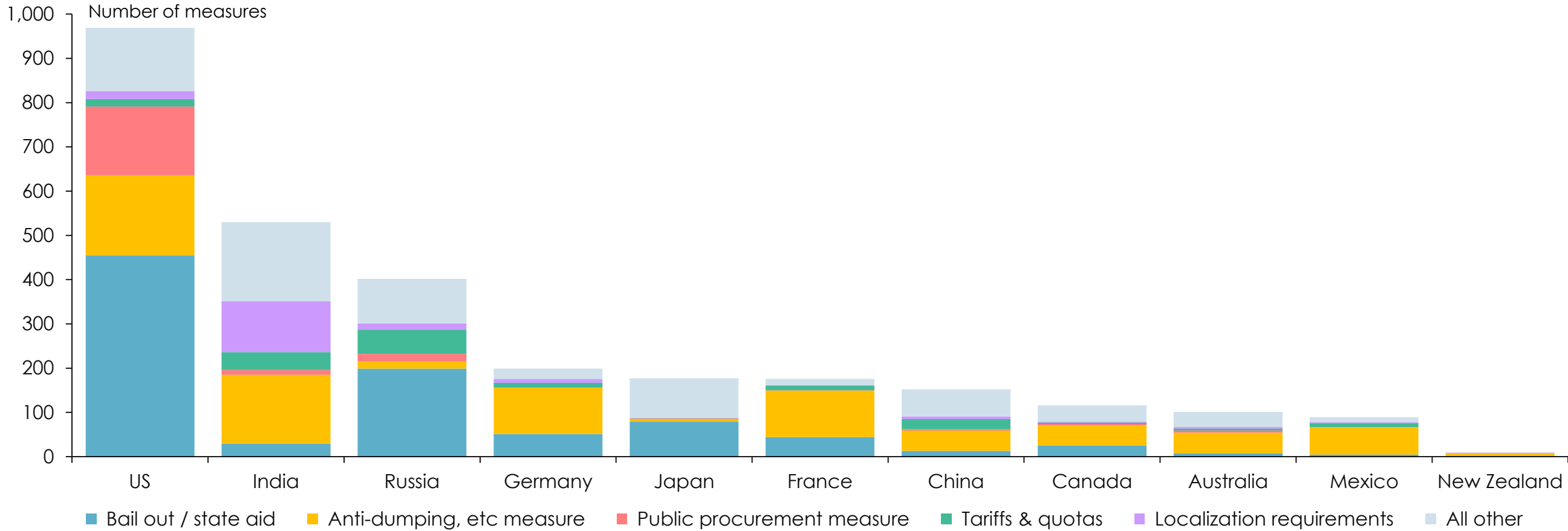
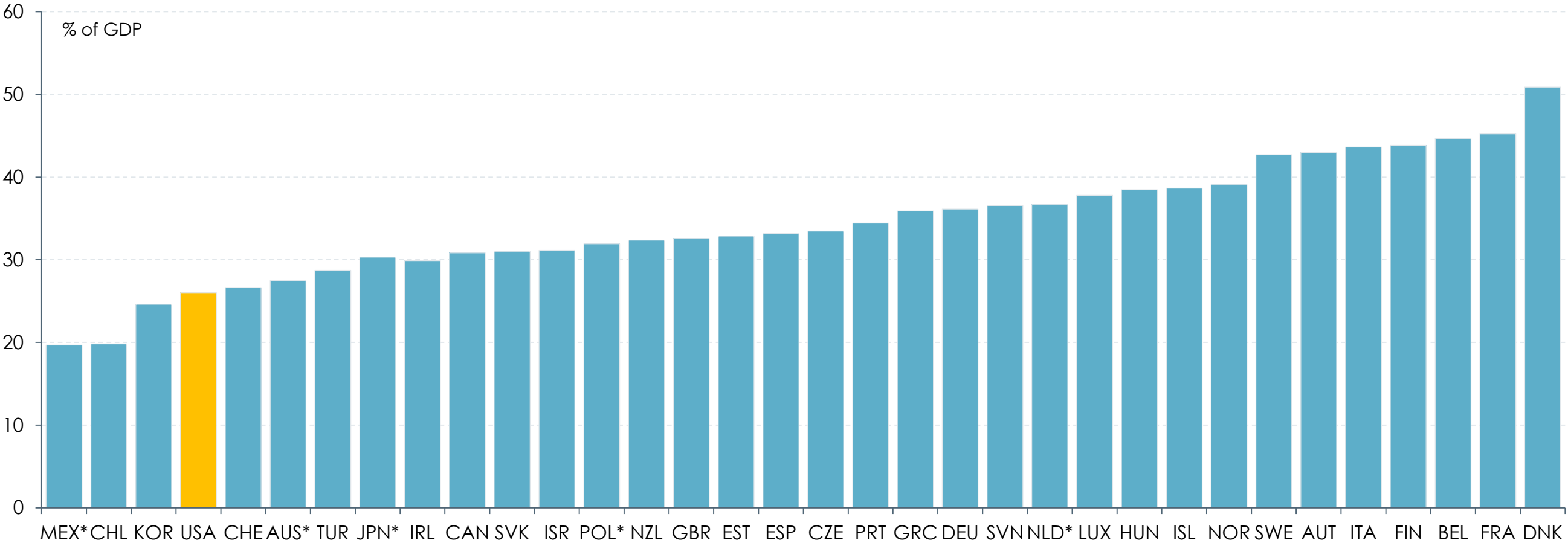— Donald Trump, acceptance speech, Republican National Convention, Cleveland Ohio, 21st July 2016

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❑ "I have made billions of dollars in business making deals – now I'm going to make our country rich again. I am going to turn our bad trade agreements into great ones … I will make individual deals with individual countries … We are going to enforce all trade violations, including through the use of taxes and tariffs, against any country that cheats … Our horrible trade agreements with China and many others, will be totally renegotiated. That includes renegotiating NAFTA to get a much better deal for America – and we'll walk away if we don't get the deal that we want"

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Actually, the US has imposed more trade-restricting measures than any other country since the financial crisis

Anti-trade measures introduced since 2008 – selected countries

Number of measures

Legend: Bail out / state aid · Anti-dumping, etc measure · Public procurement measure · Tariffs & quotas · Localization requirements · All other

Countries (left to right): US, India, Russia, Germany, Japan, France, China, Canada, Australia, Mexico, New Zealand

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❑ "America is one of the highest-taxed nations in the world … I have proposed the largest tax reduction of any candidate who has declared for the presidential race this year … Middle-income Americans will experience profound relief, and taxes will be simplified for everyone"

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Actually, the US is <u>not</u> 'one of the highest-taxed nations in the world'

Taxation as a pc of GDP – OECD member countries, 2014

"I will present the facts plainly and honestly … We will honour the American people with the truth, and nothing else"
— Donald Trump, acceptance speech, Republican National Convention, Cleveland Ohio, 21st July 2016

* Data is for 2013. *Source:* OECD, https://data.oecd.org/tax/tax-revenue.htm

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❑ "When I am President … with these new economic policies, trillions of dollars will start flowing into our country … We will build the roads, highways, bridges, tunnels, airports, and the railways of tomorrow. This, in turn, will create millions more jobs"

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Possible implications of a Trump victory for financial markets

One assessment based on market movements during the first Presidential debate

❑ US stock market falls by 12%

❑ UK and Asian stock markets fall by 10-15%

❑ US 10 year bond yields rise by about ¼ pc point

❑ Mexican peso down by 25-30%

❑ Canadian dollar down by 10%

❑ Currencies of other countries with free-trade-agreements with the US (including Korea and Australia) also lower

❑ Oil prices down by US$4 per barrel

– Justin Wolfers (University of Michigan) and Eric Zitzewitz (Dartmouth College),
What do financial markets think of the 2016 election?, Brookings Institution, October 2016

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By an overwhelming margin, US business economists think that Donald Trump's policies would have a negative impact on the US economy

Assessment of which candidate would do best job of managing the US economy
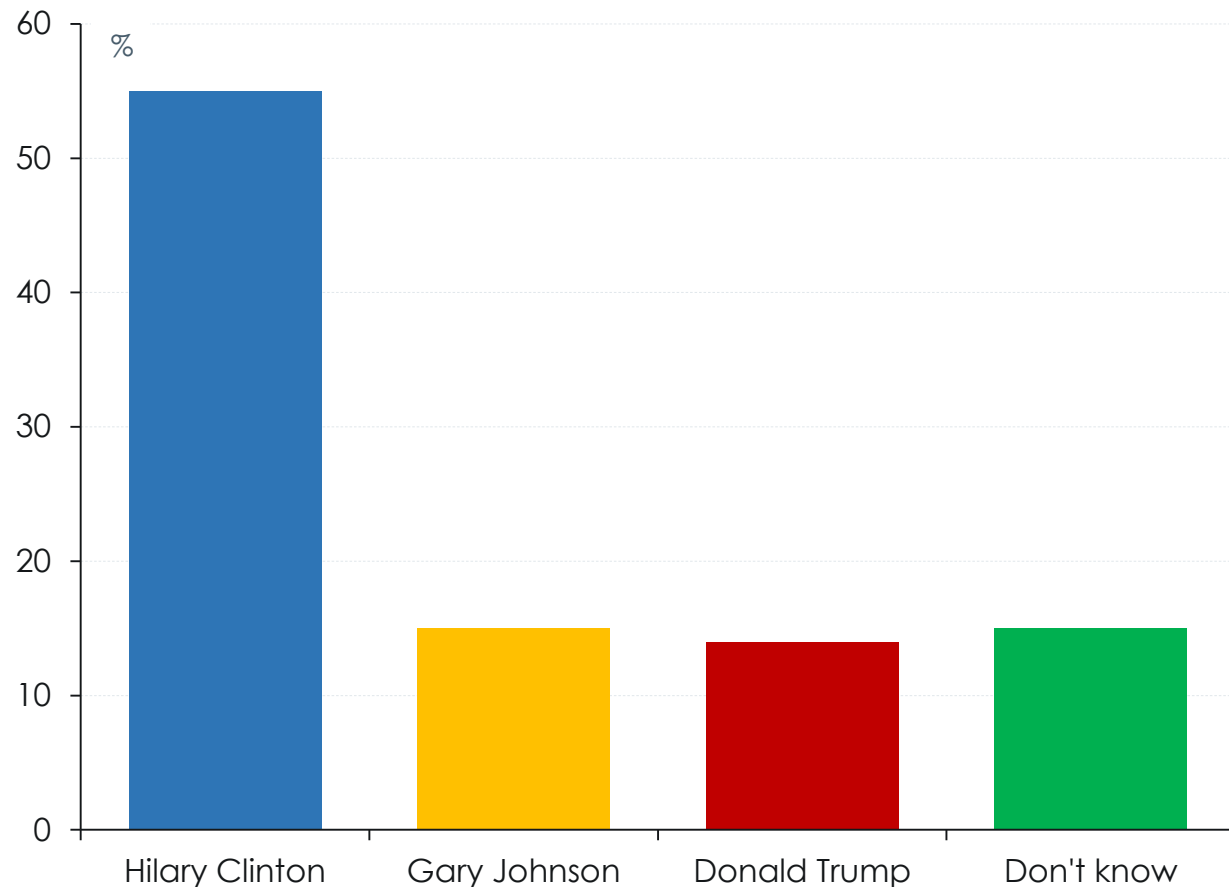
Assessment of impact of major party candidates' policies on the US economy
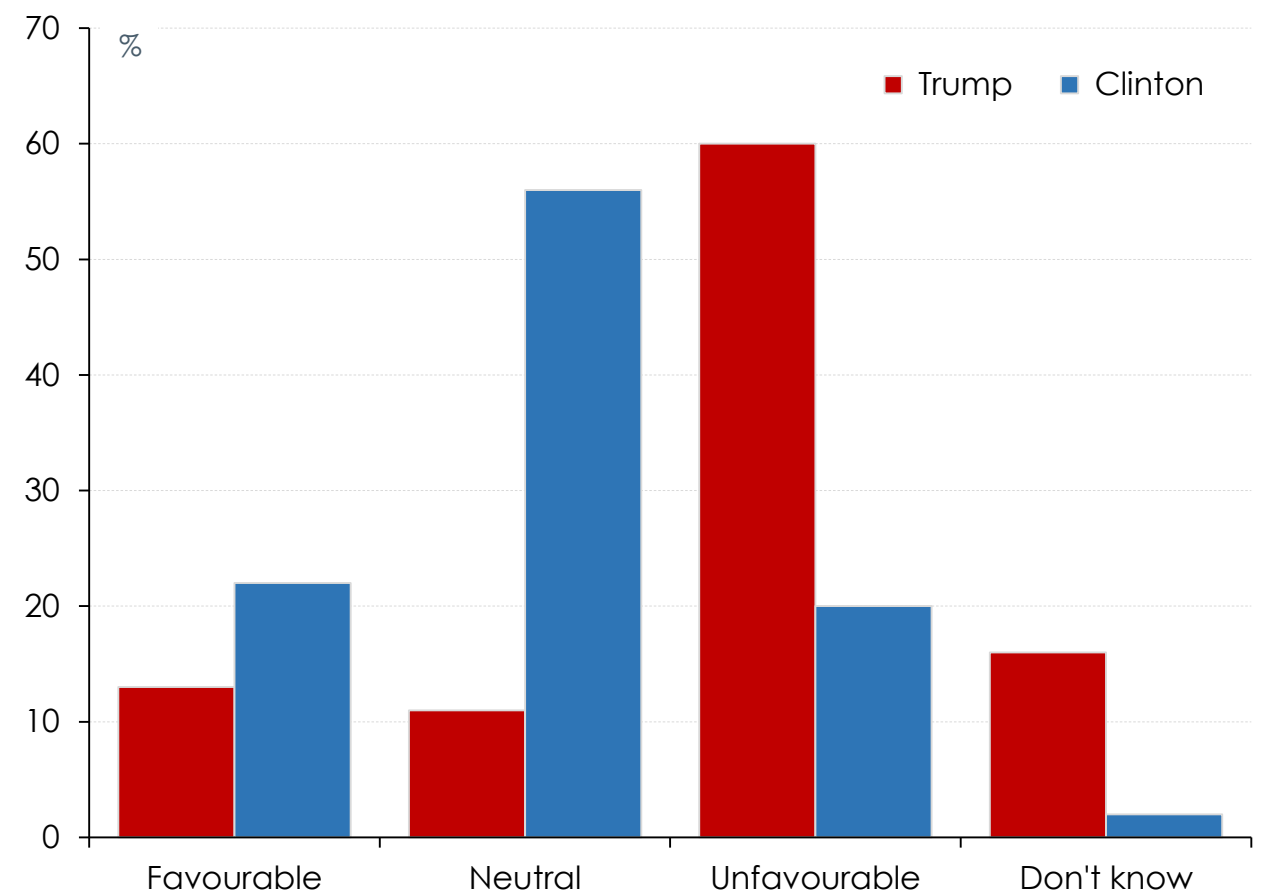
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Hillary Clinton's tax and spending proposals would do nothing to improve the US budget deficit – Donald Trump's would make it *much* worse

Twenty-year change in fiscal metrics under alternative policy proposals
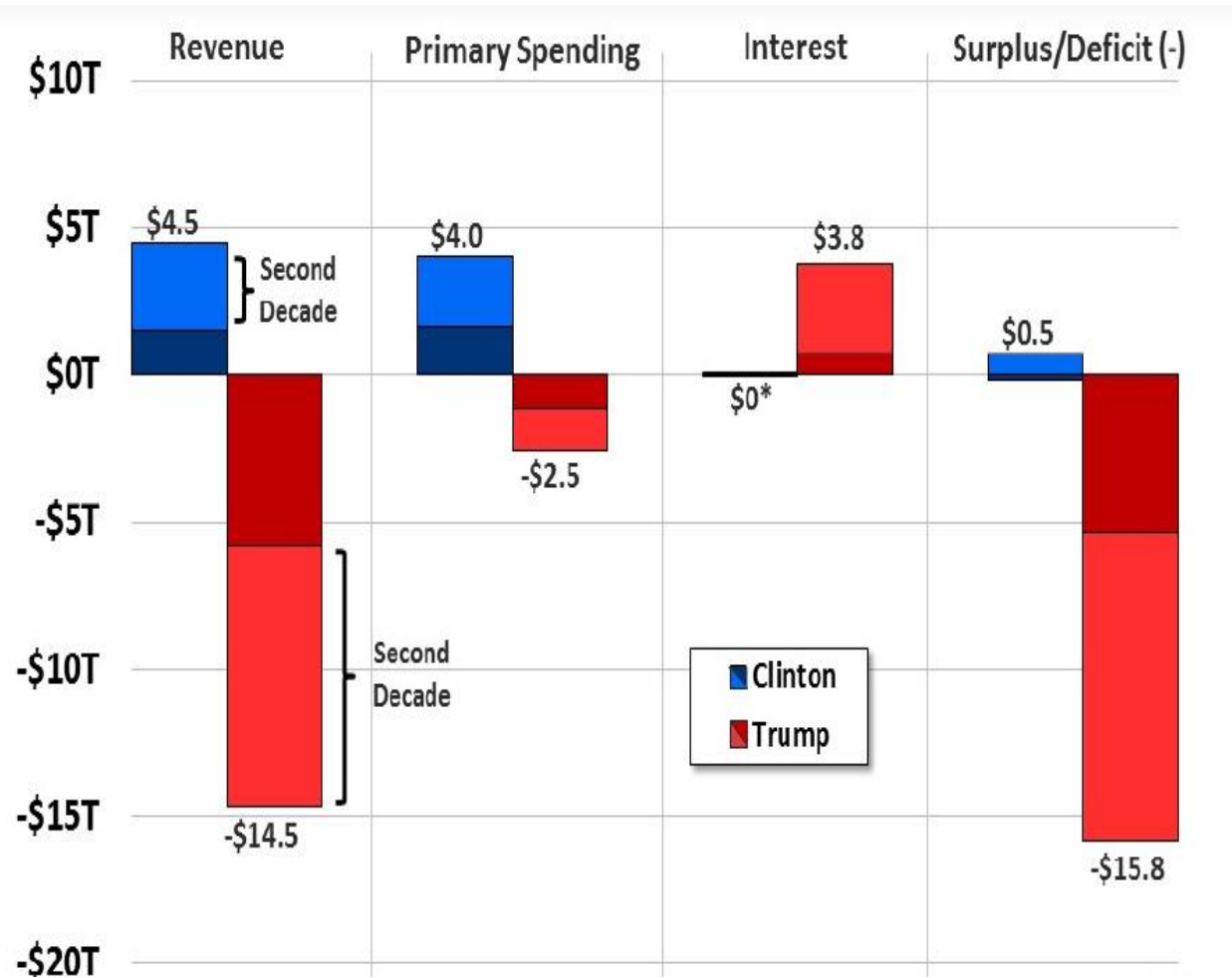
US federal debt over the next twenty years under alternative policy proposals
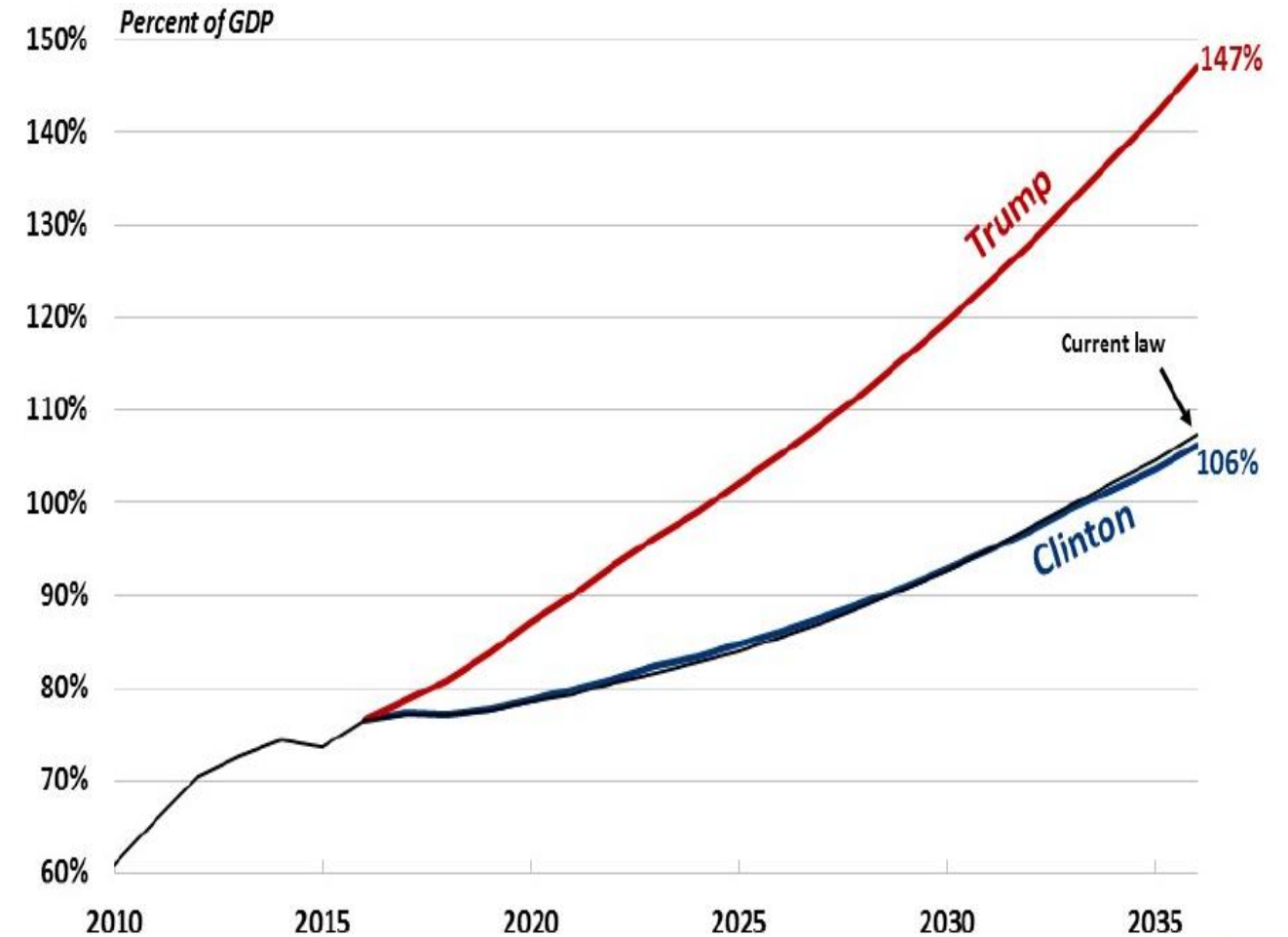
Source: Committee for a Responsible Federal Budget (CFRB), *Looking at the Long Term Under the Candidates' Plans,* 26th October 2016.

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Donald Trump's trade policies would have significant adverse consequences for the US and other economies

Key elements of Donald Trump's trade policies

- ❑ **35% tariff on US imports from Mexico**
- ❑ **Name China as a 'currency manipulator', which under existing US law would allow the imposition of tariffs of up to 45% on all US imports from China**
- ❑ **Renegotiate or abrogate existing free trade agreements including (specifically) NAFTA and KORUS**
- ❑ **(Possibly) withdraw from WTO**
- ❑ **Refuse to ratify TPP**

  – *Note:* **Hillary Clinton is also opposed to TPP (now)**

Possible consequences of Donald Trump's trade policies

- ❑ **Assuming Mexico and China retaliated against US tariffs of 35% and 45% with similar measures on US exports,**
  - – **US GDP would be almost 5% lower (than otherwise) by 2019**
  - – **US unemployment would rise to 8.4% in 2018 and 8.6% in 2019**
  - – **US inflation and interest rates would rise**
- ❑ **Mexico's and (even more so) China's retaliatory measures would damage their economies as well as the US'**
- ❑ **And of course considerable damage would also be done to other economies**

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Some other Trump policies which could prove unsettling

❑ **Trump's attitude to the independence of the US Federal Reserve**

- Donald Trump has said Federal Reserve Chair Janet Yellen "should be ashamed of herself" for "keeping interest rates artificially low to make President Obama look good"

- Trump has indicated that as President he would not re-appoint Yellen when her current term as Fed Chair expires in January 2018

- but since two of the seven positions on the Federal Reserve Board are currently vacant, as President Trump be able to re-shape the Fed to his liking almost immediately

- Trump is also supports the 'audit the Fed' movement, which would give Congress the power to second-guess monetary policy decision-making

- all of which would likely undermine confidence in the Fed and lead to higher long-term interest rates

❑ **Trump's attitude to US military alliances**

- Donald Trump has cast doubt on the US' willingness to meet commitments to long-standing allies in Europe and Asia, saying that would depend on whether those nations have "fulfilled their commitments" to the US

- Trump has also suggested that countries such as Japan, South Korea and Saudi Arabia should acquire their own nuclear weapons

- in these and other ways a Trump Administration is likely to see diminished US influence in both Europe and East Asia, ceding power to Russia and China respectively …

- heightening geo-political uncertainty …

- and prompting other nations to contemplate increasing their own defence spending

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The White House isn't the only house up for grabs on November 8th

❑ **Democrats could also take control of the Senate**
  - in the outgoing Senate, Republicans have a 54-46 majority
  - 34 Senate places are being contested at this election – 24 currently held by Republicans and 10 by Democrats
  - if Hillary Clinton wins the Presidential race, the Democrats only need to take 4 seats from Republicans in order to control the Senate (with Vice-President Tim Kaine having a casting vote)
  - Democrats are currently ahead in 6 of the contests for seats currently held by Republicans

❑ **It's much less likely that Democrats could win control of the House of Representatives**
  - in the outgoing House of Representatives, Republicans have a 246-189 majority
  - most seats in the House of Representatives are 'safe' for the incumbent party, because of the way electoral boundaries are drawn up by State legislatures
  - current polling suggests Democrats will take at most 15 seats from Republicans – well short of the 29 needed for a majority
  - turnover in House Republican ranks is likely to favour 'Tea Party' and other hard-line elements, making it more difficult for Speaker Paul Ryan to manage his 'side' - and making for even more fractious relationships with the White House

❑ **A Democrat-controlled Senate would push a Clinton Administration further to the left**
  - Democrat-controlled Senate Committees would wield veto power over 'centrist' Cabinet appointments (and appointments to other agencies such as the Federal Reserve
  - left-wing Senators such as Elizabeth Warren and Bernie Sanders will be more able to determine the legislative agenda of a Clinton Administration
  - there's not much difference between the left wing of the Democratic Party and Donald Trump on issues such as trade and the independence of the Fed

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Support for Trump in the US presidential election reflects similar sentiments to the support for 'Leave' in the UK's 'Brexit' referendum

'Brexit vote' by age and 'social class'

	Remain	Leave
18-24	73%	27%
25-34	62%	38%
35-44	52%	48%
45-54	44%	56%
55-64	43%	57%
65+	40%	60%
AB	57%	43%
C1	49%	51%
C2	36%	64%
DE	36%	64%
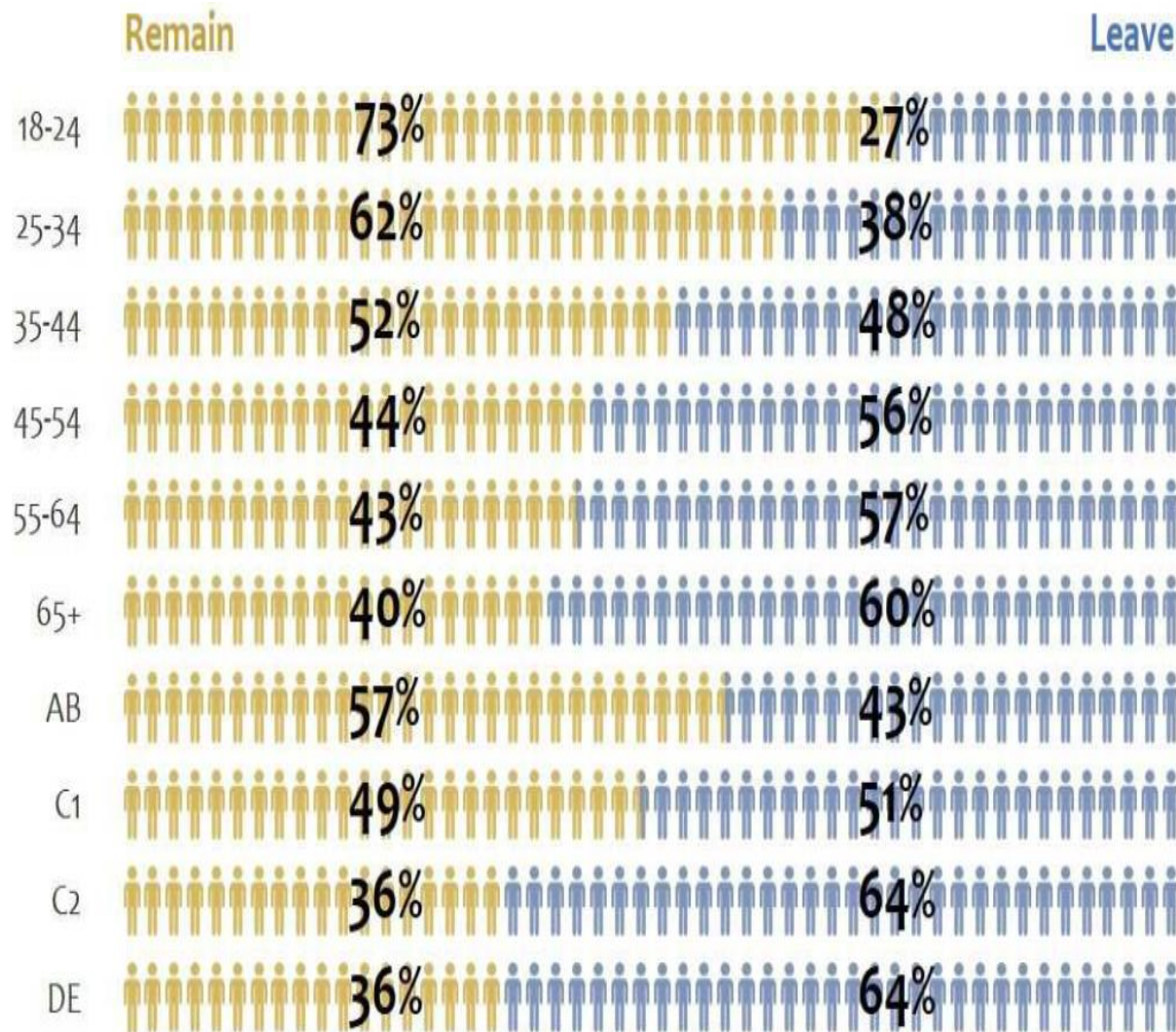
'Brexit vote' by opinion on other issues
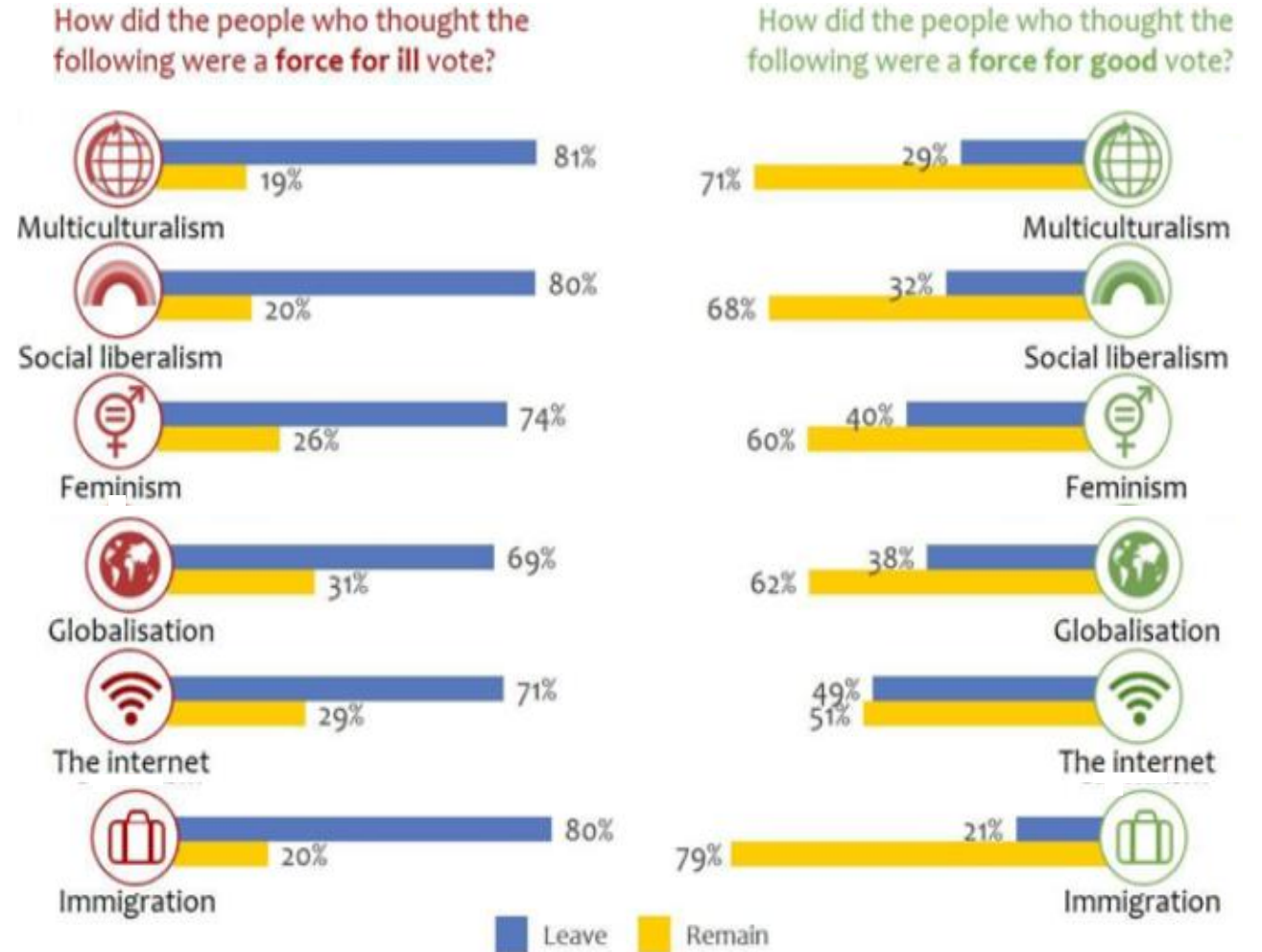
How did the people who thought the following were a force for ill vote?

	Leave	Remain
Multiculturalism	81%	19%
Social liberalism	80%	20%
Feminism	74%	26%
Globalisation	69%	31%
The internet	71%	29%
Immigration	80%	20%

How did the people who thought the following were a force for good vote?

	Leave	Remain
Multiculturalism	29%	71%
Social liberalism	32%	68%
Feminism	40%	60%
Globalisation	38%	62%
The internet	49%	51%
Immigration	21%	79%

Leave — Remain

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… and these political trends aren't unique to the US and UK

… or to either side of the North Atlantic
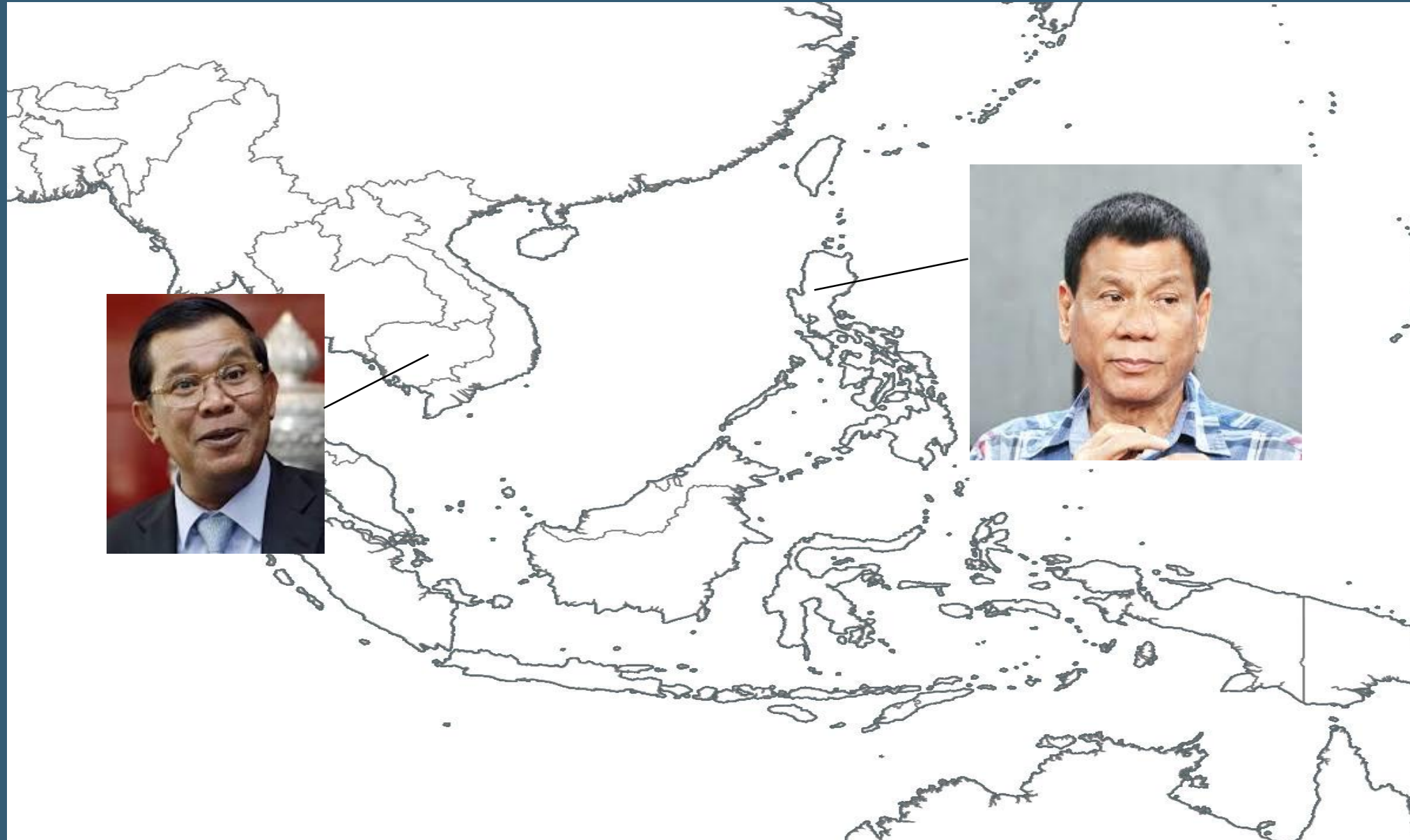
Two charts that help explain 'Brexit', Trump & Sanders, Le Pen and other troubling political trends across the 'developed' world

Growth in real income by percentiles of the global income distribution, 1988-2008

'Middle class' in 'emerging economies'

'Top 1%'

'Working / middle classes' in 'advanced economies'

Cumulative increase in real income

Percentiles of the global income distribution

Level and composition of global inequality, 1870 and 2000

Location

Location

Class

Class

1870

2000

Note: Real income measured in 2005 US dollars (converted at purchasing power parities. Inequality measured by a Theil Index.
Sources: Christoph Lakner and Branko Milanović, *Global Income Distribution: From the Fall of the Berlin Wall to the Great Recession*, World Bank Economic Review August 2015; Branko Milanović, Global Income Inequality by the Numbers: in History and Now - An Overview, World Bank Policy Research Working Paper No 6259, November 2012.

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Income inequality has increased by more in the US and the UK than in most other 'advanced' economies

Upper income groups' share of total pre-tax income in selected 'advanced' economies
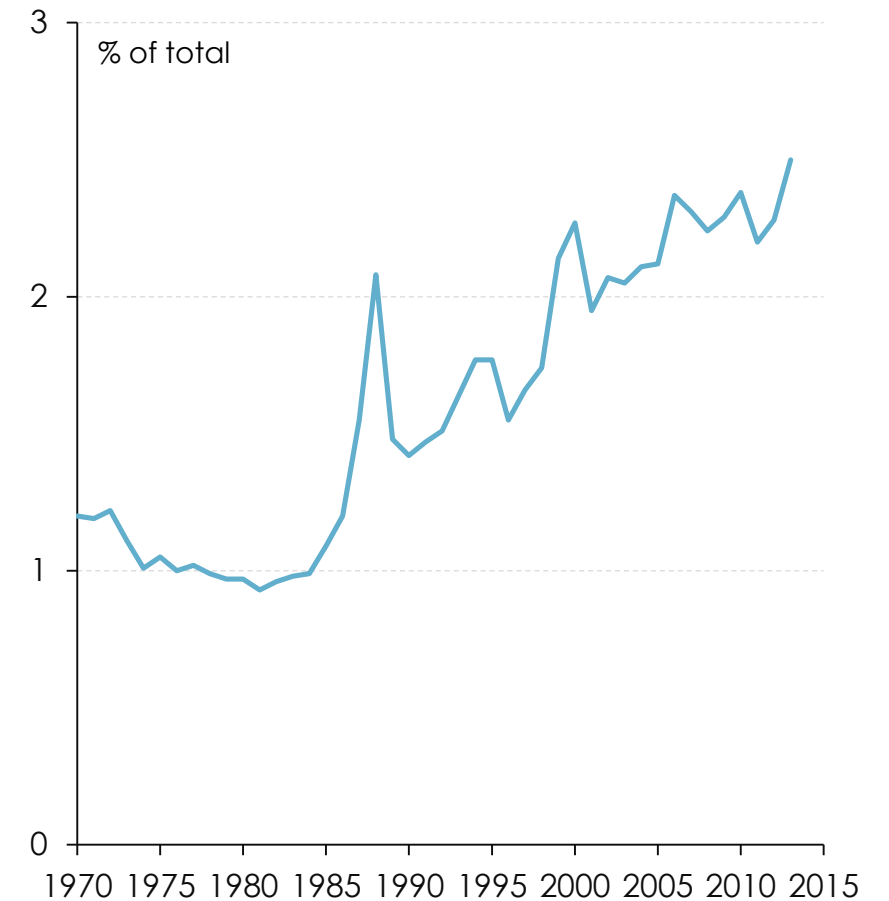

Top 10%
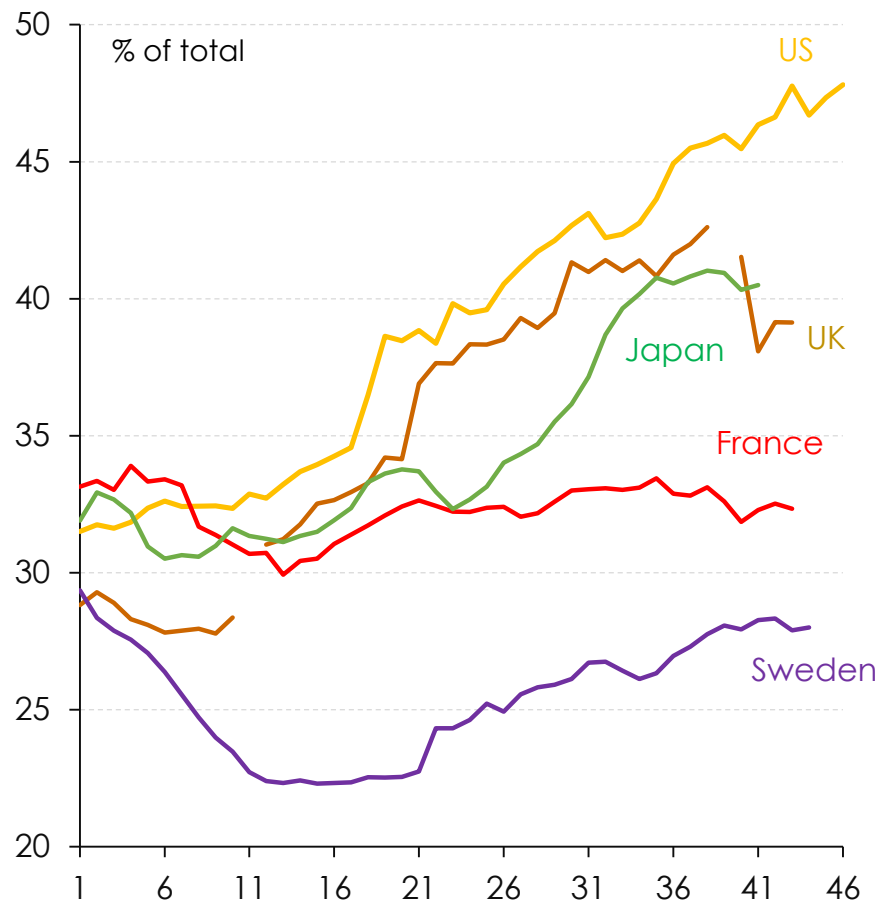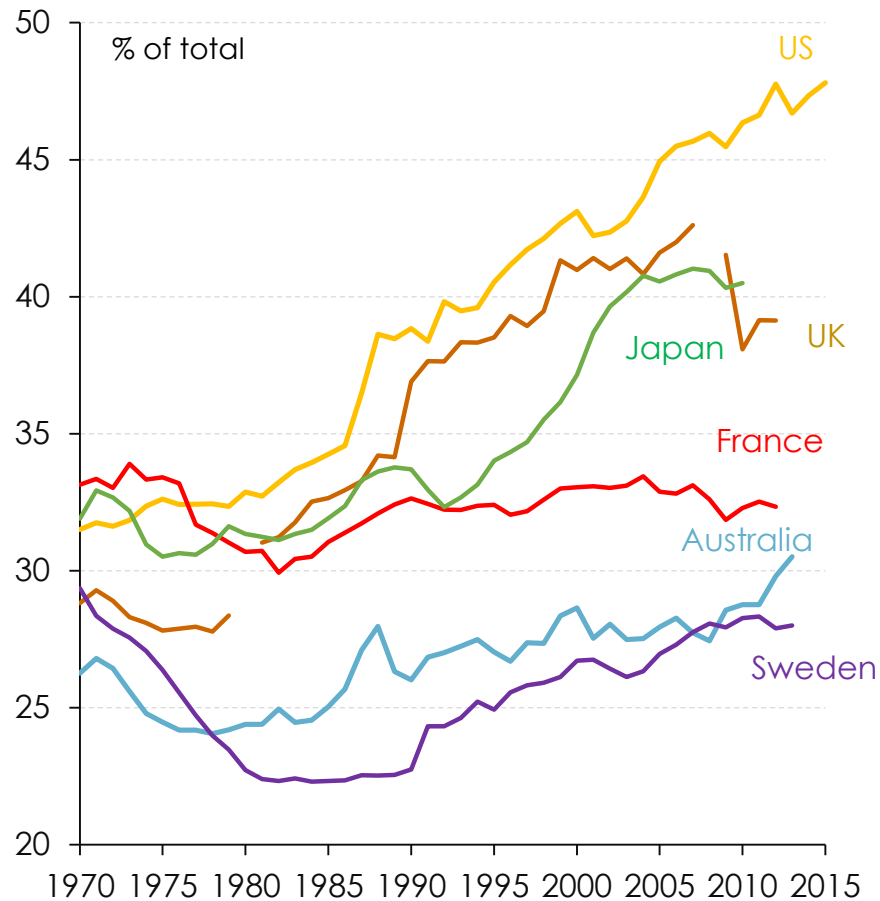
Top 1%
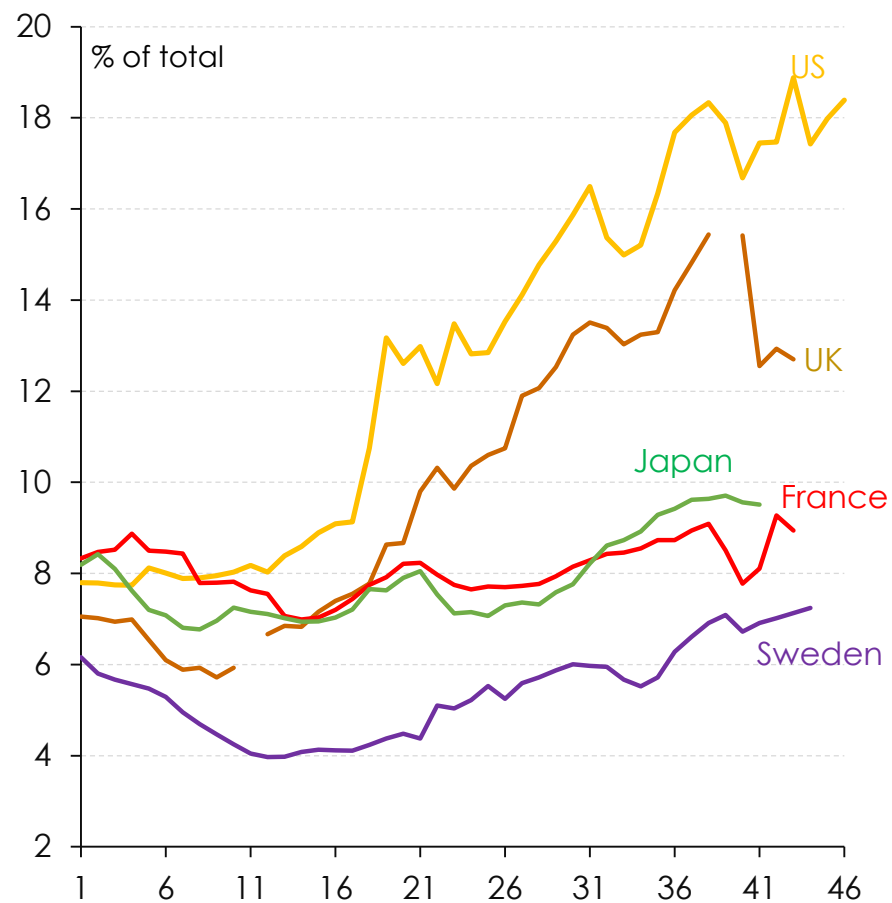
Top 0.1%
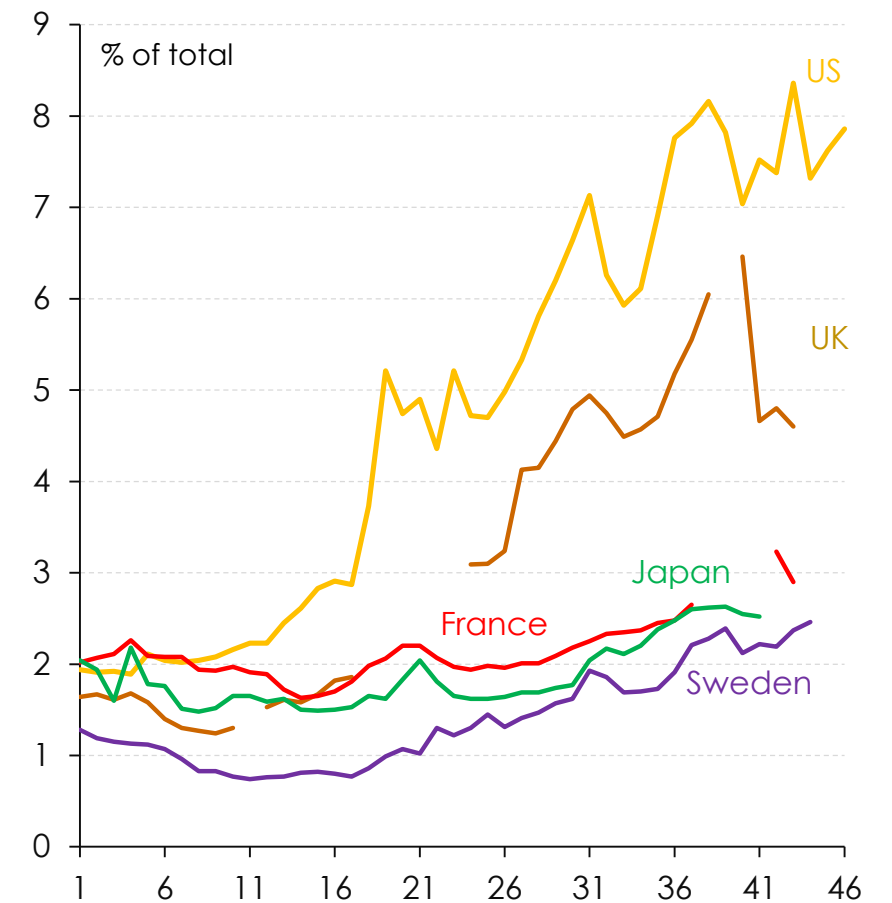
Note: Shares are of pre-tax taxable income as reported to and published by national tax collection agencies.
Sources: Facundo Alvaredo, Tony Atkinson, Thomas Piketty , Emmanuel Saez and Gabriel Zucman, *The World Wealth and Income Database* (http://www.wid.world/)
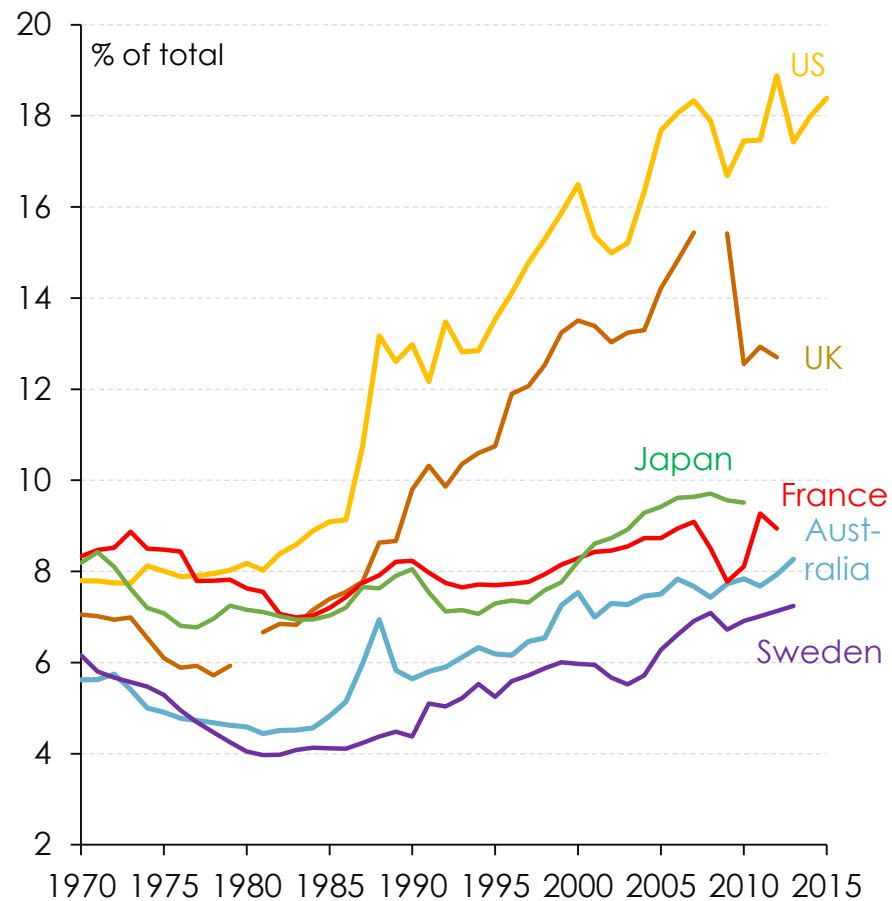
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Imports have risen strongly as a share of US GDP – but so have exports; and both have risen by less than in other 'advanced' economies

Imports as a share of GDP
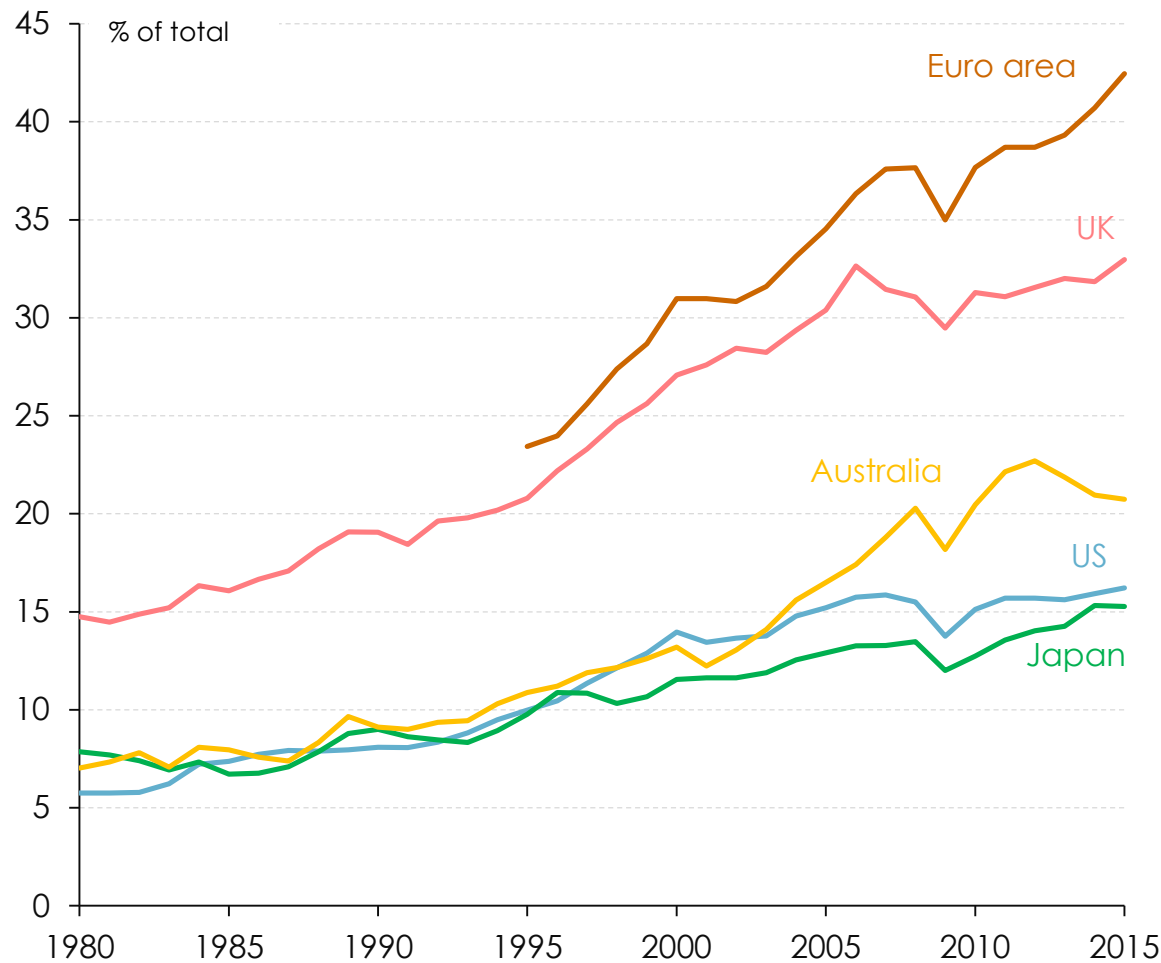
Exports as a share of GDP
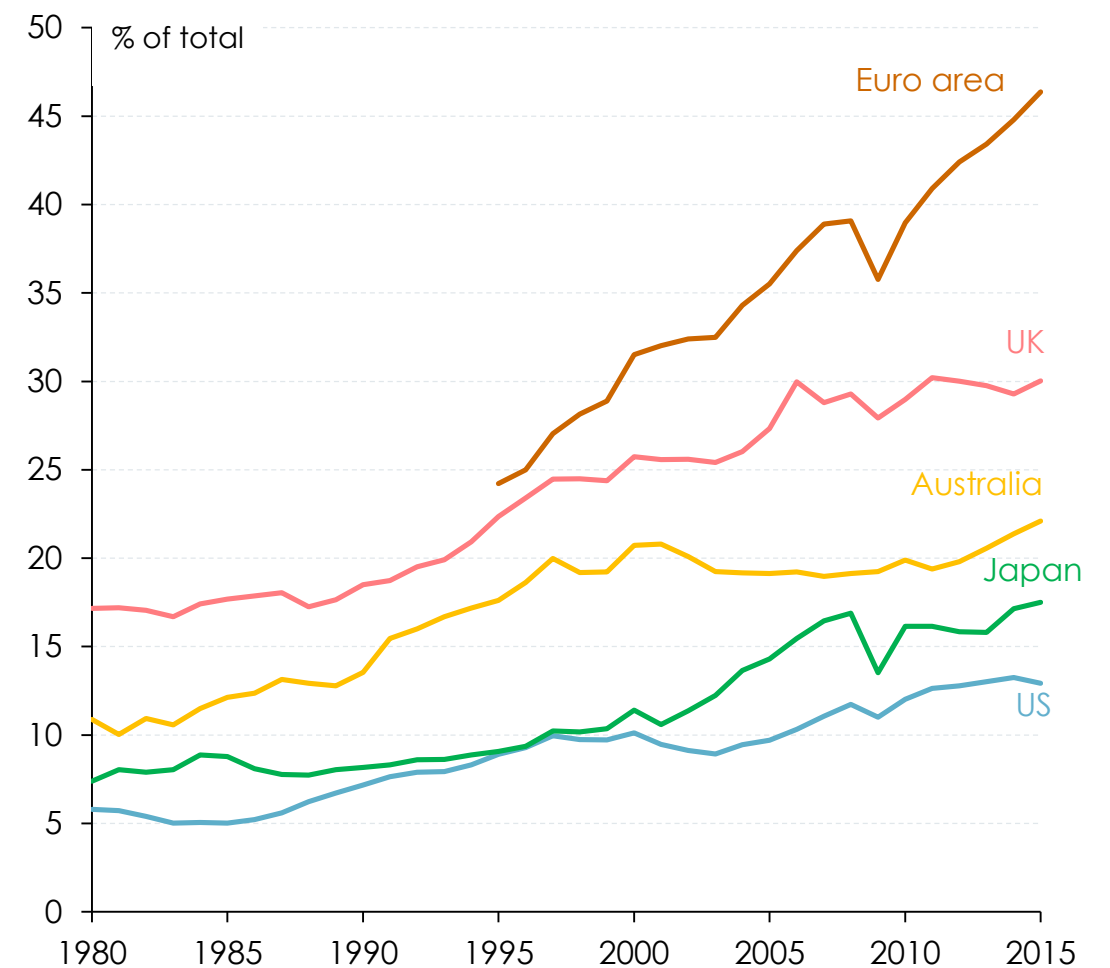
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Employment in US manufacturing fell precipitously between 1997 and 2009 - although a greater number of jobs were created in other sectors

Employment in US manufacturing
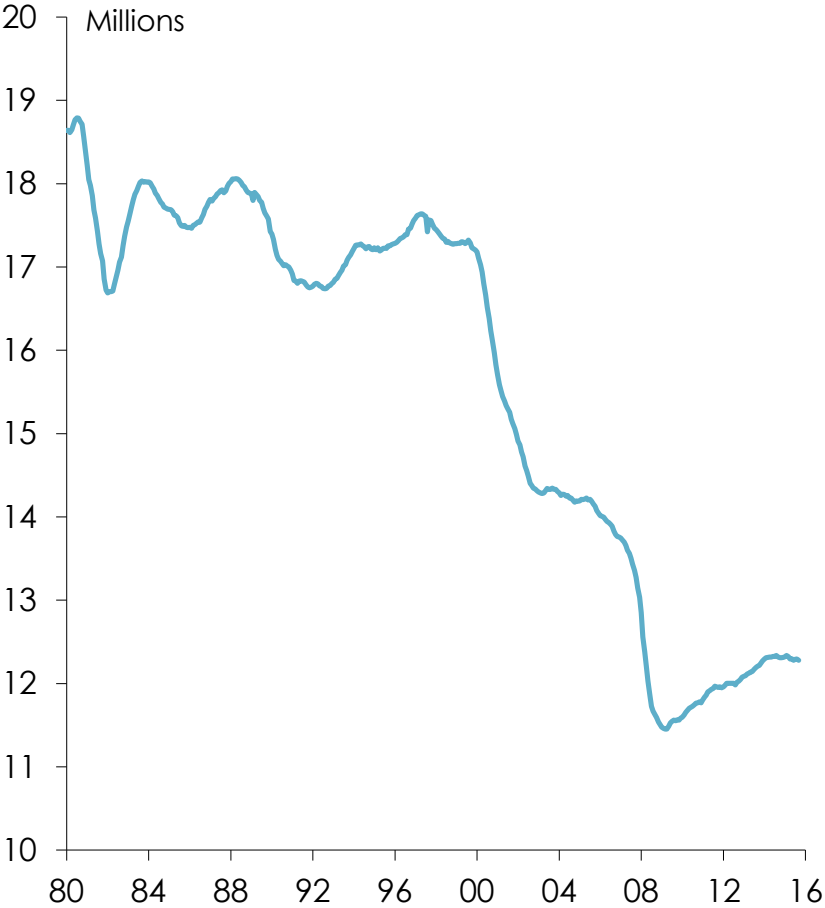
Employment in US manufacturing compared with selected services sectors

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Changes in the US labour market have been tougher on white men than on other demographic groups

Employment as a pc of the working-age population – white men vs other demographic groups
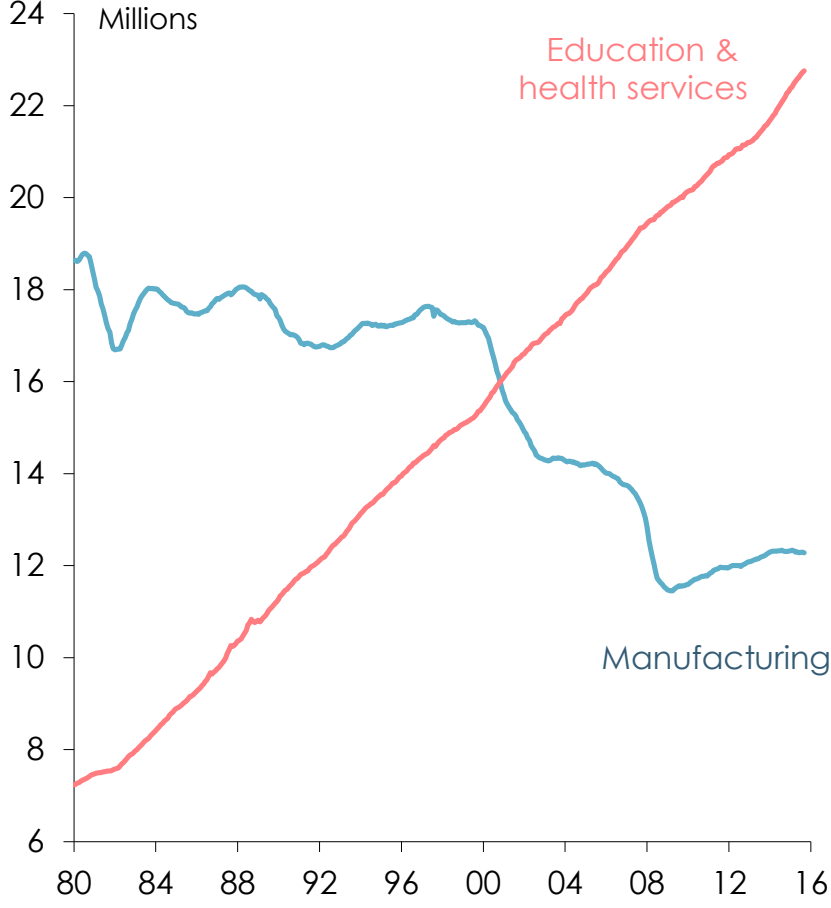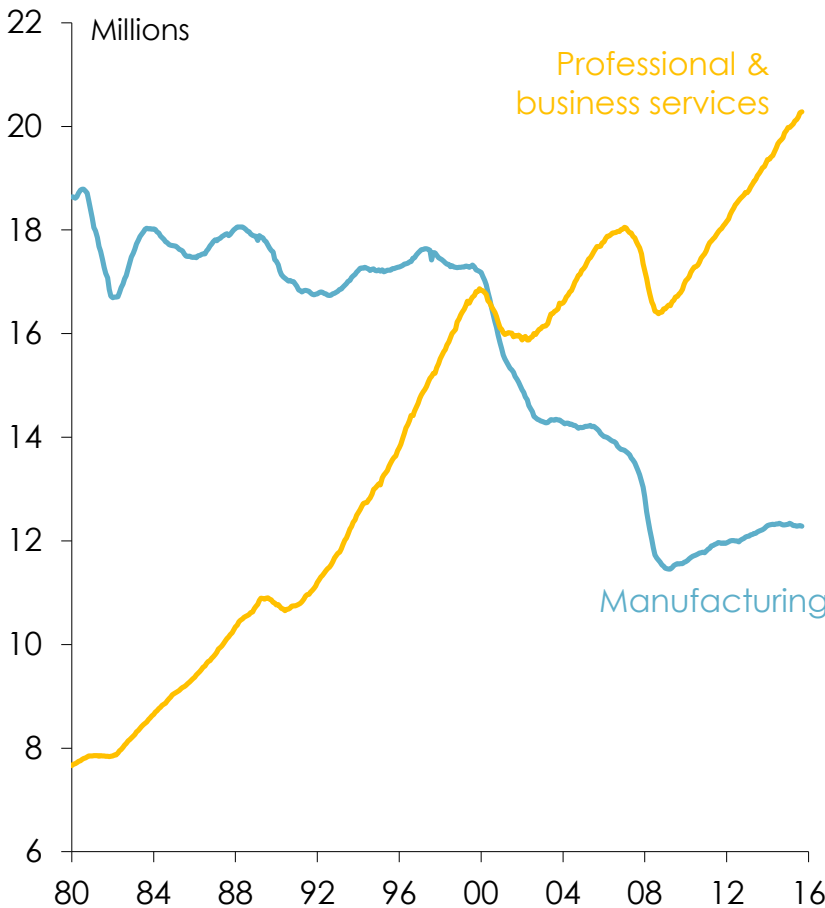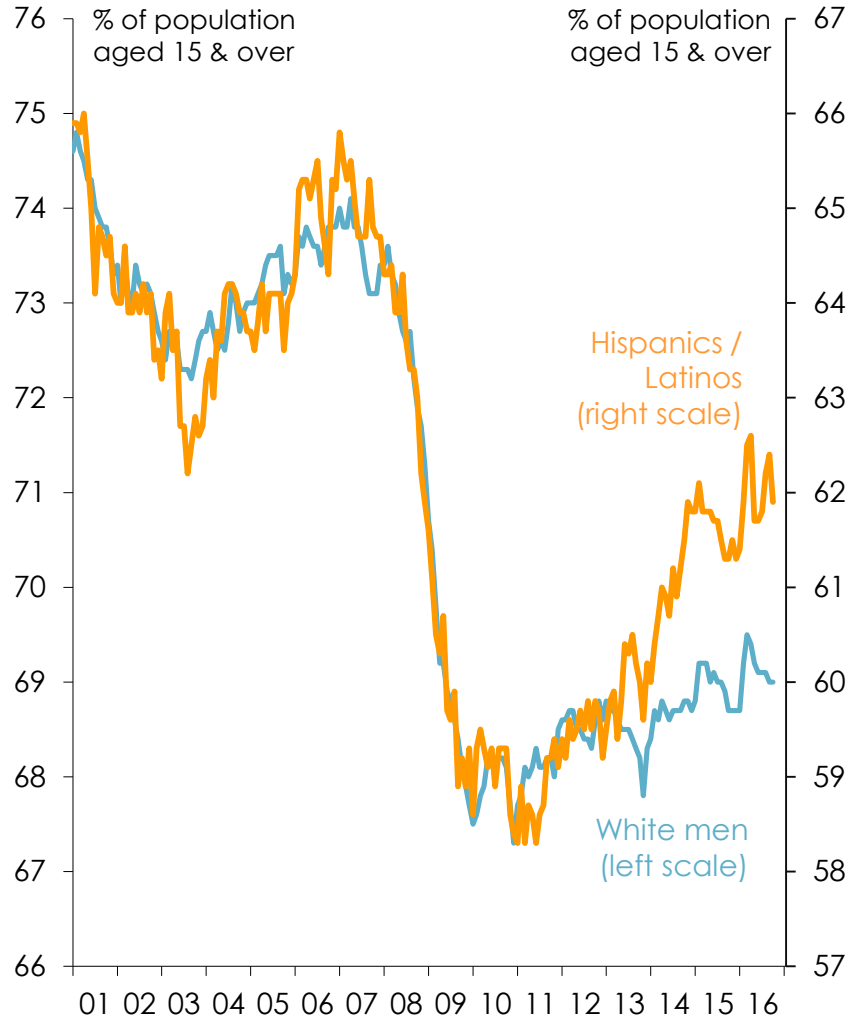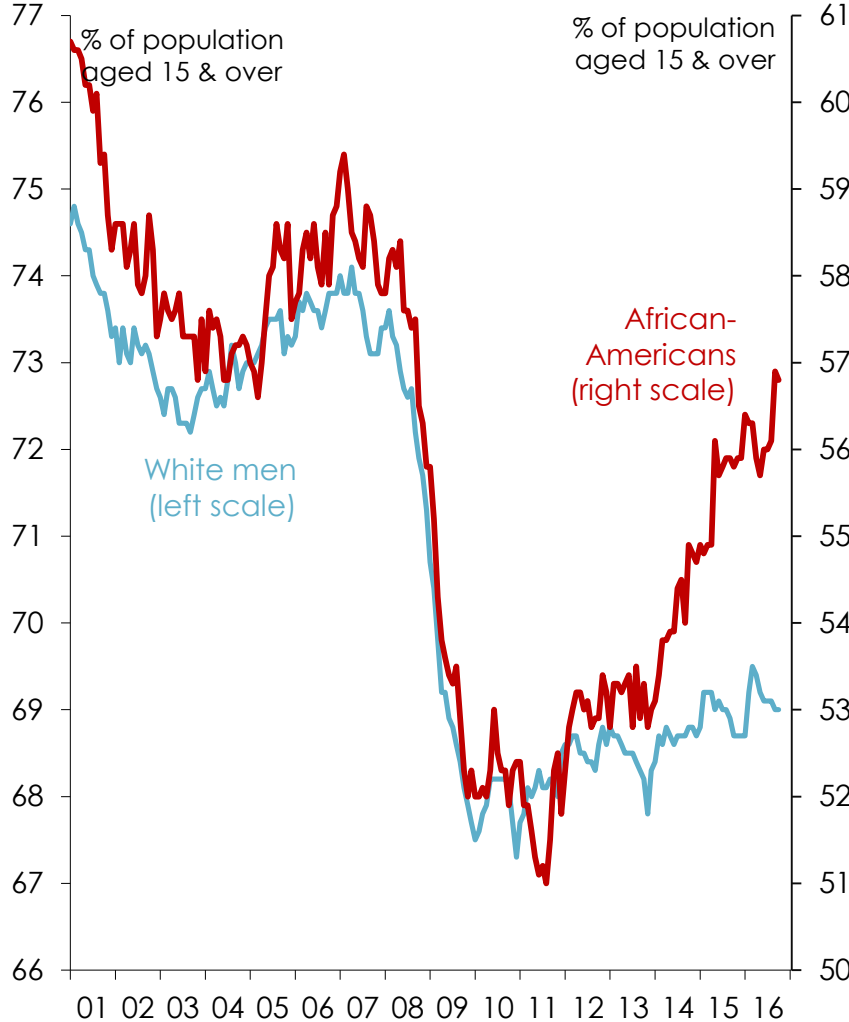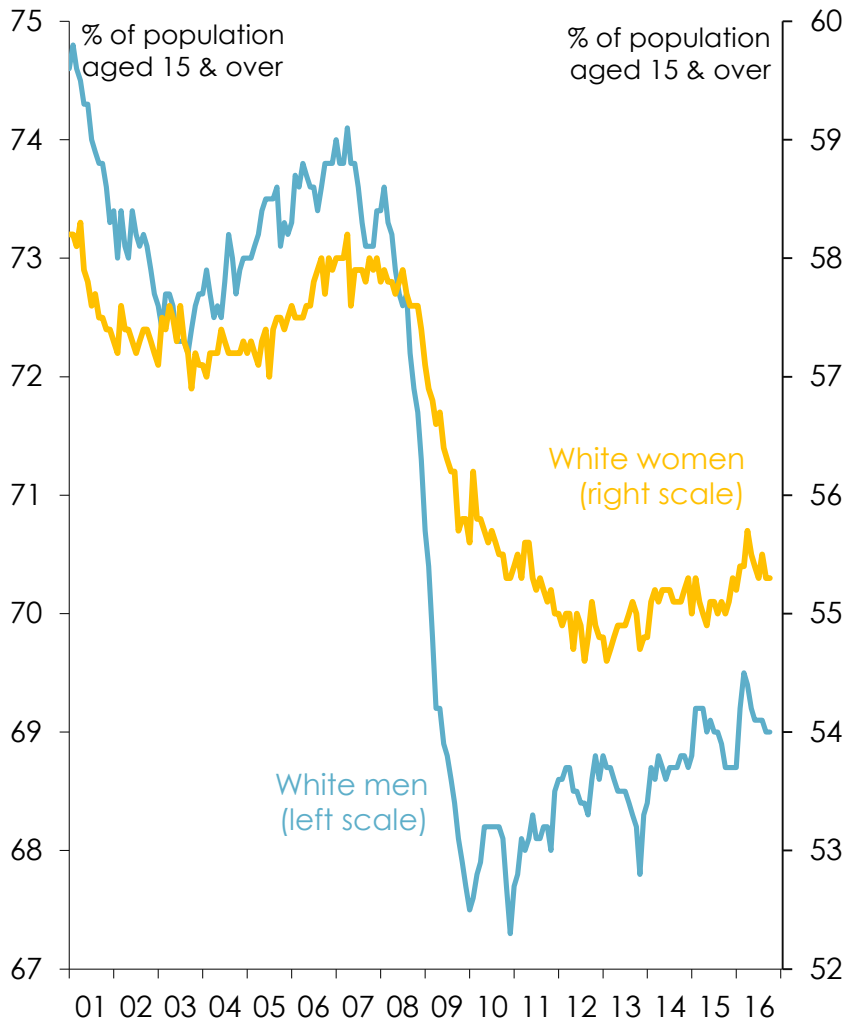
Source: US Bureau of Labor Statistics.

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Men – and especially older, poorly-educated men – have experienced significant declines in their real earnings over the last 15 years

Change in median real earnings, 2000-2015, by demographic group (16 and over)

Change in median real earnings, 2000-2015, by educational attainment (25 and over)

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White middle-aged Americans are dying more often, of self-inflicted harms

Death rates among 45-54 year olds – US whites, Hispanics and other countries
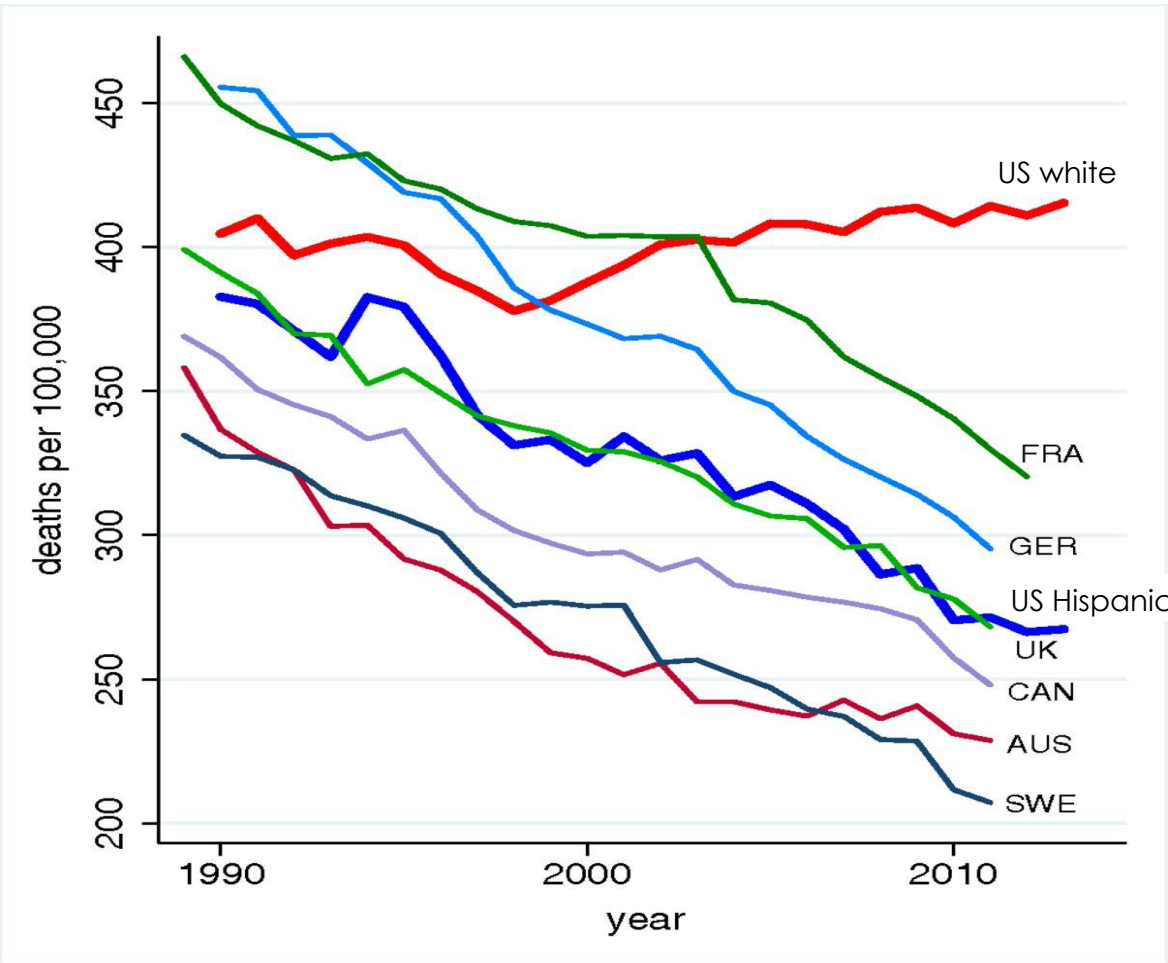
Causes of death, US whites aged 45-54
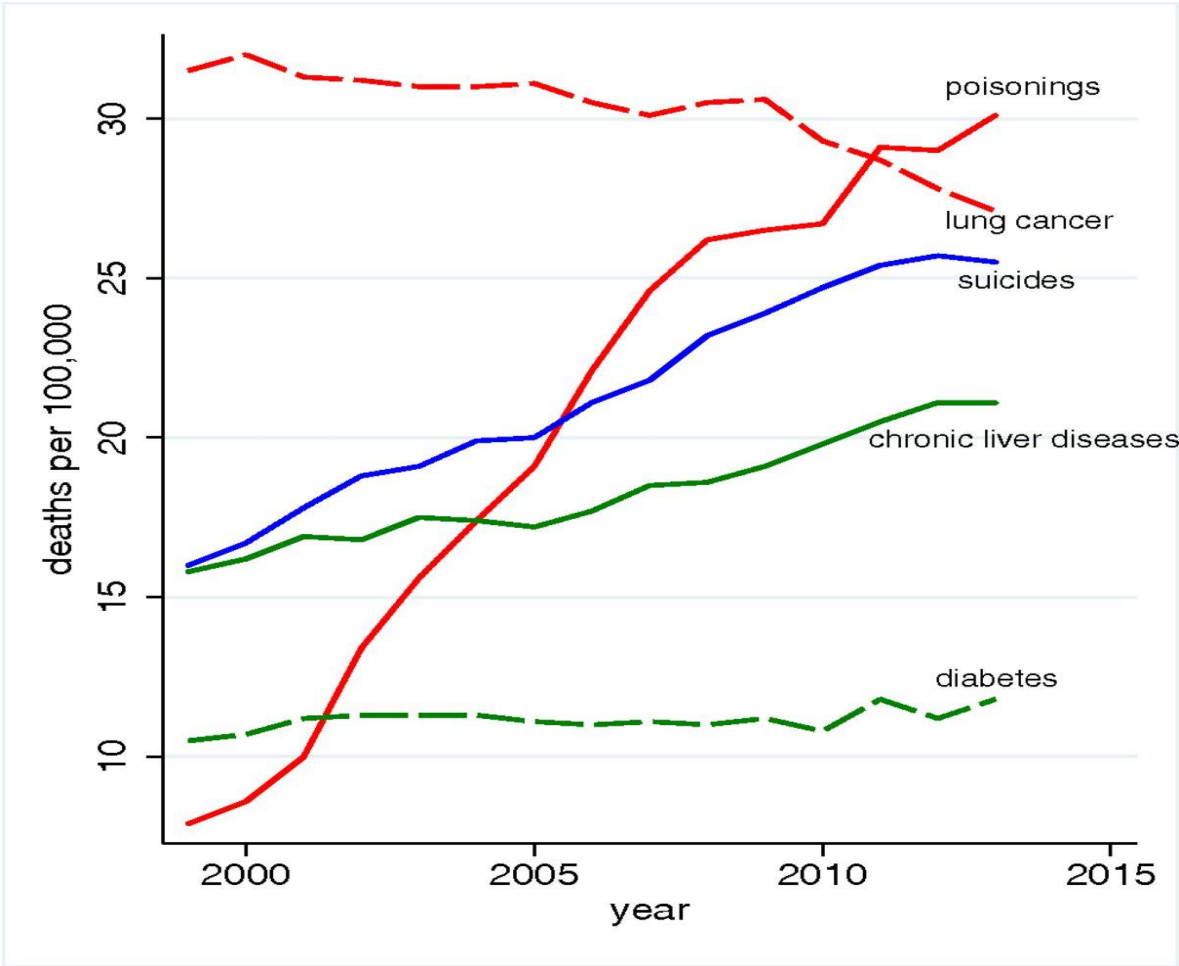
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Australia hasn't been immune from these political trends – although so far Australian populists remain on the fringe …

…. for the most part….

Not having had a recession since the early 1990s has been a major factor in the stronger income growth enjoyed by Australian households

Real GDP growth – Australia vs OECD countries

% change from year earlier
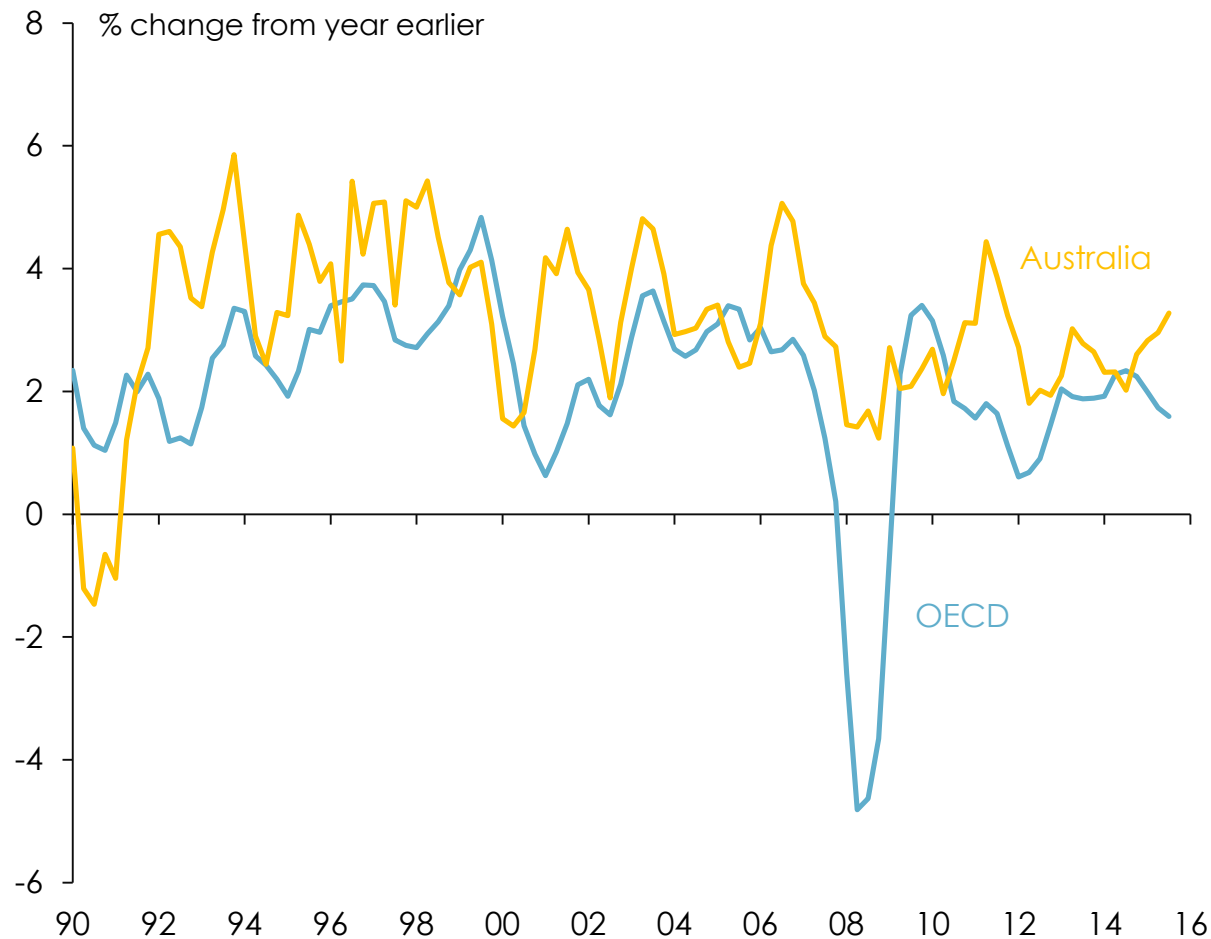
Australia

OECD

Unemployment rate – Australia vs OECD countries
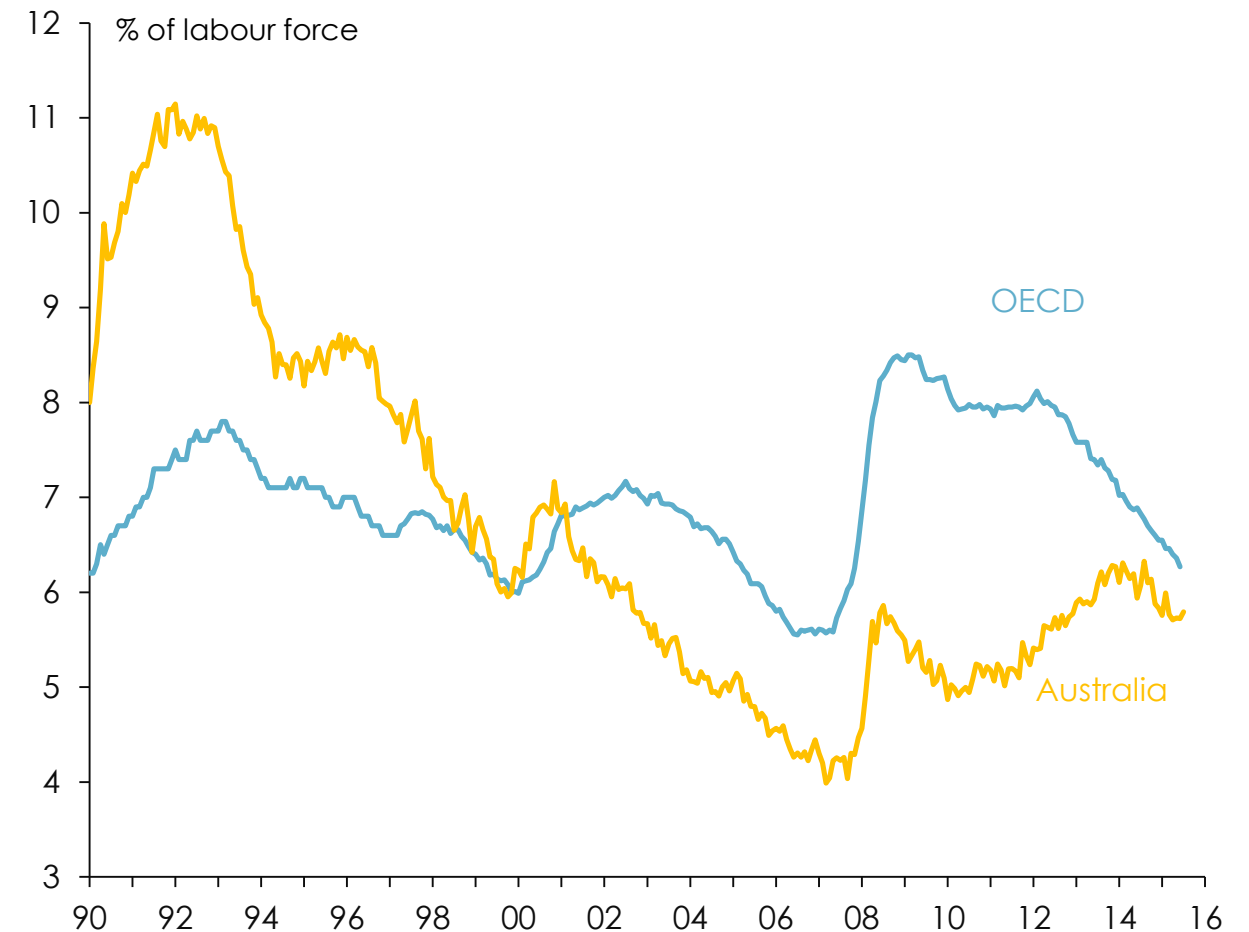
% of labour force

OECD

Australia

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Australia's per capita income has risen significantly relative to other countries over the past 25 years

Australian per capita GDP relative to the United States

Country rankings in terms of per capita GDP, 1991 and 2015

Note: GDP converted from local currency into US$ at purchasing power parities (PPPs).
Source: International Monetary Fund, *World Economic Outlook* database, October 2016.

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And while those income gains have accrued disproportionately to people at the upper end of the income distribution …

Upper income groups' share of total pre-tax income in Australia

Top 10%

Top 1%

Top 0.1%

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… Australia has actually been at the Swedish end of the international spectrum of trends in income inequality

Upper income groups' share of total pre-tax income in selected 'advanced' economies

Top 10%

Top 1%

Top 0.1%

SAUL ESLAKE

Australia's relatively good economic performance over the past 25 years reflects a combination of good management …

'General government' net lending

% of GDP

- ■ 'Advanced' economies
- ■ Australia

'General government' net debt

% of GDP

'Advanced' economies

Australia

Monetary policy interest rates

% pa

RBA cash rate

ECB repo rate

US Fed funds rate

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… and good luck, principally as a result of our unusual (for an 'advanced' economy) economic relationship with China

'Terms of trade' – Australia vs other 'advanced' economies
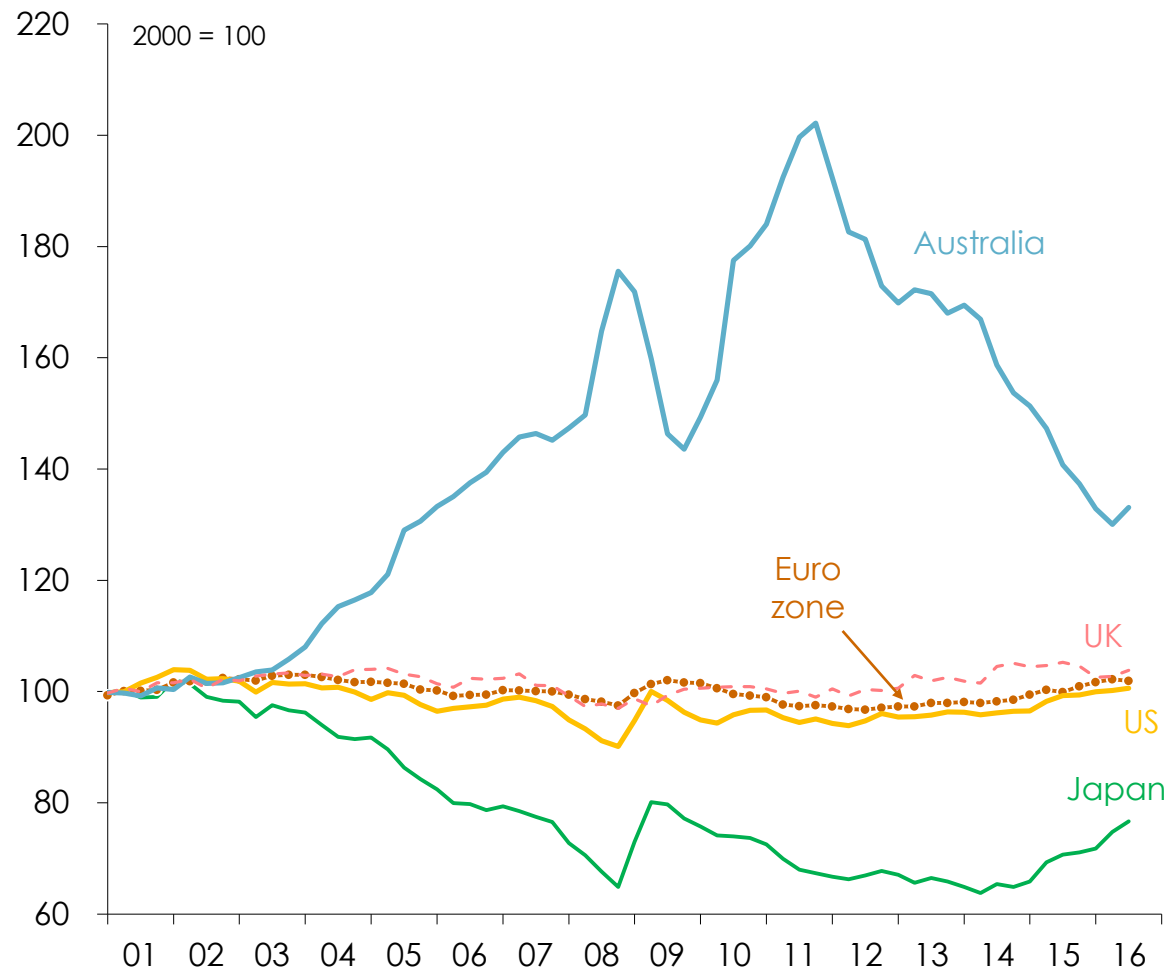
'Terms of trade' – Australia vs other commodity-exporting economies
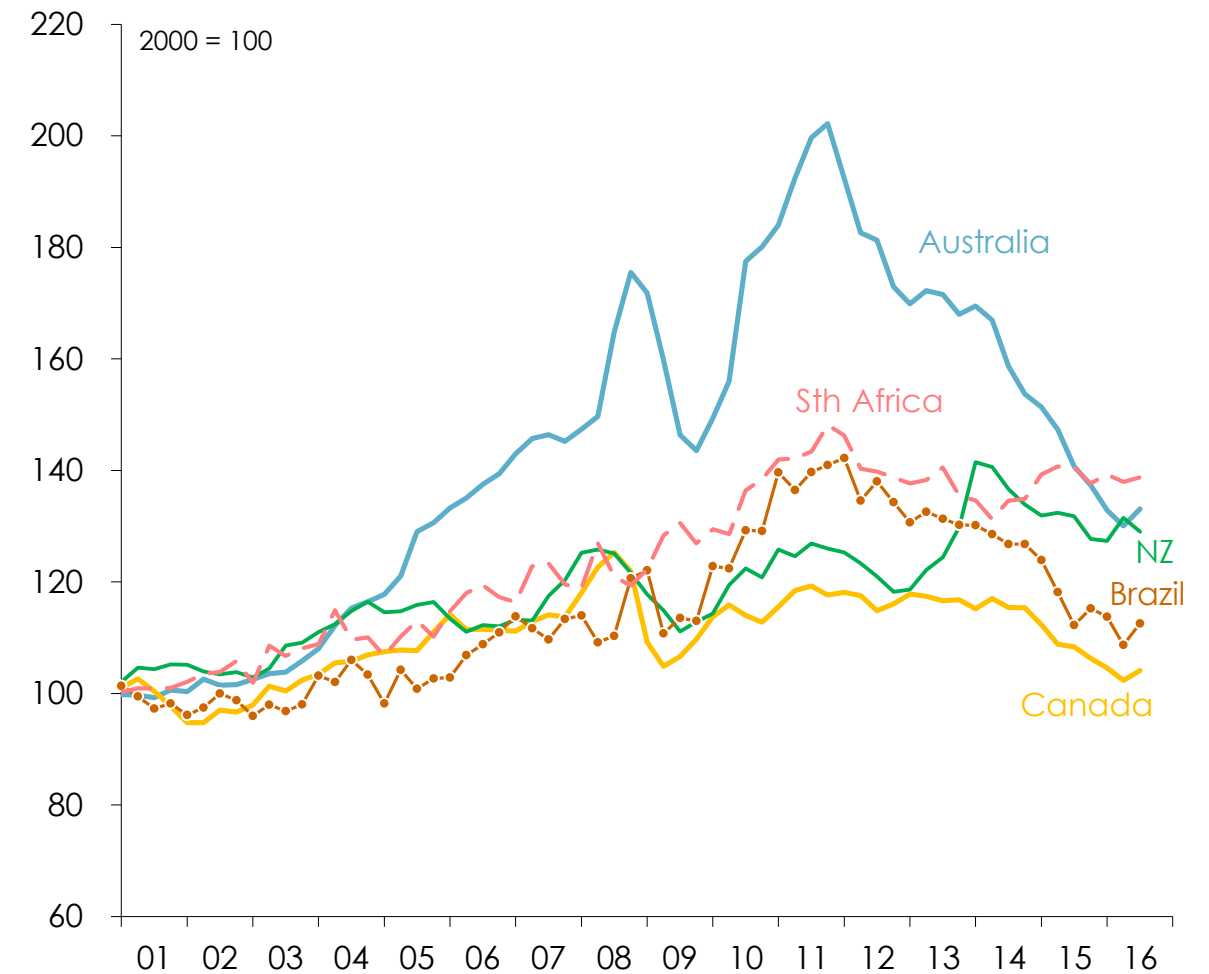
Note: 'The 'terms of trade' is the ratio of the implicit price deflator of exports of goods and services to the implicit price deflator of imports of goods and services.
Sources: ABS; US Bureau of Economic Analysis; Eurostat; UK Office for National Statistics; Japan Economic & Social Research Institute; Statistics NZ; Statistics Canada; Statistics South Africa; Instituto Brasileiro de Geografia e Estatistica; author's calculations.

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Australia is faring better than most other commodity-exporting economies despite experiencing a sharper fall in its terms of trade

Australia and other commodity exporters – real GDP growth
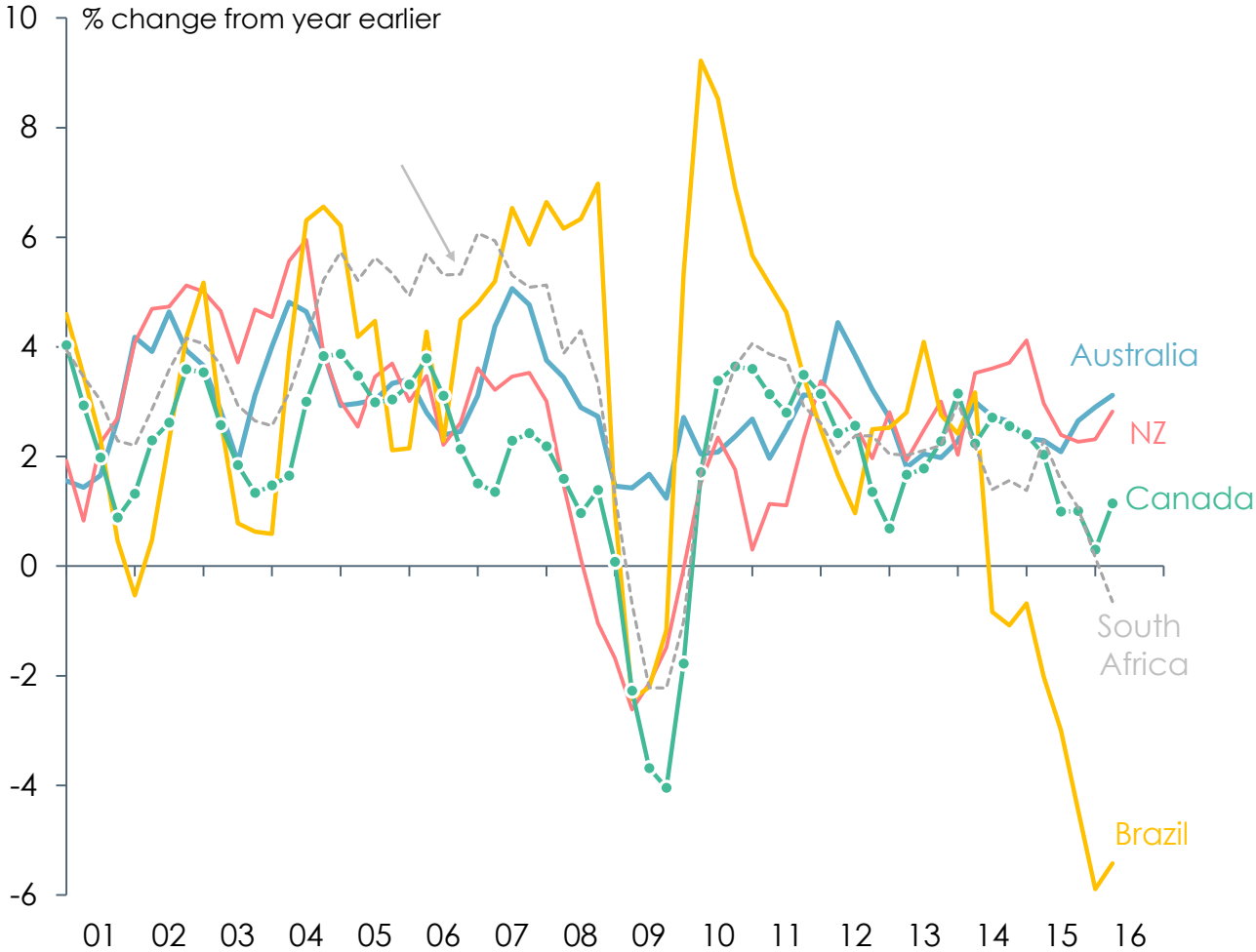
Australia and other commodity exporters - unemployment

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Australia is now more dependent on China as an export market than we have been on any single country since the UK in the 1950s

Australian merchandise exports, by destination
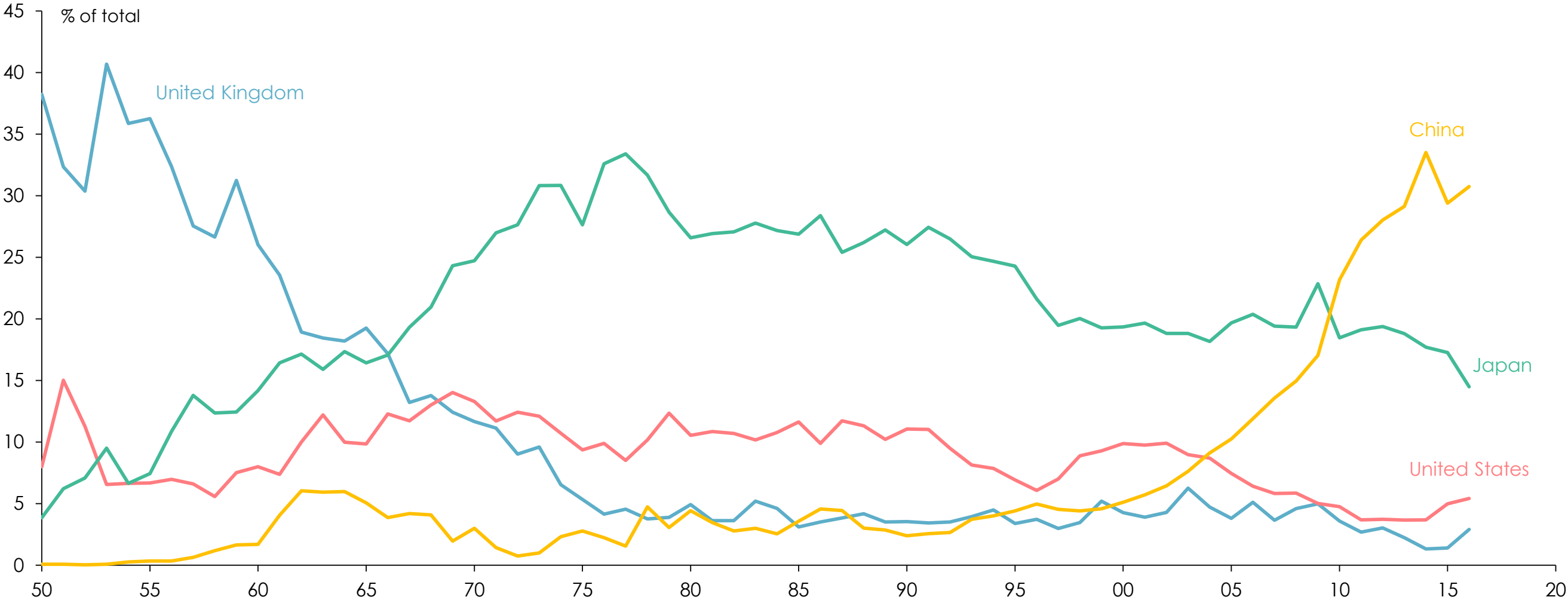
Sources: Department of Foreign Affairs & Trade, Trade time series data; ABS.

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China's sustainable economic growth rate is slowing – and the 'mix' of Chinese growth is changing

China real GDP

% change from year earlier
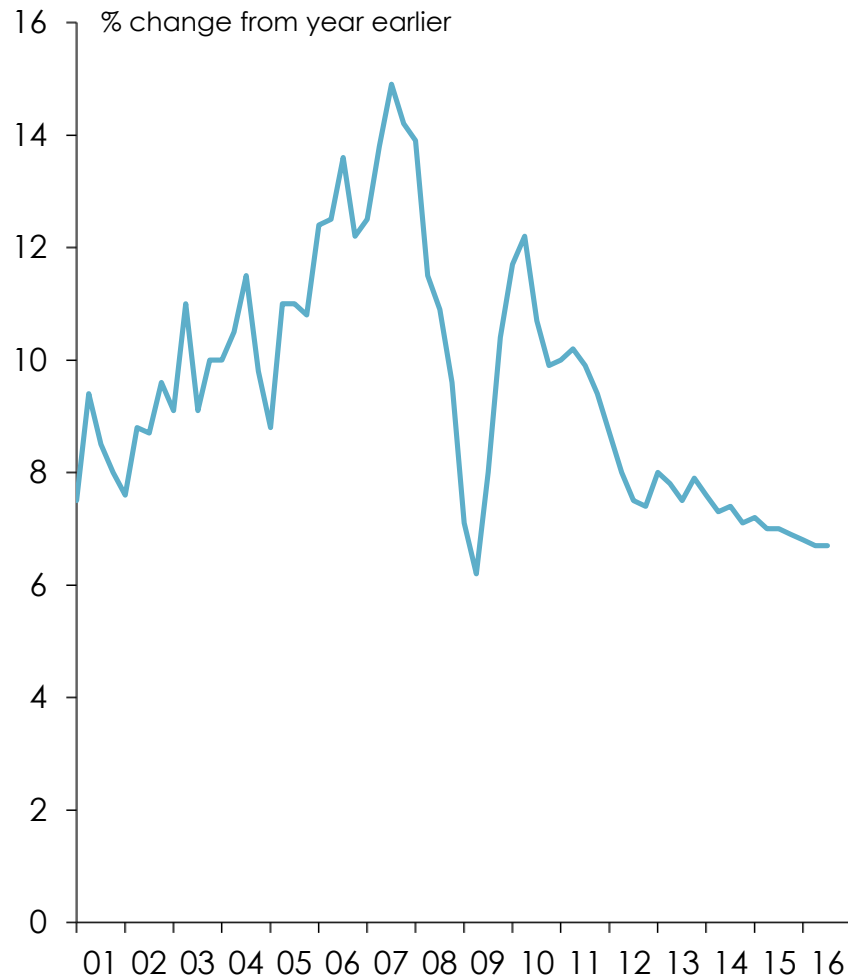
Contributions to annual growth in GDP

Pc pts contribution to change in real GDP

- Consumption
- Investment
- Net exports
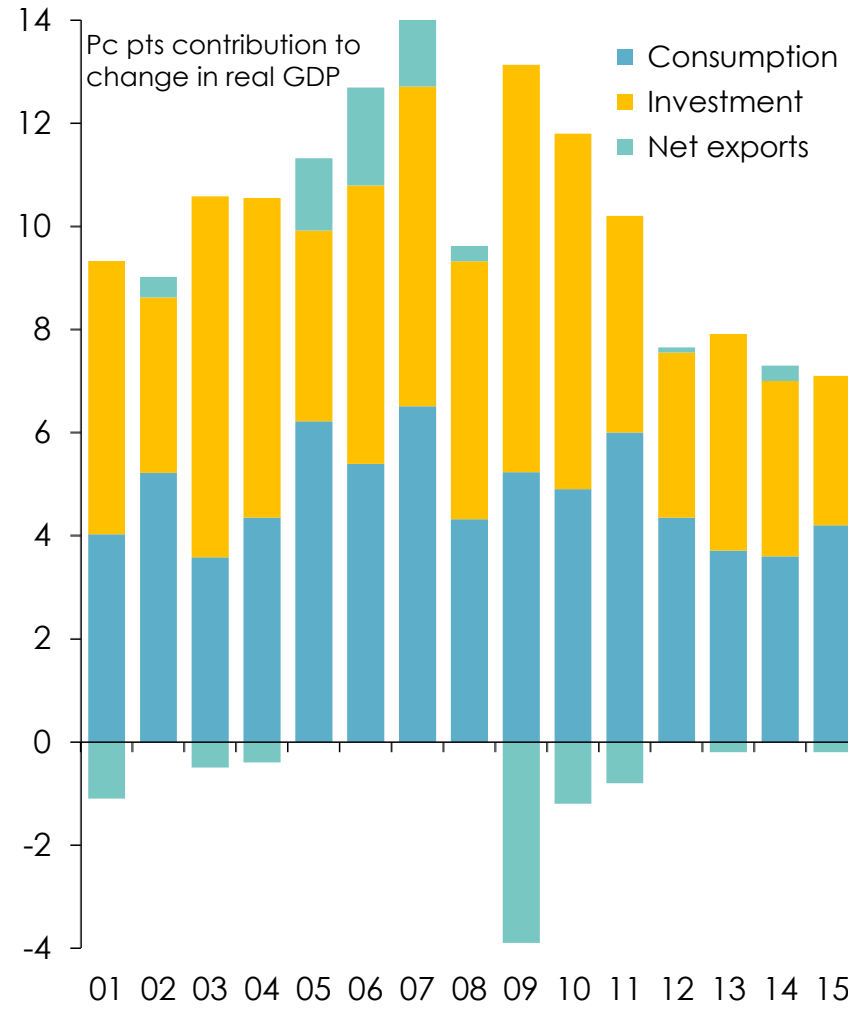
Major sector shares of GDP

% of GDP

Services

Manufacturing & construction

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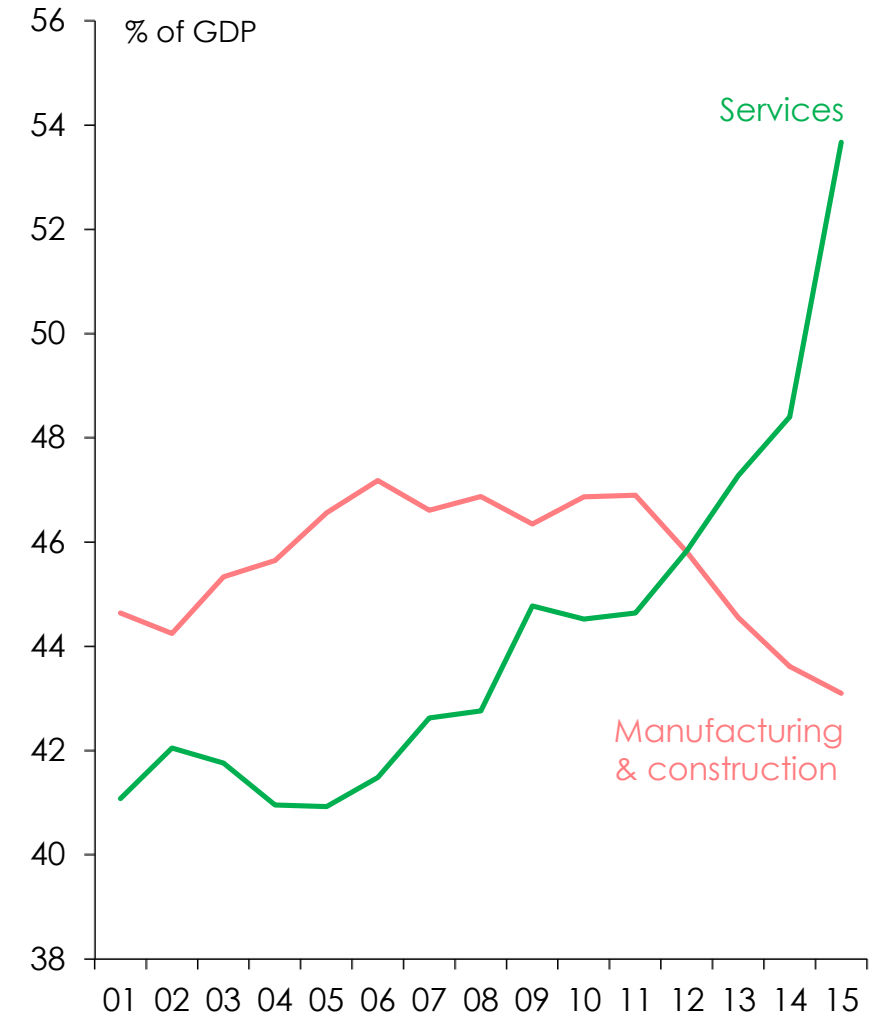
Chinese authorities have reversed the declines in the property sector and residential construction which occurred last year

Floor space under construction
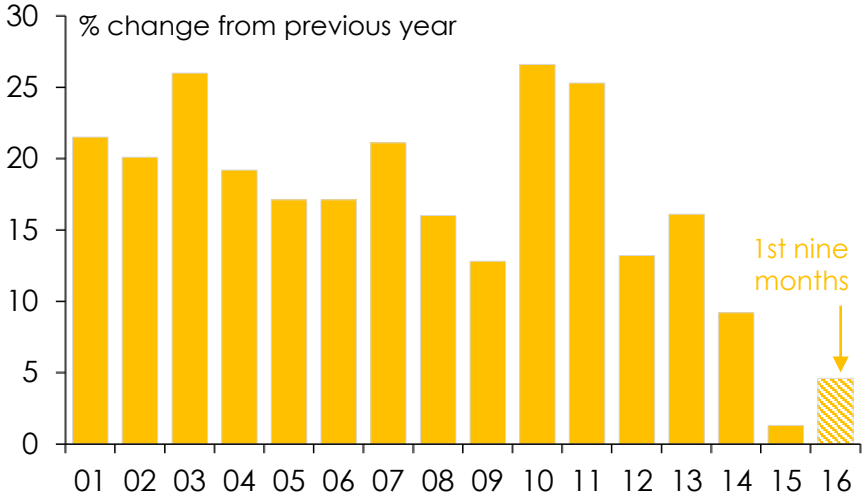
% change from previous year

1st nine months

01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16

Steel production

% change from year earlier
(12-mth moving total)

Finished

Crude

01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16

Iron ore production

Mn tonnes (12-mth moving total)

01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16

Urban property prices

% change from year earlier

CIA/Soufun 100 city average

NBS 70 city average

01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16

Cement production

% change from year earlier
(12-mth moving total)

01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16
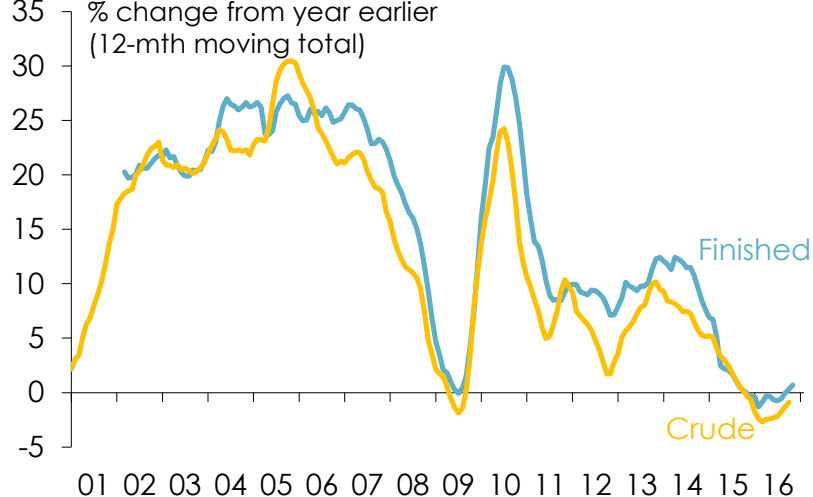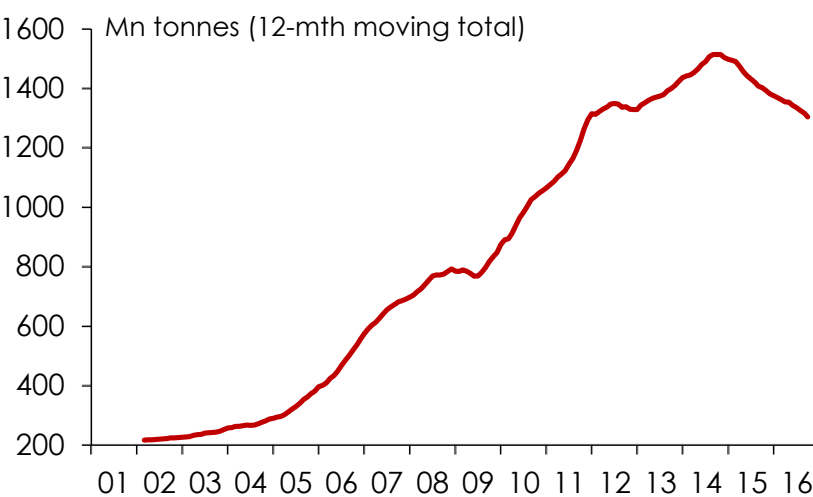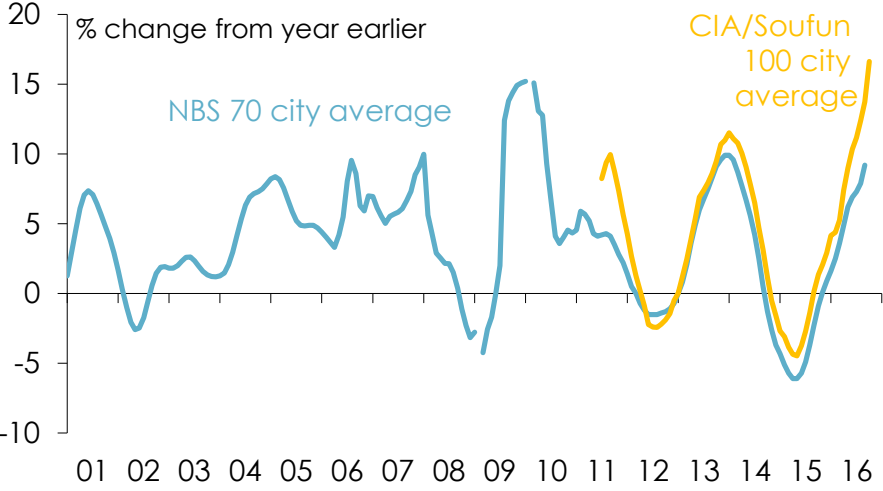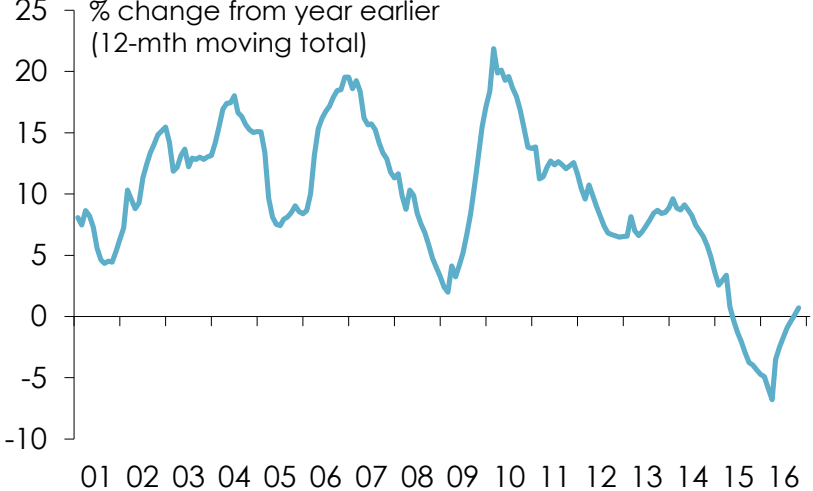
Iron ore and steel prices
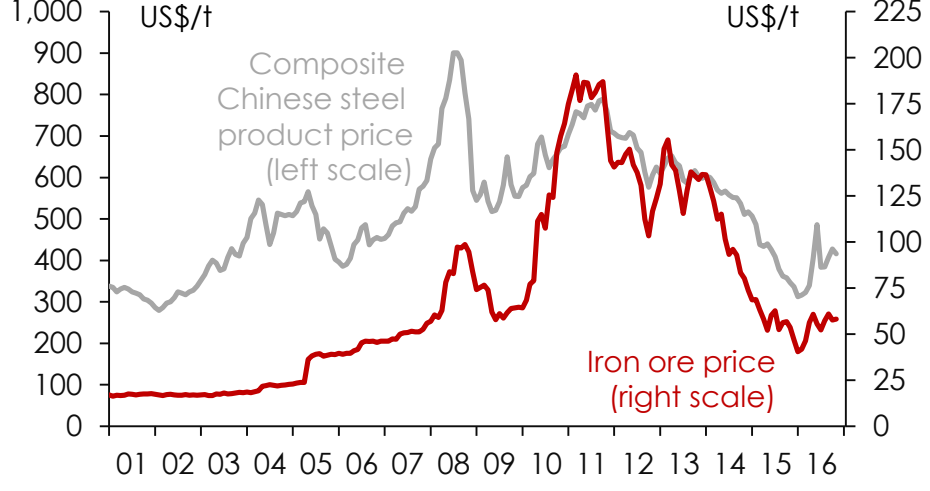
US$/t   US$/t

Composite Chinese steel product price (left scale)

Iron ore price (right scale)

01 02 03 04 05 06 07 08 09 10 11 12 13 14 15 16

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China now carries a lot of debt – most of which is owed by the corporate sector (especially SOEs) rather than households or government
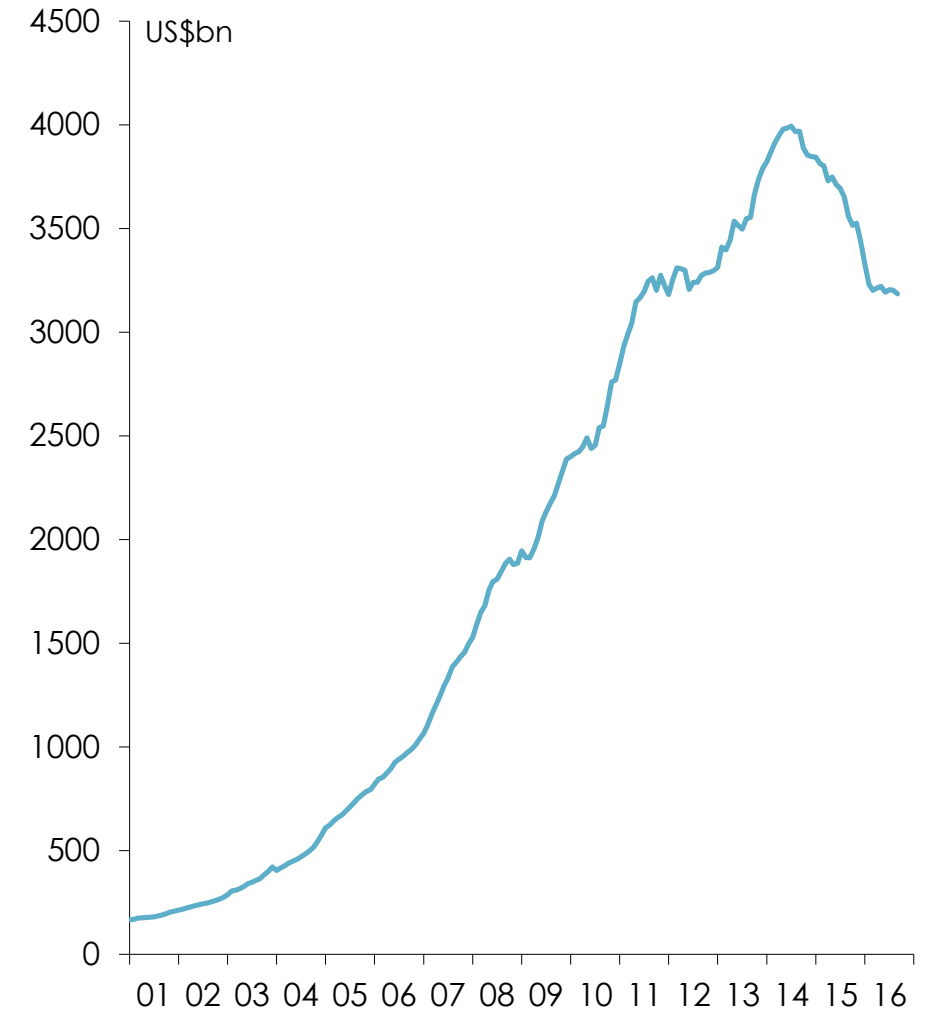
China debt outstanding as a proportion of GDP
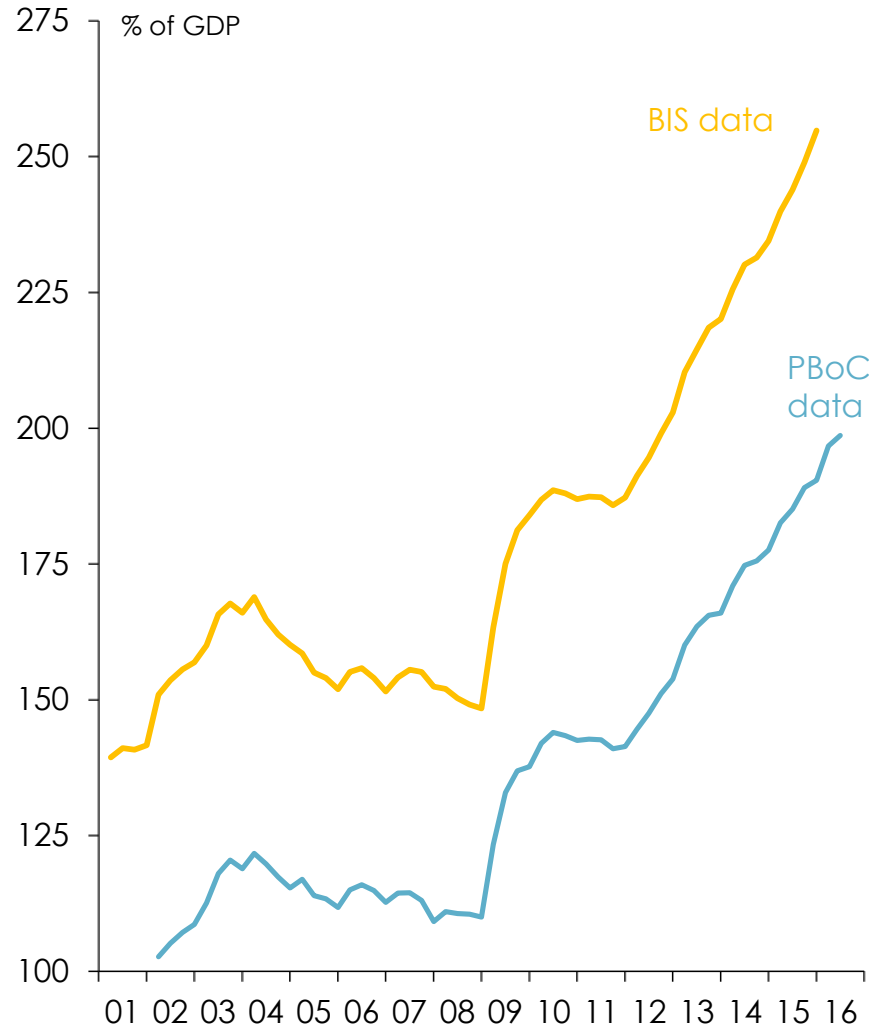
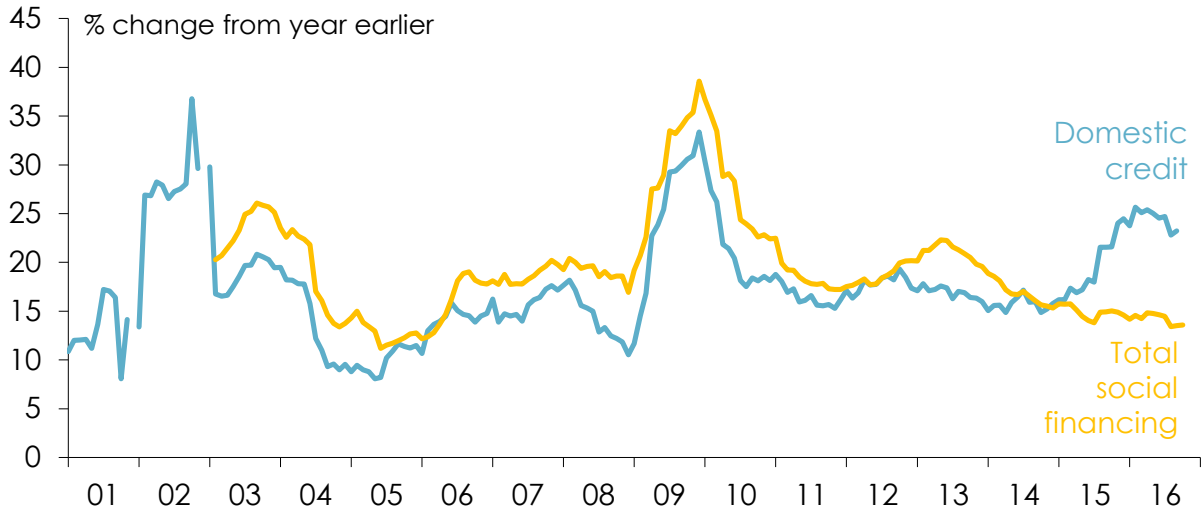## Chinese debt outstanding by major sector
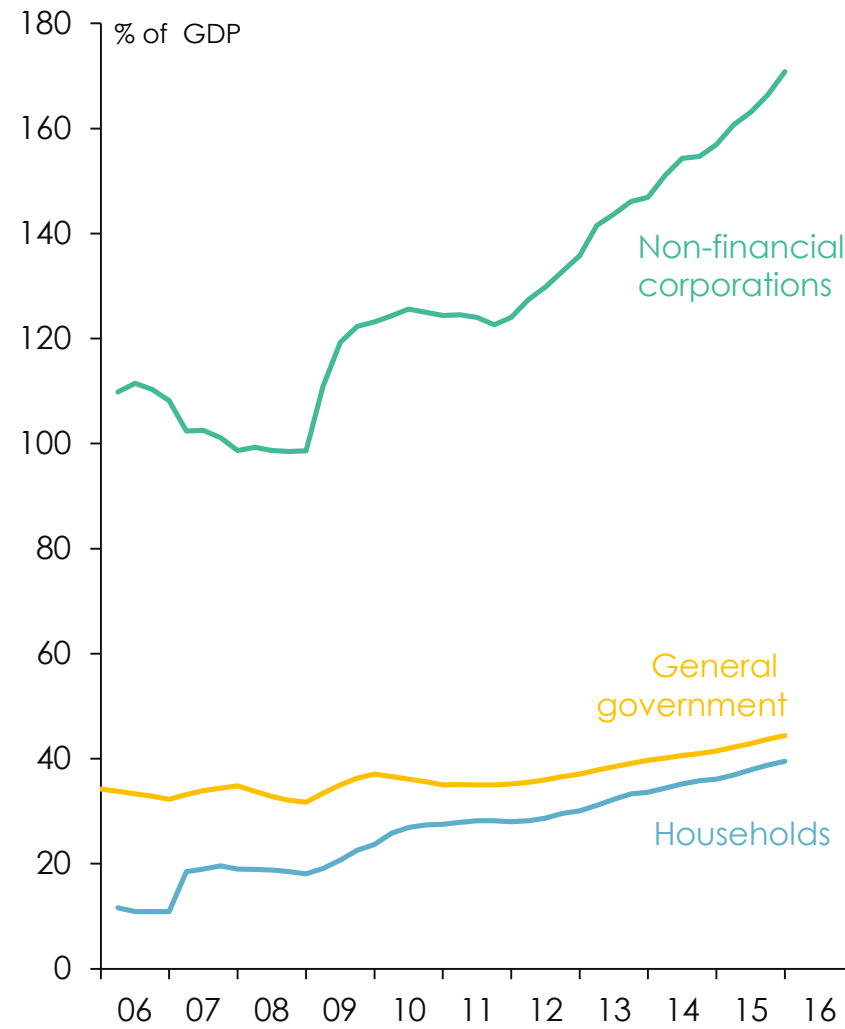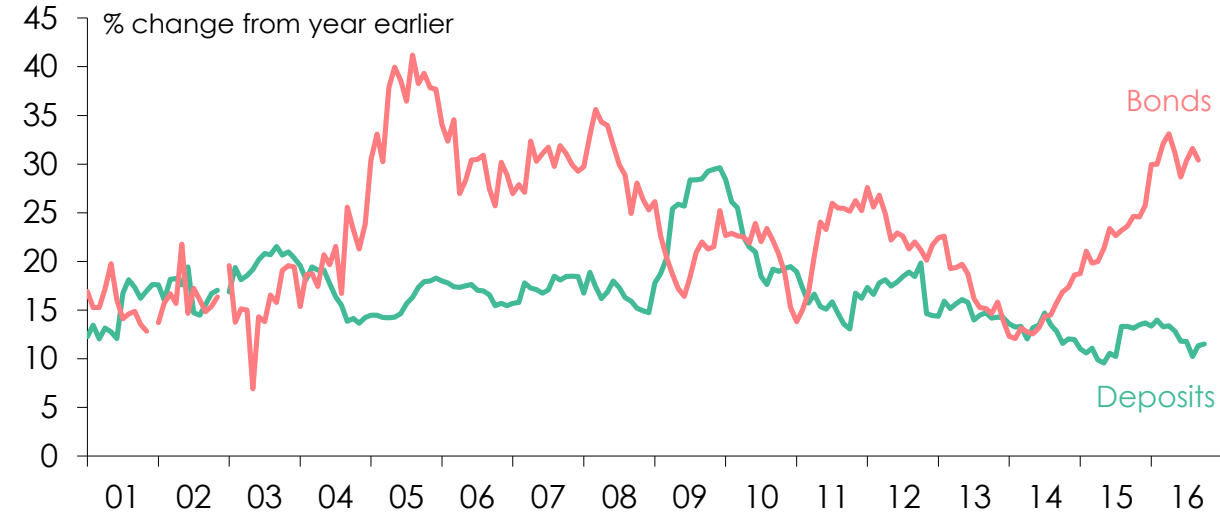

PBoC foreign exchange reserves

Sources: People's Bank of China (PBoC); Bank for International Settlements (BIS).

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The most recent round of Chinese monetary stimulus has been financed in a way which has increased the risks in the financial system

Credit growth - total

Credit growth – by sector

Banking system liabilities
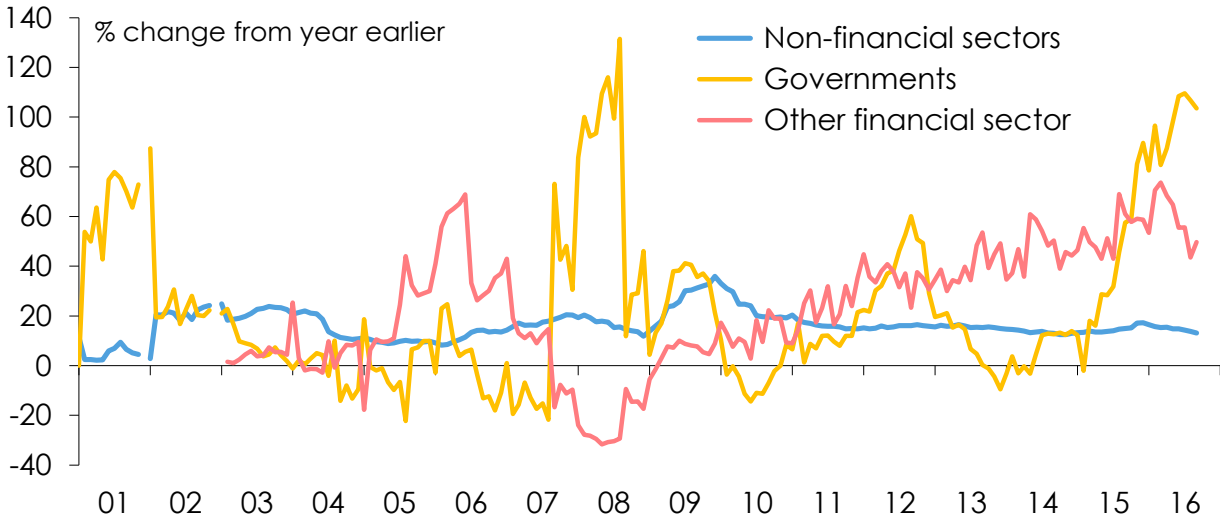
Banking system deposits-to-loans ratio
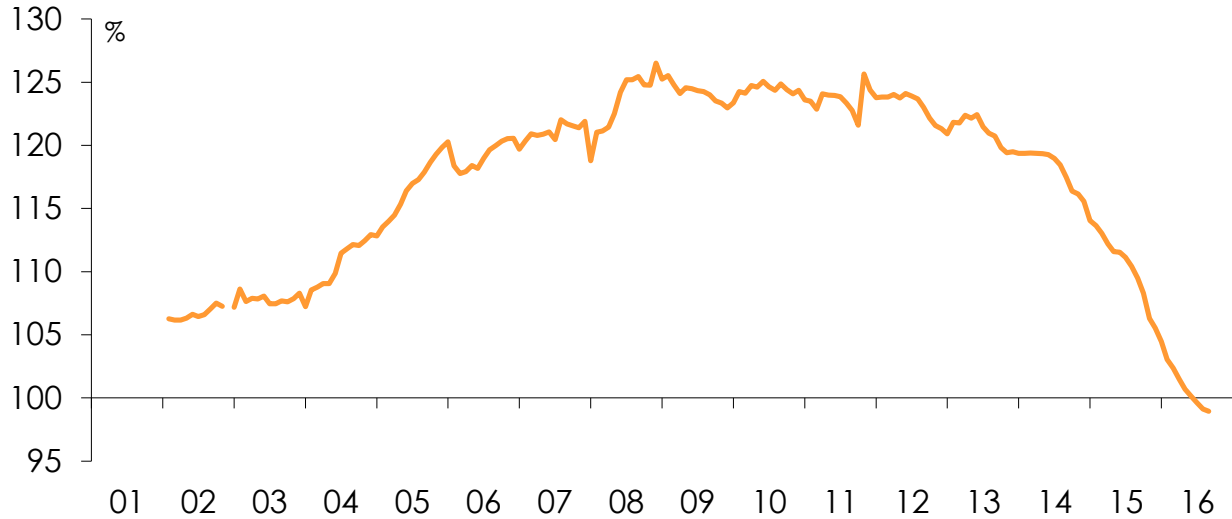
Sources: People's Bank of China; Thomson Reuters Datastream.

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Conclusions

❑ **It's by no means impossible that Donald Trump could win next Tuesday's election – even though that's not what opinion polls and statistical models predict, or what financial markets are expecting**

❑ **From a purely economic perspective, a Donald Trump victory would have more adverse consequences than a win by Hillary Clinton**
- because it isn't 'priced', a Trump victory would trigger a larger reaction in financial markets
- Trump's fiscal policies would lead to a renewed widening in the US budget deficit and faster growth in US public debt
- Trump's trade policies – and the likely reaction to them by other countries – could pitch the US economy (and others) into recession
- Trump's attitude towards the Federal Reserve would undermine confidence in US monetary policy, potentially leading to higher long-term US interest rates and a weaker US dollar
- Trump's defence and foreign affairs policies would likely make many countries around the world feel less secure and more uncertain – undermining business confidence and (potentially) further detracting from business investment

❑ **All of these developments constitute negatives for Australia**
- in particular, a weaker US$ would likely imply a stronger A$, the opposite of what is required at present

❑ **The appeal of right- and left-wing populists isn't confined to the United States**
- their confinement to the fringes of Australian politics (to date) is at least in part the result of Australia's better-than-average economic performance over the past 25 years

❑ **The risks to Australian prosperity from economic developments in China are increasing**

❑ **Which underscores the importance to Australia of building greater resilience to shocks**

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Looking forward to your questions ... please be nicer than these two guys !

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