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PRESIDENT TRUMP - A VIEW FROM ABROAD

Berenberg Macro Flash

The world is entering a period of heightened opportunities and risks. On balance, we expect the switch from political gridlock between the US Congress and the White House to results-oriented co-operation between a Republican majority in Congress and a Republican US President to yield serious pro-growth reforms that will outweigh the damage which Donald Trump's protectionist inclinations, his "rule by Twitter" and his other unconventional traits may do. This summer, the new US president will likely sign into law a major corporate tax reform devised mostly by Paul Ryan and other Republican leaders in Congress. Such a tax reform can raise the long-term growth potential of the US and give the business cycle additional momentum by bringing investment forward in time. For more on the coming regime shift in US economic policies, see [Critical current issues facing the US in 2017](#) and [US industries: gainers and losers from policy reform](#).

THE KEY RISKS

Unfortunately, Trump's unconventional and somewhat erratic rhetoric and behaviour entail significant political and economic risks:

Conflict with China? Trump's unusually harsh and fairly consistent rhetoric against China indicates a serious risk of confrontation with China that could go well beyond the usual petty trade disputes. It may all be posturing to build up a bargaining position in order to strike a good deal with Beijing in the end. However, the scope for misjudging intentions between two sides who are very different in their approach to policies but can both be rather prickly seems significant. Any major confrontation between China and the US would rock global politics.

A pact with Putin? In the same way in which he overdoes his criticism of a rising China, Trump seems to underestimate the risks to peace posed by an economically wounded Russia. If he cosies up to Russia too much, de facto condoning Russia's invasion of parts of Ukraine by lifting sanctions, he may encourage further Russian bullying or even outright military aggression. That could destabilise Europe's arc of vulnerable countries ranging from the Baltic to the Black Sea and into the Caucasus. Casting doubts on the mutual defence commitment of NATO, which he called "obsolete" in an interview early this week while his chosen secretary of defence has just praised the virtues of the alliance, would exacerbate that. Fortunately, Trump's team seems to have scaled down the pro-Russia rhetoric somewhat in the last few weeks.

Middle East: The region is a global hotbed of conflict as a rapidly rising number of young people face limited opportunities constrained by often unsuitable political regimes, grave structural rigidities and misguided economic policies. The policies of the Western world towards the region in the last fifteen years have contributed to disastrous outcomes. Chances are that some of the conflicts – notably in Syria, Iraq and Libya – may become less catastrophically acute in the near future, at least for a while. Nonetheless, if the US and the less relevant European players get it wrong again, it would be Europe rather than the US that would be affected most by the turmoil in its immediate neighbourhood including potentially by further streams of refugees.

External Protectionism: Petty protectionism is normal, unfortunately. As China seeks to deal with overcapacities in some of its industries including steel, the number of US and European anti-dumping measures against Chinese imports has gone up in recent years already. The death of the TPP trade deal with parts of



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Asia and of TTIP negotiations with Europe is most unfortunate. The US and its would-be partners are missing a great opportunity to augment their mutually beneficial exchanges and to shape the future rules of world trade while they still can. But missing an opportunity does not cause much immediate damage. Some additional noise about trade disputes with China or pressure on Mexico to renegotiate parts of NAFTA would also not affect the world much. If Trump goes much beyond that, however, all economies would suffer, the more open ones abroad even more so than the US itself.

Eclectic interventionism at home: harassing companies to invest in the US rather than Mexico may make for good show effects. But it weakens the overall attractiveness of the US as a place to invest. Companies may think twice to which extent they want to expose themselves to such US risks. It may also trigger similar impulses abroad. For the world and the US, attempts to shift activities to the US that can be done more efficiently abroad are negative-sum games.

Respect for rules and institutions: In his career so far, Trump has shown limited respect for rules and institutions, to put it mildly. If the new US president undermines the trust in rules and institutions, he would raise transaction costs for businesses who could no longer rely on such rules and institutions as much as before. For instance, if he weakens the authority and rules of the World Trade Organisation (WTO), world trade could be impaired somewhat. The damage would be felt more by the smaller players and countries which rely more on rules and institutions than the big US. Because of its size, the US is in a better position to get its way at least somewhat without binding rules and institutions than the smaller players.

SOME CONTRADICTIONS

In addition to these risks, some of Trump's apparent policy inclinations are contradictory:

US dollar: Almost all policy changes which Congress and Trump are planning (corporate tax reform, border adjustment tax, incentive for US companies to bring profits earned abroad into the US, significant fiscal stimulus) would keep the US dollar overvalued or strengthen it somewhat further. At the same time, a strong dollar and a boost to US domestic demand will suck in more imports. The president who wants to bring down the US external deficit will likely see it rise instead, adding to risks that Trump may turn to more outright protectionism. Mere words that he does not want a stronger dollar will probably not affect the currency for long.

Mexico: Fear of Trump has added to Mexico's current economic and political problems. Less economic growth and more political instability in Mexico would mean that the recent net migration of Mexicans back from the US into their erstwhile home country would give way to a rising number of Mexicans forced to seek their luck in the US again. That would not be exactly what Trump promised his voters. Weakening a major neighbour and trading partner is rarely a good strategy to foster the interests of one's own country.

AN UNCERTAIN OUTLOOK

If he works with Congress, Trump can get things done. If he plays his cards well, he can preside over an economic upswing that looked set to gain some momentum anyway and will receive a significant boost from a major corporate tax reform. He may claim that a general border adjustment tax as part of a corporate tax reform would already do so much to "protect" American workers that he need not follow up very much on his other protectionist threats. He would work with rather than against the global trade order and NATO. He would measure his success in terms of continuing employment growth rather than in terms of reducing the US's overall trade deficit or its economically mostly meaningless bilateral deficits with selected countries. He would continue to use his popular rhetoric more for show rather than to change actual



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policies in 140-sign tweets. In office, Trump will be surrounded by advisers, ministers and Republican partners in Congress who have a vested interest in success. After all, they want to be re-elected or confirmed in office when their current term is over. Whether they will be able to sufficiently constrain Trump's impulsive behaviour over time remains a very big question. The president has the decisive say in foreign policy. Risks and opportunities loom large. If some of these risks materialise, smaller and more exposed countries elsewhere would be affected more than the US. Even more than usual, the world is paying attention to events in Washington.

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