Trend Macro™

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MACROCOSM

2017: It's Bigger than The Donald

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Donald Luskin

Faster growth will come not from Trump, but from the grass-roots forces that elected him.

We'll look forward in just a moment – but first, a look back. Our *three key forecasts for 2016*, all very out of consensus at the time, were all fulfilled (see "2016: Two Charts, Six Words, One Man" December 31, 2015).

- *Donald J. Trump* was elected President of the United States.
- The first quarter was a *near-recession*, the first ever caused by too-low oil prices. It caused *deep corrections* in global markets, but it was short-lived. *US stocks* had a rocky start and a better-than-average year, the eighth up-year in a row.
- After the error of "liftoff," *the Fed* stayed on the sidelines all year – ultimately hiking the funds rate only in December, and signaling extreme caution and gradualism.

Several other key forecasts made along the way were also fulfilled.

- *Oil* bottomed in January (see "Oil: Priced for Perfection in an Imperfect World" January 20, 2016), ending up among the best-performing investible assets of the year (see "How High Can Oil Go?" May 10, 2016).
- The *near-recession* ended in February (see "Have We Suffered Enough?" February 26, 2016).
- *China's* new exchange rate regime stabilized growth (see "Yuan Direction" February 16, 2016).
- *Brexit* was a phony crisis and a risk-on buying opportunity (see "On the Brexit Referendum" June 24, 2016).
- Global long-term *bond yields* bottomed in July (see "Brexit: Who Won, Who Lost, What's Next?" July 11, 2016).
- *Italy's referendum* was a phony crisis (see "On Sunday's Italian Referendum, and the November Jobs Report" December 2, 2016).
- *OPEC* members and non-members agreed to cut production (see "OPEC Will Lose Its Battle of Algiers" September 9, 2016).

There are two cases in which we missed the boat.

- Having called the historic July bottom, we underestimated how far and how fast global long-term *bond yields* would back up in the fourth quarter (see "Gundlach and Load" September 12, 2016).

Update to strategic view

US MACRO, US STOCKS, US BONDS, US FED, OIL, COMMODITIES, FX, EMERGING MARKETS STOCKS: It's not just about Trump – it's about what got him elected, a global grass-roots turning away from safety and toward opportunity. In 2017 immediate good will come from Trump's deregulatory agenda; pro-growth tax cuts are highly likely; there will be less public infrastructure spending than the market expects; and there will be saber-rattling about protectionism, with little action. US and global economic growth will accelerate, and inflation expectations will continue to revive. The Fed will be gradual and cautious, not tightening *per se*, but hiking only when there is evidence that the "neutral rate of interest" has risen. It will be a good year for stocks and commodities globally, and a poor one for bonds. The dollar will weaken, and emerging markets will perform well. Oil will get to $65, probably in the first quarter.

[Strategy dashboard]

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- We failed to anticipate the broad strength of the *US dollar* after Brexit.
- Oh, and *oil* didn't make it all the way to our target of $65 – but that's what 2017-Q1 is for.

Now looking forward, the standard tactical forecast nowadays puts President Trump front-and-center in a scenario of vast change. There's little point in our doing that now, because we've said it all long before. Everyone now is talking about how he will revive the "animal spirits" of the economy – but we've been saying that since the spring, before anyone else thought he could even be nominated (see "Trump May Be First Since Reagan To Unleash America's Animal Spirits" March 19, 2016). Everyone is now talking about his transformative policies on taxes, trade, regulation and infrastructure, and wondering what can and will actually get done – but we've been talking about that since early summer (see "Trump's Pro-Growth Path to Victory" June 21, 2016).

- *So let us just say that we expect that a great deal of immediate good will come from Trump's deregulatory agenda; that there is a high likelihood of pro-growth tax cuts; that there will turn out to be less public infrastructure spending than the market chatter seems to expect; and there will be much saber-rattling about protectionism, with hopefully little actual effect (such episodes are the most likely sources of market corrections over the year). Inescapably, we will track all this rumor by rumor and headline by headline as Job One.*
- *US and global economic growth should accelerate, and inflation expectations should continue to revive.*
- *In the background, we expect the Fed will continue to be gradual and cautious. It will not tighten per se, but only hike the funds rate when there is evidence that the "neutral rate of interest" has risen. From here, that looks like two rate hikes over the course of the year.*
- *That should add up to another good year for stocks and commodities globally, and a poor one for bonds. Global equity risk premia will make new post-crisis lows.*
- *We expect that's something like the consensus view. Where we probably depart from consensus is our expectation that the dollar will weaken, and that emerging markets will perform well.*
- *And we expect that crude oil will get to $65, probably in the first quarter* (see "2017: Making American Crude Again" December 29, 2016).

All that said, we think we won't be able to truly understand 2017 – and how profoundly pro-growth the secular outlook from here really is – if we do what everyone else is doing, and put Trump front-and-center. We think he is only an effect, not a cause. He will do specific things that matter, possibly a great deal – but the real agent of change is the underlying force that put him in the position he now occupies. That force – the cause – is a growing demand world-wide, from the grass-roots, in the hearts and minds of millions of ordinary individual people – the economic participants who do

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Creators Syndicate
December 27, 2016

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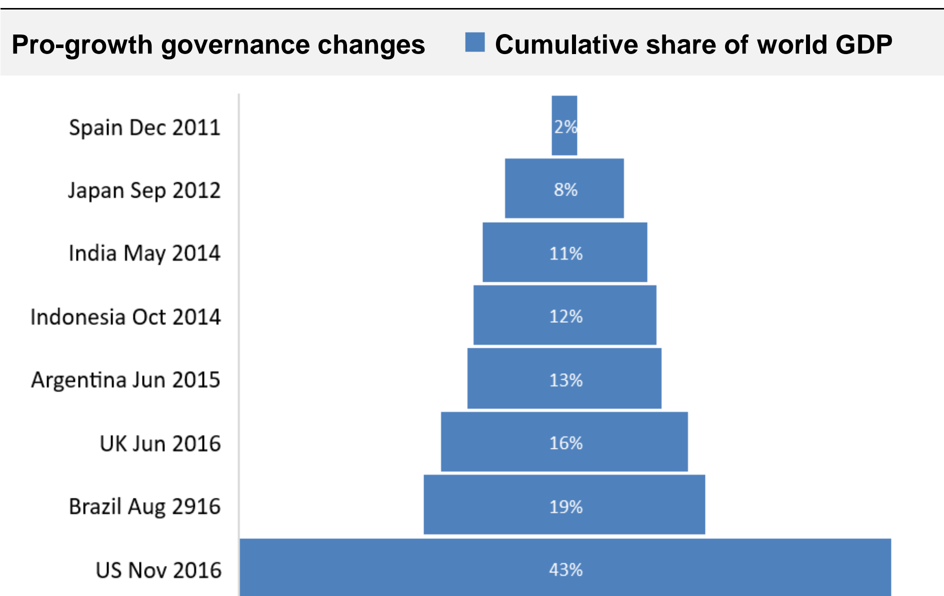
most of the working and paying and living and dying – *for the rejection of the failed governance that led to the era of "secular stagnation," replacing it with a return to growth.*

- Trump is only the most recent and – because of the preeminent position of the US in the global economy – most outstanding example of that force in action.
- We think it started five years ago in Spain, in the depths of the euro crisis, when conservative Thatcherite Mariano Rajoy won the presidency of Spain in the biggest electoral landslide in the history of Spain's democracy. Even in Europe's southern periphery, he was able to transform Spain with tax cuts and labor market reforms into Europe's fastest-growing economy.
- Such transformations have spread across the world, nation by nation, in every region, usually in utter defiance of polls and "prediction markets," finally arriving in the US with the election of Trump, and now cumulatively encompassing 43% of global GDP (please see the chart below).



Source: Various, TrendMacro calculations

- France will be next when, as we expect, Thatcherite François Fillon is elected president in 2017.
- It's insufficient – and unfairly pejorative – to explain these transformations of governance as merely "populism" or "nationalism." Those are words elite incumbents use to delegitimized those with differing views. To be sure, such threads do run through some of these cases to different degrees. Indeed, even to see them as "transformations" requires a case-by-case look each particular toppling of each particular *status quo*.
- And for that matter it is unfair to blame the leaders who had previously delivered the *status quo*. They were what the electorate wanted – *then*. In the US, we can't blame George W. Bush or Barack Obama for policies and leadership messages that led to 16

years of inferior growth. We wanted that – *then*. We chose those leaders. They didn't force themselves on us.

- It's too simple, but if we had to encapsulate the shift in global preferences we'd quote a version of Benjamin Franklin's famous maxim – "Those who would give up essential Liberty, to purchase a little temporary Safety, deserve neither Liberty nor Safety."
- As we see it, in the new millennium, with the arrival of the Global War Against Terror, the rise of China, and the global financial crisis, the global electorate shifted the center of its preferences toward safety. The price, we believe, has been "secular stagnation," as a more regulated, more inward-looking and less venturesome world has failed to generate traditional growth rates.
- Now, it seems, country by country, the global electorate is deciding that was too high a price to pay, and the center of preferences is shifting back.
- If that's all too abstract, intuitive and unscientific for you, we can only plead that, at its deepest level, economics isn't a science at all – it is the understanding of human action. This approach has served us well, especially when we have had to interpret and predict the interaction of politics and markets.
- *There will be plenty of time for event-driven microanalysis of policy development and impacts. But at this moment of reflection at the dawn of the New Year, step back from the individual person of Trump, or his policies. Focus instead on the environment of preferences that welled him up, from among many possible choices, to be president. That environment itself is the key to understanding the coming year. It is an environment that will be profoundly pro-growth – in terms of the human actions of spending, business investment, capital formation, labor force participation and so on – no matter what Trump happens to actually do.*

Bottom line

It's not just about Trump – it's about what got him elected, a global grass-roots turning away from safety and toward opportunity. In 2017 immediate good will come from Trump's deregulatory agenda; pro-growth tax cuts are highly likely; there will be less public infrastructure spending than the market expects; and there will be saber-rattling about protectionism, with little action. US and global economic growth will accelerate, and inflation expectations will continue to revive. The Fed will be gradual and cautious, not tightening *per se*, but hiking only when there is evidence that the "neutral rate of interest" has risen. It will be a good year for stocks and commodities globally, and a poor one for bonds. The dollar will weaken, and emerging markets will perform well. Oil will get to $65, probably in the first quarter.