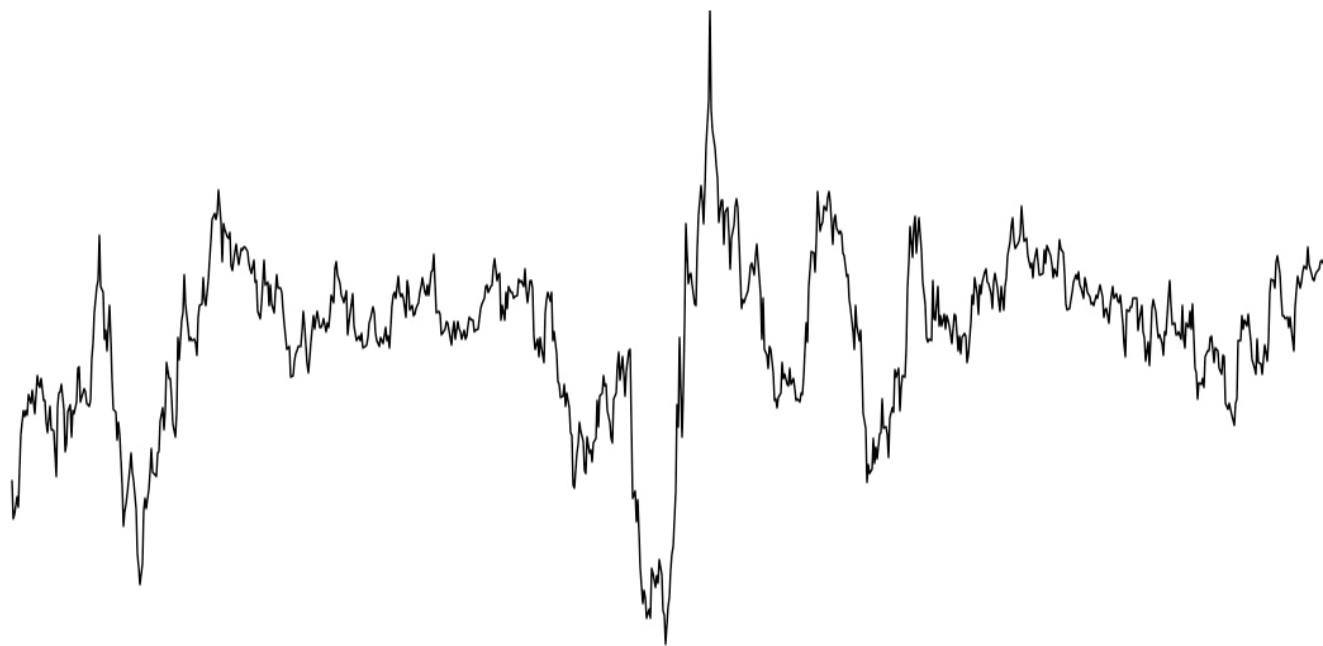


ALPHA SOURCES

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SWEET IRONY

You will find no harsher critique of Mr. Trump's indiscriminate use of social media than yours truly. If it were up to me, the president's phone would have been deactivated a long time ago. Last week's performance on *economics*, however, struck at the heart of a story economists and strategists have been circling for a long time. **How far will monetary policy divergence be stretched in this cycle?**

[Mr. Trump first suggested](#) that other major economies—Europe and Asia—are unfairly manipulating their interest rates and currencies, before following up with a swing at Fed for making things worse by hiking rates. In short; the White

House is suddenly spooked by the risk to the economy from a stronger dollar and higher rates. This is probably a reasonable *political* worry ahead of the mid-terms, but it is also sweet irony. If Mr. Trump wants to complain to anyone about the vigour of the dollar, he should start with a look in the mirror.

Aggressive tax and short-term inflationary tariffs in an economy with a near record-low unemployment and savings rate could only have one outcome in the end. A more assertive Fed and a stronger dollar always were obvious side-effects of such a policy constellation. This is particularly the case since the president was probably right about one



thing; the U.S. can win the trade war, in so far as it does more real economic damage to Europe and China than it does to the U.S. As a result though, and contrary to Mr. Navarro’s promises of a lower trade deficit, victory will come in the form of stronger economy and a *wider* trade deficit.

In the short run, Mr. Trump isn’t doing his course any good. The Fed is probably more likely to solidify its hawkish stance than to step back, in response to the president’s dissatisfaction with higher interest rates. Meanwhile in Europe and Asia, central banks won’t be in a hurry to adjust their policy signals just because Mr. Trump is unhappy. Indeed, it could embolden them to double down. In addition, non-U.S. monetary policy-makers will probably be content, to see their currencies depreciate in tandem with an escalation in the trade wars.

Political theatricals aside, we should be alert to the *economic* gist of this discussion. Almost every decision macro-investors make, boils down to taking a position on the interplay between global central bank policy. The divergence in

global monetary policies, and widening interest rate differentials, is a story with staying power, but eventually, it has to reverse, or at least pause. Either the Fed kicks back from table, implicitly admitting that it cannot drive U.S. short-term rates higher in a world where its major counterparts are stuck at zero bound or in easing mode. Alternatively, the rest of the world dons the hiking gears and begins to follow the FOMC.

At the moment, the increasingly frantic discussion about the flattening U.S. yield curve suggests that the former is most likely. But the discourse can flip quickly. [Reports last week](#) suggested that the BOJ is considering a tweak to its yield-curve-control policy and QE. Some analysts even are musing that the BOJ will lower its inflation target.

A shift in BOJ policy, even if technical in nature, would be at least as important for markets as a more modest Fed. Easy monetary policies in Asia and Europe are now the main swing factor for global liquidity; any indication that it is drying up, even a little bit, would be an important signal to investors.

fig. 01 / It doesn’t look dramatic, yet — fig. 02 / Don’t look Mr. Trump, it could get worse

