Global Investment Insights

The art of the deal

So, the great negotiator and deal-maker (self-admitted) is now engaged in international brinkmanship over tariffs and trade. He can claim he is being true to his electioneering promises as he takes aim at China, which has a massive trade surplus with the U.S. (although the U.S. operates a surplus on services). China is considered an easy and obvious target and we can almost hear Mr. Trump's supporters cheering these initiatives from the rooftops.

China has a trade surplus with many countries. It is the natural order of things when it comes to trade. Overall, the global deficits and surpluses must square to zero. The U.S., in particular, enjoys spending and consuming—the household savings ratio is now very close to its all-time low, the level of consumer credit outstanding relative to personal income is at a record high, personal consumption as a percentage of gross domestic product (GDP) is also around its record high and the federal government consistently runs loose fiscal policies. A proportion of this exuberant spending naturally spills abroad. Foreign savers effectively fund the U.S. overspend.

A significant trade skirmish would be very bad news. In the U.S., it will raise domestic price levels and impede growth. A tiny minority will benefit at the expense of the majority. Yet Mr. Trump tweets that "trade wars are good." Even the most cursory examination of economic history demonstrates that tariffs, embargoes, subsidies and other techniques to distort trade flows do nothing to advance a nation's prosperity over the long haul.

Australia only recently gave up on its domestic motor vehicle manufacturing industry after 60 years and billions of dollars of taxpayer-funded subsidies. At last count, the Australian population was around 24 million—far too small to support a domestic industry of this type yet political opportunism and vested interests rode roughshod over basic economics. It is ironic that the subsidies went to foreign-owned companies. Most other countries also play the subsidy/tariff/tax game so that the much vaunted *level playing field* resembles a rocky outcrop. Politics invariably triumphs.

We have been concerned about the state of world trade for some time. It is a great puller of GDP growth—invariably growing much faster than GDP and adding to global wellbeing. However, since the financial crisis, the "pull" has been extremely subdued relative to the past.

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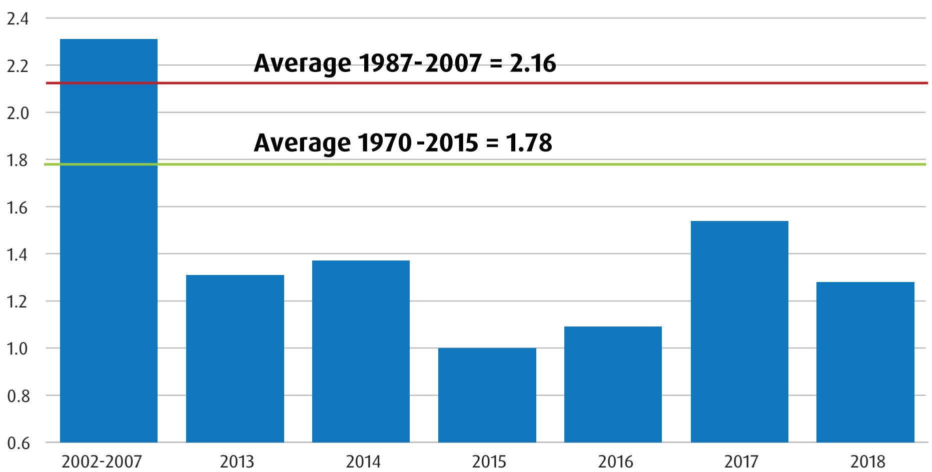
The Organization for Economic Cooperation and Development (OECD) recently put some valuable flesh on the trade bones and we have reproduced their findings below.

Global trade is weak relative to historic norms

Ratio of global trade growth to global GDP growth



Source: OECD Economic Outlook: November 2017

The decline in the ratio of trade growth to GDP growth relative to the immediate pre-crisis years and the earlier decades is stark. The OECD notes that the number of new trade restrictions in the major economies has built up in the last decade—a not unexpected consequence of a financial crisis (*our comment*). When confidence in the economic foundations is shaken, it is all too easy (and popular) to run to protectionist policies.

We fervently hope that these policies go no further and gradually unwind. Mr. Trump can lead by example. We won't have long to wait to find out.

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