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"President Trump" and His First 100 Honeymoon Days: Thoughts on Sustainability of Stronger Dollar

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＜New President and His First 100 Days＞

As is well known, there is a notion called "First 100 days" in US politics. In around the first 100 days from inauguration of a new president (or his election victory), all political parties and the media refrain from making open criticisms or harsh evaluation to the new president, and rather support to promote his policies. This is the expression to describe "a certain period of sweet welcoming mood" when they warmly watch the processes of legislating many of his important bills and acts. It may be the practice that could have started in the US where the government regime change takes place almost regularly in every 8 years under two-party system, since people understand that it will take some time before the functions of new government take off. The victory of Mr. Trump was so shocking that it went far beyond the simple expression of "unprecedented" though, as to see the reaction at the financial market a week after the election suggests the tradition of "first 100 days" seems to have been kept "as precedent".

＜Financial Market welcomes "Trump Reflationary Policies"＞

The rise of equity prices, interest rate and the value of the dollar are progressing in the US financial market and what is in its backdrop is more than anything but the expectation for "policy mix of fiscal expansion and monetary tightening" under the new administration. Given the prospect that the US economy will pick up in the near future with higher inflation under the reflationary policy of a large scale of "tax cut, infrastructure investment and deregulation", the market is now responding by incorporating at once in its sentiment the scenario of a rising stock prices expected in that process together with a forecast of expansion of budget deficit that will lead to a rise of inflationary expectation, a rise in the US long-term interest rates (an accelerated interest hike by the Fed), and the higher dollar. Although there are falls and rises by sectors, the major stock price indices are renewing record highs every day, driven by such deregulation-expected industries as energy, pharmaceutical, and finance or infrastructure related

industry. In addition, what is more surprising than the buoyant stock prices is the rise of the US Treasury yields. Since the market was permeated until recently by a forecast for a prolonged period of extraordinarily low interest rates reflecting the prolonged stagnation of the global economy, the speed and magnitude of interest rate reversal from excessively low level are astonishingly large as to see the rise of 10 year bond yield by 50bp in about a week.

＜Widening of Interest Rate Differentials and Stronger Dollar＞

The background factor of the rapid appreciation of the dollar against the yen in the dollar/yen exchange market was entirely the interest rate differentials that followed the rise of the US long-term interest rates. Since it was a major forecast of the market that if Mr. Trump won the election, the yen would rise upon risk adversion, the market would have accepted with a sense of unexpectedness the move of the dollar appreciating against the yen that started in the overseas market on November 9th. Perhaps due to the 100 days effect or else, there began to appear even an article that compares the economic policies of the Trump administration, to which almost no official information is available yet, to the successful Reaganomics in the 1980s and the market psychology is surely changing from that "the appreciation of the dollar is unexpected" to that "it is natural for the dollar to rise." Also there is a strong tendency that many of the participants in the foreign exchange market welcome any move of the market as a sign for business opportunity. The forecast for an appreciating dollar depending on the expectation on a "Trump Reflation" may also have been encouraged by their investment behavior to follow whatever trend that hints a chance of business rather than to put a damper on the current.

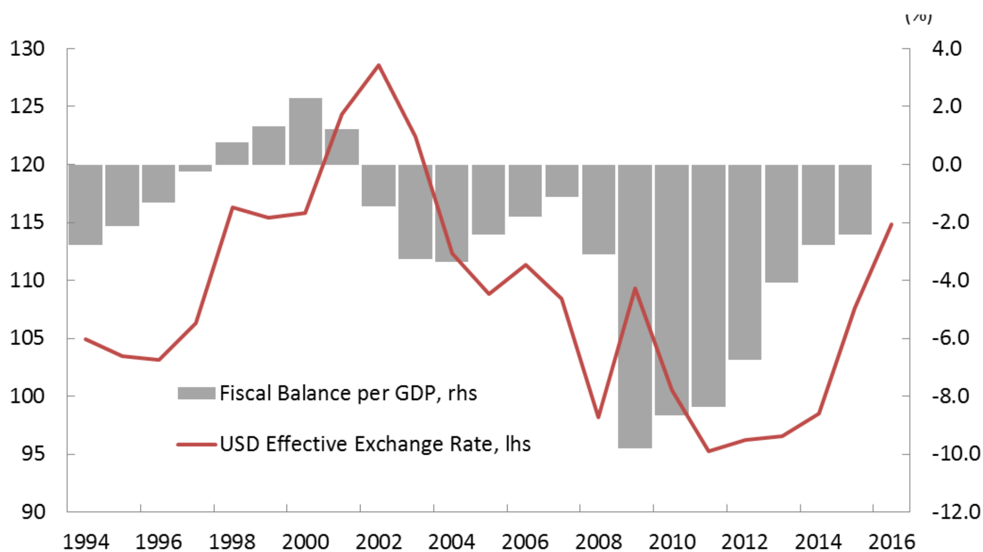
<Dollar Appreciation Expectations Last Only During the First 100 days?>

However, the author thinks that the sustainability of appreciation of the dollar against the yen and its magnitude should be gauged with care for the following three reasons. Surely the exchange rates that once started to move may continue for about 100 days, but it doesn't seem likely that the confidence for a prolonged period of high dollar against the yen can be easily fixed.

The first reason is a damage to fiscal discipline. Although we don't have sufficient information yet, based on his public commitments, a large-scaled tax cut like lowering of top corporate tax rate (from 35% to 15%), infrastructure investment and expected expansion of military budget to "Make America Great Again" would inevitably require a relaxation of fiscal discipline under the new administration. To what extent these measure are realized is still uncertain as they are philosophically incompatible with the traditional stance of the Republican party that advocates for a fiscal equilibrium and a small government, but expansion of the budget deficit cannot be avoided since both mainstream of the Republican party and conservatives have agreed at least on tax reforms that include lowering of corporate tax rate and

infrastructure investment. As the Chart 1 suggests, there is a tendency between the dollar exchange rate and the fiscal balance that in the long run an expansion of the budget deficit will lead to a depreciation of the dollar while improvement of the balance leads to an appreciation of the dollar. So we may think that there will be a limit to the simultaneous development of the worsening of fiscal balance and the appreciation of the dollar.

（Chart 1）US Fiscal Balance and US Dollar Effective Exchange Rates



The second reason is the theory of a purchasing power parity that suggests inflation affects the value of a currency. The current logic goes like this: expansion of fiscal expenditures increases the inflation expectation followed by rising US long-term interest rates that trigger an accelerated hikes of policy rates by the Fed that in turn encourage the appreciation of the dollar. But this does not think of any further development beyond. An acceleration of inflation finally and essentially gives a currency of a country a falling impact (depreciation) rather than a rising one (appreciation). If we go back to the theory of a purchasing power parity, the US dollar, a currency of a country where inflationary pressure is increasing, should be headed to fall (depreciate)

The third is the inclination of Mr. Trump to protectionism. It will not be compatible for the US to pursue for protectionism and at the same time to continue to accept higher value of its currency based on the market force. Actually the Obama administration enacted last year Trade Facilitation and Trade Enforcement Act of 2015 and in response the US Treasury started in April to publish a list of monitoring countries for determining the country manipulating its exchange rates (See The Eyes of IIMA, No.40 of this series). In the latest issue of the FOREIGN EXCHANGE POLICIES OF MAJOR TRADING PARTNERS OF THE UNITED STATES, published in October, 6 countries were included in the monitoring list, among of which 3 countries of China, Germany, and Japan have been judged as having relatively large economic scale and trade balance surplus with the Unite States. Mr. Trump has stated that he will

determine China as a currency manipulator as soon as he takes the office as president, but including that, the possibility that the new administration will accept for a long time the appreciation of the dollar against the currencies of these three countries will be low.

Mr. Trump is not the only one who has stated about the adverse effects of the higher dollar on the US economy. The US Fed cited two factors of “the rebalance in the emerging economies” and “the impact of the appreciation of the dollar” as reasons for the downward swing of the US economy in the first half of this year, repeatedly pointing them out in the public documents including FMOC statements. Mr. Stanley Fischer, who can be said to be a heavyweight in the international financial world rather than just an important Fed official, presented in his lecture his calculation result that 10% higher dollar would put downward pressure on the US GDP by 1.5% in 3 years. If the appreciation of the dollar will be accelerated more severely and rapidly, the US monetary authorities will strengthen their vigilance and modify their monetary tightening stance to more moderate one. The present appreciation of the dollar reflects a synergy effect of “expectation for the accelerated interest rate hikes by the Fed (expectation for higher US interest rates)” and reflow of fleeting money from emerging economies”, but the rapid progress of appreciation of the dollar itself is highly likely to cloud the judgment of the Fed on an interest rate hike.

＜From Trump Risk to Trump Chance＞

Before the election, the financial market had mostly negative and skeptical evaluation on Mr. Trump and his campaign agendas but after the election result became clear, as if turning over their hands, more and more positive interpretations have been expressed. These responses may represent their feeling of relief after they heard his triumph speech that had a moderate content or reflect their expectation that the radical policy lines will be corrected given his successful business experiences as a real estate tycoon. The ideas are not beyond comprehension to think that it would be better to get on the chance if the emergence of a trick star like Mr. Trump will trigger a chance to break a long-term stagnation as it is said “the mind affects the business.” Furthermore, in any country, an exchange rate environment will continue for some time where investors like macro-oriented funds which take advantage of any political regime change as a perfect business chance will join the stream of "higher stock prices, rising interest rates and appreciating dollar.”

But the greatest concern of the author is that, whether it is fiscal expenditure policy like tax cuts and infrastructure investment or protectionist policies like increase of import tariffs and exclusion of immigrant workers, the macroeconomic consequences of Mr. Trump’s major economic policies all lead to a rise of inflation in the US. Inflation will further impoverish the “people left from the globalization”, those symbolized by the so-called low income whites that became a driving force to elect Mr. Trump to the president. If the cheaper dollar is added to this, domestic inflationary pressure will be further strengthened, resulting in a further expansion of

differentials. On the other hand, his trade policy promoted under the idea of "America First" will cause an adverse wind not only against Mexico but also against the whole global economic activities through decreased exports from US's major trading partners including China. One of the English media called the optimistic exchange rates seen after the election as "Trump party", but if it is only a momentary party, the day the party will be over may come sooner than expected before waiting for the end of the first 100 days. Anyway, it will take more time and more information before we can feel certain that the Trump risk has been changed to a Trump chance.

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