

Trump is the Dr Strangelove of financial markets

World economy
The markets have suddenly realised that the man in the White House is flirting with mutually assured economic destruction.



Nouriel Roubini

Financial markets have finally awoken to the fact Donald Trump is the United States' President. Given the world has endured two years of reckless tweets and public statements by the world's most powerful man, the obvious question is: what took so long?

For one thing, until now, investors had bought into the argument that Trump is all bark and no bite. They were willing to give him the benefit of the doubt as long as he pursued tax cuts, deregulation and other policies beneficial to the corporate sector and shareholders. And many trusted that, at the end of the day, the "adults in the room" would restrain Trump and ensure the administration's policies didn't jump the guardrails of orthodoxy.

These assumptions were more or less vindicated during Trump's first year in office, when economic growth and an expected increase in corporate profits—owing to forthcoming tax cuts and deregulation—resulted in strong sharemarket performance. In 2017, US stock indices rose more than 20 per cent.

But things changed radically in 2018, and especially in the past few months. Despite corporate earnings growing by more than 20 per cent (thanks to the tax cuts), US equity markets moved sideways for most of the year, and have now taken a sharp turn south. At this point, broad indices are in correction territory (meaning a 10 per cent drop from the recent peak), and indices of tech stocks, such as the Nasdaq, are in bear-market territory (a drop of 20 per cent or more). Though financial markets' higher volatility reflects concerns about China, Italy and other eurozone economies, and key emerging economies, most of the recent turmoil is due to Trump. The year started with the enactment of a reckless tax cut that pushed up long-term interest rates and created a sugar high in an economy already close to full employment. As early as February, growing concerns about inflation rising above the US Federal Reserve's 2 per cent target led to the year's first risk-off.

Then came Trump's trade wars with China and other key US trade partners. The latest US actions against China seem to augur a broader trade, economic and geopolitical cold war.

An additional worry is that Trump's other policies will have stagflationary effects (reduced growth alongside higher inflation). After all, Trump is planning to limit inward foreign direct investment, and



There are similarities between the madman in Stanley Kubrick's classic film and Trump.

has already implemented broad restrictions on immigration, which will reduce labour-supply growth at a time when workforce ageing and skills mismatches are already a growing problem.

Moreover, the administration has yet to propose an infrastructure plan to spur private-sector productivity or hasten the transition to a green economy. And Trump has continued to bash corporations for their hiring, production, investment and pricing practices, singling out tech firms just when they are already facing a wider backlash and increased competition from their Chinese counterparts. Emerging markets have also been shaken by US policies. Fiscal stimulus and monetary-policy tightening have pushed up short- and long-term interest rates and strengthened the US dollar. As a result, emerging economies have experienced capital flight and rising dollar-denominated debt. Those that rely heavily on exports have suffered the effects of lower commodity prices, and all that trade even indirectly with China have felt the effects of the trade war. Even Trump's oil policies have created volatility. After the resumption of US sanctions against Iran pushed up oil prices, the administration's efforts to carve out exemptions and bully Saudi Arabia into increasing its own production led to a sharp price drop. Though US consumers benefit from lower oil prices, US energy firms' stock prices do not. Besides, excessive oil-price

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volatility is bad for producers and consumers alike, because it hinders sensible investment and consumption decisions.

Making matters worse, it is now clear that the benefits of last year's tax cuts have accrued almost entirely to the corporate sector, rather than to households in the form of higher real (inflation-adjusted) wages. That means household consumption could soon slow down, further undercutting the economy.

More than anything else, though, the sharp fall in US and global equities during the last quarter is a response to Trump's own utterances and actions. Even worse than the heightened risk of a full-scale trade war with China (despite the recent "truce" agreed with Chinese President Xi Jinping) are Trump's public attacks on the US Federal Reserve, which began as early as the spring of 2018, when the US economy was growing at more than 4 per cent.

Given these earlier attacks, markets were spooked this month when the Fed correctly decided to hike interest rates while also

signalling a more gradual pace of rate increases in 2019. Most likely, the Fed's relative hawkishness is a reaction to Trump's threats against it. In the face of hostile presidential tweets, Fed chairman Jerome Powell needed to signal that the central bank remains politically independent. But then came Trump's decision to shut down large segments of the federal government over Congress' refusal to fund his useless Mexican border wall. That sent markets into a near-panic, and the government shutdown was soon followed by reports that Trump wants to fire Powell—a move that could turn a correction into a crash. Just before the Christmas holiday, US Treasury Secretary Steven Mnuchin was forced to issue a public statement to placate the markets. He announced that Trump was not planning to fire Powell after all, and that US banks' finances are sound, effectively highlighting the question of whether they really are.

Recent changes within the administration that do not necessarily affect economic policymaking are also rattling the markets. The impending departure of White House Chief of Staff John Kelly and Secretary of Defence James Mattis will leave the room devoid of adults. The coterie of economic nationalists and foreign-policy hawks who remain will cater to Trump's every whim. As matters stand, the risk of a full-scale geopolitical conflagration with China cannot be ruled out. A new cold war would effectively lead to de-globalisation, disrupting supply chains everywhere, but particularly in the tech sector, as the recent ZTE and Huawei cases signal. At the same time, Trump seems to be hell-bent on undermining the cohesion of the European Union and NATO at a time when Europe is economically and politically fragile. And Special Counsel Robert Mueller's investigation into Trump's 2016 election campaign's ties to Russia hangs over his presidency. Trump is the Dr Strangelove of financial markets. Like the paranoid madman in Stanley Kubrick's classic film, he is flirting with mutually assured economic destruction. Now that markets see the danger, the risk of a financial crisis and global recession has grown.

PROJECT SYNDICATE

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Prepare to say goodbye to the cold, hard cash in your pocket

Technology
The end of cash is very near. That won't change the need for self-discipline in spending it.



Richard Holden

As another new year arrives, we are greeted with two typical sets of announcements: various minor laws that go into effect on January 1, and the release of cabinet papers revealing what the government was worrying about 20 years ago.

One of these years there will be a more consequential announcement. "Australia goes cashless", the headline will blare. Not next year, not the one after. But soon, and for good. I have written before, on these pages, about why Australia should go cashless—including the more than \$6 billion in increased revenues from those dodging GST and income tax through the cash economy; and how an electronic paper trail deters illegal transactions.

I've also written about how Australia could go cashless. We have already moved strongly away from cash and to electronic transactions thanks to our world-class payments system. The RBA-sponsored New Payments Platform (NPP) is making peer-to-peer payments even easier, meaning it's simple to do everything from split a restaurant bill 10 ways, to pay a babysitter, to buy a car without cash.

Today I tell you that Australia will go cashless. It's just a matter of time.

This isn't the mere extrapolation of a trend—although the trend away from cash is powerful. These days the average

Australian goes to an ATM about once every two weeks. A decade ago that was closer to once every week. Today Australians make about 500 electronic transactions a year, compared to 100 at the turn of the century.

Cheques have almost disappeared. In the mid-1990s Australians wrote about 45 cheques per year. Now it's three on average. RBA governor Philip Lowe acknowledged in late November "it will be appropriate at

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The reason for all these trends is, of course, that electronic payments have become much more convenient. It's far quicker to "tap-and-go" than take the same debit card to an ATM, withdraw the cash and then pay. As fees on tap-and-go payments go to zero, they will only rise in

number. Similarly, Commonwealth Bank of Australia has capitulated to customer demand and joined ANZ Banking Group in introducing Apple Pay. Millions of customers will now pay for most everyday items with their iPhone or Apple Watch.

Of course, there are objections to a cashless Australia. The most common one is the question of what happens in a natural disaster. "If there's a massive blackout we need cash", I'm often told. "What about a tsunami?" comes up more often than one might think. In either of these scenarios, shops won't be open. Even in small, localised blackouts, shops typically shut due to lack of lighting, refrigeration or security concerns. And precisely because such events are either rare or short-lived, cash does not really have an advantage.

Perhaps a more interesting role for cash is in a version of what Nobel Laureate Richard Thaler dubbed "mental accounting". Some people find it easier to keep track of their finances, by having various "envelopes" of cash for dedicated purposes—one for food, one for petrol, one for rent and so on.

This is a perfectly understandable and reasonable approach—but again, cash no longer has the edge here. There are plenty of budgeting and expense-tracking solutions, including for mobile phones. As the NPP develops further and financial institutions

expand the functionality of their offerings, virtual digital envelopes for different expense categories will be easy to keep. In short, "there's an app for that".

Finally, once cash becomes rarely used, one wonders about the transactions that still do involve cash. They are, statistically speaking, much more likely to involve illicit goods or tax evasion. Thus, as we approach a cashless society there is a big incentive to go all the way.

Sweden is already showing what is both possible and likely, with 98 per cent of transactions being cashless. This is expected to be 99.5 per cent by 2020.

With Australia's advanced payments system, near ubiquitous banking usage and significant mobile phone penetration, we are poised to become fully cashless. Perhaps as soon as 2025.

Cash is the horse-and-buggy of the 21st century. It had its time, but now we have a better way. There will continue to be a transition while cash is phased out. There will be some folks who lament the change. And there will always be doomsayers predicting a cash-only response to natural disasters. But, in the immortal words of Homer Simpson, "you can't stop progress".

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