From stock market growth to the geopolitics of the dollar

The Joe Biden era is unfolding. The reality of the transformations and priorities that the new, old president wants to leave for posterity is beginning to dawn. The changes certainly concern form and language, but also and above all substance. It is not a total break with Donald Trump's strategy, especially with regard to the main geopolitical priority, China. Both start from the assumption that their country is no longer the first and only absolute world power, as happened after 1989 with the fall of the Berlin Wall and the end of the Cold War. However, the United States remains the first relative military and technological power. Trump wanted to be the expression of the old America, the incarnation of the strong man who can enrich himself thanks to the infinite resources of capitalism and its territory in which to circumscribe his strategic defence. Sure, he saw the new world coming. But he believed that the negotiating power of the determined entrepreneur and Wall Street were the tools to ride out the changes. He was not concerned about the energy transition. If the market is naturally predisposed to want to use the cheapest energy in the world today, oil-based energy, why change?

It is precisely because of this view that he struggled to understand the need to address the pandemic with real common safeguards. It has always put the freedom of the individual first. Then, of course, the pharmaceutical companies would sniff out the 'business' and then quickly come up with a vaccine. For businessman Donald Trump, the centre of economic policy revolved around Wall Street. Even though he was elected and supported by the vote of Main Street - the people left behind by globalisation - Trump wanted a strong American stock exchange, an expression of business optimism.

He then reduced corporate taxes from 35% to 21%. In fact, his Tax Act allowed loopholes all in favour of large multinationals in the utility, gas, automotive and hydrocarbon sectors.

According to an analysis by the Institute on Taxation and Economic Policy, dated 16 November 2019[1], the majority of the 379 American mega-companies paid an average of 11.3 per cent of their profits to the Treasury. Indeed, in 2018, *"91 companies, including Amazon, Chevron, Halliburton and IBM,"* explain the editors of the study, *"either literally paid no taxes, i.e. a zero rate, or reported a negative rate on their balance sheets, benefiting, for example, from tax breaks or tax credits reimbursed by the US Treasury Department".*[2] His strategy, however, allowed him to go beyond the monetary support of Quantitative Easing (QE), which was losing its ability to influence economic growth. His idea of encouraging American companies to return home through tax breaks has also helped to boost the economy and bring unemployment down.

The approach to China was tough, but almost more commercial than political in nature. Trump focused on customs duties and the prospect of pushing the Chinese to buy American, particularly in agriculture. The fact that Powell accompanied these successes with a rise in US rates, thereby strengthening the dollar, sent the then White House tenant into a rage, precisely because he feared the repercussions on the stock markets. And, above all, the weak dollar favoured American exports. Many Americans liked Trump's policy. Without the coronavirus, he would most likely have been re-elected.

For Joe Biden, a man who has experienced the delicate balance of power of the Cold War at close quarters, the approach is less business-oriented and more geopolitical. For him, stock market performance is subordinate to the reform of the American economy and not the other way around. The relative strength of the United States, in order to remain at a high level, needs a growing real economy and strong social solidarity, managed by a strong state. The expression of this strategy is not only on Wall Street, but in the performance of the dollar. This is the tool and the key to understanding his approach, which will accompany the multilateralism he intends to relaunch. He recognises the Chinese danger and the

[1] Corporate Tax Avoidance in the First Year of the Trump Tax Law, 16 dicembre 2019, https://itep.org/corporate-tax-avoidance-in-the-first-year-of-the-trump-tax-law/

[2] Idem.

challenge that Xi Jimping issued to the world when he announced that by 2025 his country would be the undisputed technological leader. To complete this picture, however, China also needs to be a major financial hub. The yuan must become the reserve currency for international trade, ousting the dollar. In the financial sphere, Mao's country does not have Goldman Sachs or J.P. Morgan, but it can rely on Hong Kong. He has therefore decided to break the deadlock and make this territory functional to his power policy.

Biden knows that time is short if he is to succeed in containing China. Politically, he has two years, before the next Congress is renewed, to implement his policy. But in the first twelve months of his mandate the most important and painful pawns must be moved: then it is back to the electoral campaign. He also has two important partners in his strategy: the Treasury with Yanet Yellen and the Federal Reserve with Jerome Powell. If he wants to dominate through the dollar, American growth must be powerful: it is the only way to make the frightening debt sustainable. So it is vital to overcome the pandemic quickly with the right measures and vaccines: he has promised that by July 90% of Americans will be immunised. To overcome the pandemic, he has launched a $1.9 trillion programme, including the delivery of greenbacks into the pockets of citizens ('Helicopter money', as the then Fed chairman Ben Bernanke called it). It is also launching a programme of more than 2 trillion in infrastructure investments: roads, bridges, energy transition. He is therefore responding to the central bankers' appeals: you cannot rely on their QE alone. So he is also planning to raise taxes on corporations (from 21% to 28%) and on the wealthiest Americans.

All this fervour may create inflation, hence the end of the Fed's bond-buying and perhaps a rise in rates. The stock markets would be affected. But the FED is willing to tolerate inflation, even beyond the 2% target, and promises not to raise rates. Such an approach would lead to the devaluation of the dollar (due to increased debt and inflation) and push the already overvalued stock markets towards the creation of a financial bubble. The Federal Reserve should prevent this. But how? It cannot intervene directly: it would create panic. So it is relying on the bond market, which is itself pushing the 10-year yield to

2%. This strengthens the dollar and contains stock market exuberance. Elements that are probably in line with Trump's wishes. A strong dollar punishes (brings into line?) those oligarchs who have benefited from the Trump era such as Bolsonaro, Erdogan, Putin. It helps the European Union, at this difficult time when the pandemic is raging, because it facilitates exports. These will probably go more to the USA thanks to the infrastructure investment plan: he must have promised the Europeans something, especially Germany, to encourage them to support his Chinese and Russian challenge.

The preference for the strong dollar even at the expense of the stock market conceals some danger. The years of easy money have created distortions and exaggerations. As interest rates rise, those who have abused the levers of finance, perhaps out of sheer greed, will suffer the Darwinian selection of the market. Credit Suisse knows a thing or two about this: in the space of a month, it has had to deal with two extreme cases, Greensill and Archegos, which will lead to losses running into billions. For example, one of Archegos' main investments, ViacomSBS, was valued by Credit Suisse analysts at USD 28 and then USD 37 in recent months, while the stock was hovering around 100. At these levels, perhaps around USD 80, everything is easy. But if the (obviously overvalued) stock falls, the investor has to pay back the loss based on multiples that are difficult to weight if obtained through opaque derivatives (*Equity Total Return Swaps*). Has no one in the bank consulted its analysts' valuations? Hard to answer. But situations where easy money has prompted excessive risk-taking will reveal themselves in the coming months. The Fed will only intervene if there are systemic risks.

The dollar has already shown its strengthening during the first quarter (against Eur +3.9% since the beginning of the year). From these levels it could tactically retreat. We should monitor the 10-year US bond which rose from 0.91% to 1.7% in the quarter (which allowed the dollar to strengthen). The next resistance is at 1.78% and then 2.12%. It would be too dangerous to go beyond these levels and so the room for further strengthening of the dollar is not particularly large either. But precisely because the greenback has become a geopolitical tool, it is now more difficult than usual to hazard forecasts. Rates and US GDP will remain more important indicators than debt (for now). The fact that the Swiss franc lost 6.8% against the US dollar in the first quarter of the year is a sign of previous overvaluation, but also a measure of global risk appetite.

Stock markets are expensive. Especially the US stock market. It will be up to the strength of the infrastructure plan and the speed at which the pandemic is overcome by vaccines to determine whether growth will be strong enough to reward corporate profits, which will have to contend with higher taxes. Europe is in pretty bad shape with the third wave of coronavirus. But the vaccines are coming. With no complete central state, the EU will remain unbalanced on the central bank, which will continue to pump money into the system and thus support risky assets. The UK and the pound will come out of the pandemic first: they will be able to take advantage of it. Emerging countries will suffer from the strong dollar, to which they are indebted. China has deliberately anticipated the correction of its domestic stock markets to avoid a financial bubble and is curbing the overweening exuberance of its technology companies. It will do anything for the stability of its currency. It is no longer the only place in the world with a growing economy, as it was in 2020, but it remains an important growth pole. After stabilisation, perhaps already underway, there will be an opportunity to get back in. Biden has thrown a lot at the table in just a few months. The downside of his decisions, even those that can hurt the stock markets, is more electorally sustainable in the first year. It is good to remember that.

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