Markets quiet but imply feeble nominal growth

Having been on a “trade war watch” for several weeks it seems as if markets really aren’t considering Trump’s grandstanding such a big deal. Tariffs will hurt both the US and its trading “foes”, for sure, but not cause huge damage to NGDP growth. Perhaps these new trade barriers will reduce real growth a bit but not by much. The war generates headlines and pages of copy but signifies little. Some patterns of demand will switch as will some production. Trump is powerless to stop Harley Davidson setting up a factory in China to serve China. He can’t stop the rest of the world switching away from US soya beans to Brazilian ones. None of this is optimal, but it is hardly the end of the world.

Part of the reason is that China might have been badly impacted a few years ago when trade was such a large percentage of its GDP, but the share has fallen dramatically over the last decade or so as the internal market has grown and grown. It is now looking more like the US where external trade is a small percentage of GDP – the internal market is everything.

Thus, it is back to monetary policy as the main concern for real growth. In the long run monetary policy is not neutral and can be damaging to real growth – via messing up stable, trend growth in NGDP. This damage can occur through:

1. messing up the supply side through excessive, but more importantly, volatile inflation (1970s); or
2. damaging recessions after which the lost real production is not made up by any nominal overshoot during the recovery phase (2008-9); or, a variant on this, where
3. lost production not being made up through perpetual undershooting of trend nominal growth, as we see now.

Although markets mostly have drifted over the last few weeks, there have been setbacks as commodity prices, both precious metals (gold) and others (oil, copper) have weakened. The USD and equities have remained largely rangebound, but the yield curve has flattened some more. Flat at higher overall yields is both fine and, actually, desirable.

Overall this has been bad for our market-driven NGDP Forecast which is showing the worst YoY growth one year ahead for the past 12 months – a feeble sub-4% rate. A modest real growth slowdown, coupled with low inflation and a Fed that thinks it needs to slow down growth is never a good idea.