



OFF THE NEWS

A Central Bank of Flexibility

Traditionally, the European Central Bank has reflected a relatively cordial environment of mutual respect even when there have been serious policy differences. Policymakers work hard to create the impression of consensus. This was even the case during President Mario Draghi's tenure, when his German colleagues were often in fierce opposition.

All of this has changed. Many policymakers today are privately scornful of President Christine Lagarde's lack of fundamental understanding of monetary policy. "We really don't listen to her anymore," a policymaker told *TIE*. Lagarde's general practice is to read the statements provided by ECB Chief Economist Philip Lane. Lane is described as having the intellectual sophistication in monetary affairs that Lagarde lacks, but seems to be influenced in his thinking by one impulse when confronted with a difficult decision: delay, delay, delay.

Many colleagues were confused with Lane's decision in March to have Lagarde stick to February staff projections which called for an inflation rate in 2023 of only 2.1 percent and in 2024 of only 1.9 percent.

Even more confusing is that at the March 10 Governing Council meeting, there was said to be little discussion of possible second-round inflationary effects even though trade unions in some countries are expected to ask for higher wages in coming months to deal with higher energy and other prices.

The ECB leadership has recruited Vice President Luis de Guindos to reach out to eurozone governments to try to use fiscal policy (temporary targeted assistance) to help avoid a wage-price spiral. In his new role, de Guindos has repeatedly warned that any fragmentation

of the euro area in terms of diverging interest rate levels in capital markets could endanger the effectiveness of monetary policy. Was the ECB vice president hinting that the central bank's bond purchases might not actually end in autumn as announced by Lagarde?

De Guindos went on to stress that the "most important decision" by the Council on March 10 was to disconnect potential interest rate increases from the bond purchase program. As has been widely reported, the ECB leadership used the phrase "sometime after" to describe when interest rates would go up, which of course offers no time specificity. Chief Economist Lane has praised the central bank for integrating "flexibility" into the central bank's policymaking apparatus. Such flexibility is demonstrated by de Guindos' latest hint that the European Central Bank now could end its bond purchases in July followed the same month by an interest rate increase. The hint is no doubt a response to the dollar's rising strength against the euro.

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ECB President Christine Lagarde is said to lack sophistication in monetary affairs.



ECB Chief Economist Philip Lane is the intellectual power behind the throne.



ECB Vice President Luis de Guindos is the new agent of flexibility.

U.S. Presidential Politics Winter Card

The GOP is expected to win big in November—possibly winning forty seats in the U.S. House of Representatives and maybe also taking control of the United States Senate. The latest NBC/Wall Street Journal polling data show a collapse of support for Biden with no enthusiasm on the Democratic side for the upcoming elections and with surprising enthusiasm among independents for possibly voting this time for GOP candidates. Put another way, Biden's favorable support in the Gallup polls is 6 percentage points lower than President Obama's was in 2010 just before the Democrats lost a whopping 63 seats in the mid-term elections. And today, the public is far more pessimistic toward the future than in 2010.

Democrats won the White House in 2020 because their candidate was not Donald Trump. Republicans hope to win the White House in 2024 because their candidate is not Joe Biden.

The irony is that contrary to conventional wisdom, the GOP did not do as well as expected in the Congressional redistricting process. The problem for the Democrats is that the polls show that the voters simply do not like President Biden. As one political strategist put it to *TIE*, "The President called the rise in the price of gasoline 'the Putin gas tax', but nobody believes that explanation." All they know is that in California, for example, filling up a gas tank can run as much as \$200.

By February 2023, the GOP will face its own food fight. A lot will depend on whether former President Donald Trump runs again. Former New Jersey Republican Governor Chris Christie has already announced an interest in running for president. In the 2016 presidential campaign, Christie saw his job as taking down the GOP front runner Marco Rubio. He was quite successful in that endeavor. In 2024, Christie sees his job as taking down Trump, assuming the former president runs.

To launch his campaign, Christie wrote a book detailing all of Trump's blunders. He recently underwent a three-week campaign tour to promote the book. The book sold only 3,000 copies. Did Christie's book campaign fail because of a lack of interest in Christie, or because of a lack of interest in Trump?

There will likely be other horses in the race for both parties. Washington political insiders have been

surprised by the ability of Florida Governor Ron DeSantis (R) to raise money. DeSantis has raised \$100 million for his reelection campaign as governor. DeSantis is described as having all of Trump's political instincts, but none of his over-the-top brashness which suburban housewives find so offensive. DeSantis, however, is perceived as having two liabilities. First, he gives off a highly intense impression in public that makes him seem unapproachable. Second, he has no sophisticated campaign team around him. His wife runs his political operation. He is often two hours late for events and, in general, is disorganized.

Which leaves this wildcard: In late April, a group of GOP high-dollar political donors approached conservative Democratic Senator Joe Manchin (WV) about switching parties to run in the 2024 Republican primaries against former President Trump. Manchin, who blocked President Biden's Build Back Better program in Congress, is highly popular among Republicans. Manchin offered no commitment.

American presidential politics have hit a weird stage. Democrats won the White House in 2020 because their candidate was not Donald Trump. Republicans hope to win the White House in 2024 because their candidate is not Joe Biden. But if Trump is on the ballot, the GOP's position could weaken. Trump enjoys a loyal base but continues to have negatives in most polling among key swing voting groups. A Trump victory in 2024, if it happened, would likely entail a scenario similar to 2016—a loss of the popular vote and a razor-thin win in the electoral college.

President Joe Manchin? Joe Biden's greatest nightmare? But ultimately the GOP's nightmare too?



GOP "primary killer": Former New Jersey governor and presidential hopeful Chris Christie (R).



A smiling Florida Governor Ron DeSantis (R) charming the voters.



Coming Global Dollar Shortage?

An ugly possible scenario.

Here's the latest scenario making the rounds in Japanese financial market circles. Over the next year or so, the yen will continue to weaken. The trend suggests a ¥150 yen-dollar rate, mostly because the dollar will continue to strengthen. After all, the United States is tightening monetary policy and Japan is not.

By early next year, the U.S. economy will likely be flirting with recession. With President Biden's fiscal measures now having been spent, fiscal policy will become a net negative in the macroeconomic equation. Inflation will continue to erode the purchasing power of consumers. So consumption will seriously erode.

By early next year if not sooner, the Federal Reserve will become nervous about further tightening. Some policymakers will talk about ending tightening policies. The dollar will weaken as a result of such talk, but the recession will continue. The U.S.

trade deficit will shrink. The result: The rest of the world will suffer from a severe dollar shortage as a result of the shrinking of the U.S. current account.

Such a scenario, if it materializes, will be particularly difficult for Japan. For the first time in decades, Japan could experience a weaker yen together with a huge trade deficit. Under this scenario, raising rates would not be enough to support the yen. The government would need

to reduce the budget deficit simply because by then private sector savings will likely not be enough to finance the deficit.

Japan will feel intense pressure to do the inevitable—to tighten both fiscal and monetary policies in a recession. As a result, the Liberal Democratic Party will fall into chaos with a major internal conflict between a pro-Abe LDP faction and an anti-Abe LDP faction. Political and policy dysfunction will reign supreme in the world's third-largest democracy.

The rest of the world will suffer from a severe dollar shortage as a result of the shrinking of the U.S. current account.



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Coming Chinese Dollar Debt Default?

With the Ukraine war raging and the West hitting Russia with a wide array of aggressive economic sanctions, it is popular to suggest that in response, Russia's global partner China will eventually promote development of a bifurcated global system with the West on one side and Russia, China, and the like on the other. Such a change in the makeup of the global economy would require the end of the dollar's universal role as the world's reserve currency.

Yet such an outcome would face some serious roadblocks. One of them is China's debt. China has \$2.4 trillion in dollar-denominated debt with an

average maturity of about four years. That requires an annual debt service payment of about \$600 billion. Here's the problem. China's annual current account surplus is only between \$300–\$400 billion. With the world economy deglobalizing, that surplus is likely to shrink. So a dollar-denominated debt default by China at some point seems probable. Concluded one Tokyo policy strategist: "The notion of a new bifurcated global system with a reserve currency for one side tied to China is absurd, particularly under conditions of dollar debt default and a continued lack of overall transparency." Another policy strategist put it in simpler terms: "For China, the numbers don't add up."

Washington, D.C., traditionally is full of rumors about personnel changes, most of which are wrong. One rumor lately is that **Treasury Secretary Janet Yellen** will retire after the November U.S. mid-term elections.

The fires of this rumor, nevertheless, were stoked by a May 27 *Politico* piece arguing that the distinguished former Fed chair is often not in step with some of the ultra-progressive advisors surrounding President Biden.



The Gangsters Advance Toward the Commanding Heights

"The present threat to democracy is the product of 16 consecutive years of decline in global freedom. A total of 60 countries suffered declines over the past year, while only 25 improved. As of today, some 38 percent of the global population live in Not Free countries, the highest proportion since 1997. Only about 20 percent now live in Free countries. ...

"The regimes of China, Russia, and other authoritarian countries have gained enormous power in the international system, and freer countries have seen their established norms challenged and fractured. ...

"[T]he CCP has used its vast economic clout and even military threats to suppress international criticism of its own violations of democratic principles and human rights, for instance by punishing governments and other foreign entities that criticize its demolition of civil liberties in Hong Kong or question its expansive territorial claims.

"In 2021, the CCP further extended the scope of speech it would not tolerate, employing economic and technological leverage to pressure governments, international institutions, and the private sector to echo its preferred narratives. ... A Marriott hotel in the Czech Republic declined to host a November 2021 World Uyghur Congress gathering, arguing that it preferred to observe 'political neutrality.' New Zealand's Parliament refrained from identifying Beijing's actions in Xinjiang as a genocide after the trade minister voiced concerns that such language would hinder economic relations with China. Such threats are credible given Beijing's past reprisals against foreign companies and nations, including the imposition of tariffs on Australian exports after Canberra called for an independent investigation into the origin of COVID-19."

—Sarah Repucci and Amy Slipowitz, *Freedom in the World 2022*, *Freedom House*