FINANCIAL TIMES

Donald Trump in Davos: dollar talk adds to fears of trade war

Sam Fleming and Shawn Donnan

January 26, 2018

Donald Trump may have avoided the heavy snow that fell on the global business elite in Davos earlier this week, but he could not ignore the storm clouds building elsewhere in Europe.

Just as the American president was arriving in the Swiss mountains for the World Economic Forum on Thursday, Mario Draghi issued an extraordinary rebuke to the US. The European Central Bank president suggested that comments the previous day by Steven Mnuchin,

Mr Trump's treasury secretary, welcoming a weaker US dollar were a breach of agreements designed to prevent currency wars. Mr Trump did his best to quell the controversy, insisting the US was still committed to a strong dollar. But the confusion increased the anxiety among other major economies about the bellicose and unpredictable direction of the US's international economic policy.

After years of miserable growth, the rebound in the global economy is looking more promising than at any other time since the financial crisis, with the International Monetary Fund upgrading global forecasts for 2017, 2018 and 2019, world trade growth accelerating and corporate leaders basking in more effervescent business conditions.

That momentum could be checked, however, if leading economic powers start clashing over currencies or trade relations as America pulls back from its role at the vanguard of the liberal international order. Polling across 134 countries from Gallup suggests America's traditional leadership role has eroded badly under Mr Trump's "America First" regime, with approval around the world sinking to unprecedented lows.

“There has been a lot of thunder, and now the storm is coming,” says Matthew Goodman, a former White House and Treasury official who is now at the Center for Strategic & International Studies. “Maybe the world economy can absorb all of this, but these actions on trade and currency have ripple effects around the world and I don’t take them lightly.”

The White House’s more aggressive approach to economic policy, which it foreshadowed this week with the announcement of tariffs on imported solar panels and washing machines, is likely to be intensified after Mr Trump’s State of the Union address next week.

The administration has made it clear it plans to take action against China on intellectual property theft. Also looming are potential tariffs on steel and aluminium. Still alive too is Mr Trump’s threat to withdraw from the North American Free Trade Agreement. While the president currently appears more inclined to renegotiate Nafta, this remains a key risk to equity markets’ stellar run.

Mr Trump’s message at Davos on Friday was an attempt to sell the America First agenda as beneficial to the world. “America First does not mean America alone,” he said. “When the United States grows, so does the world.”

While US growth figures undershot analyst expectations on Friday, with gross domestic product expanding at an annualised rate of 2.6 per cent, big companies have much to be thankful for: stock prices are at an all-time high, Mr Trump has cut US companies’ tax rates, and regulations are being stripped away.

Yet Stephen Moore, a former economic adviser to the Trump campaign who is now a visiting fellow at the Heritage Foundation, says there remained an “obsession” among some White House advisers with curbing the US trade deficit that could drive them towards economically counterproductive policies on both the currency and trade.

“When you look at the kinds of things that could disrupt this burst of growth, the movement against international trade would be one of them,” he says. “I think this infatuation with the weak dollar is misguided. I am in favour of a strong and stable dollar. It is fool’s gold to think a weak dollar will somehow improve the economic situation.”

Similar concerns were evident in Europe this week. Mr Draghi spoke for other top policymakers on Thursday when he implicitly criticised Mr Mnuchin’s bold declaration that “obviously a weaker dollar is good for us as it relates to trade and opportunities”.

Mr Draghi did not mention the US by name, but he twice referred to an agreement between leading economies last October not to talk down their currencies — an agreement that includes the US. Mr Mnuchin and his boss later insisted the words had been misinterpreted and that there was no change in US dollar policy.

Mr Trump himself has form when it comes to talking down the dollar: just days before his inauguration last January he told the Wall Street Journal that its high value was “killing” the US.

The dollar fell around 13 per cent last year against a basket of major currencies, driven in part by improved prospects overseas. It has dropped another 3.5 per cent this year. The question is whether other nations will, despite Mr Trump's protestations, conclude that the US is angling for a weaker exchange rate in a reversal of the strong dollar policy that has notionally held sway since Robert Rubin was Treasury secretary under President Bill Clinton. This could pave the way for a new round of destabilising currency wars, as well as damaging overseas demand for US assets.

The American delegation in Davos gave the impression of a pugnacious approach to global economic relations that clashed with calls from a range of European and other leaders for multilateral solutions to global challenges. The combative tone was not limited to currencies: speaking about the possibility of trade wars, commerce secretary Wilbur Ross warned that "US troops are now coming to the ramparts".

Trump administration officials insist they are not out to explode the multilateral system and that they are seeking to reform rather than destroy institutions such as the World Trade Organization. But they have made clear the world should expect more actions like this week's tariffs — and that China will be their primary target. "Across the board everyone sees China as a major threat that needs to be dealt with," says a senior White House official.

For some finance ministers and analysts, US dollar weakness could serve a useful end if it alleviates some of the pressure in Washington for antagonistic trade policies. Philip Hammond, the UK chancellor, told Bloomberg Television that if a softer dollar helps to make Americans feel the global trading system is fairer to them "that is a good thing for all of us".

C Fred Bergsten, a long-term advocate of a more activist US currency policy at the Peterson Institute for International Economics, says that reducing the trade gap is a legitimate goal after decades of relentless deficits and that a weakened dollar represented "a far superior alternative" to outright protectionism. "I would argue the robust economic outlook suggests the world could accept a further, modest decline in the exchange rate of the dollar," he says.

The recent dollar sell-off only partly reverses a surge in the currency that started in 2014. And while the spectre of protectionism looms large over the White House's trade policies, the new tariffs on solar cells and washing machines are within the boundaries of past US and even global practice. Barack Obama triggered similar "safeguards" on Chinese tyres in 2009, George W Bush applied tariffs to US steel imports in 2002.

"It is not a launch of a trade war because we are acting within the rules," Daniel Ikenson, the lead trade analyst at the libertarian Cato Institute, says of the tariffs. The tariffs Mr Trump elected to pursue are temporary. They also were not as severe as the ones sought by the companies looking for protection.

Nevertheless, Mr Ikenson and others in Washington's pro-trade community are worried about what comes next. The administration's investigation of China's IP regime and efforts to force technology transfers by foreign companies make trade experts nervous.

The US has raised the prospect of new unilateral action by the US, including tariffs against Chinese imports and a crackdown on investment. The EU and Japan have been working to convince the Trump administration to fight as part of an alliance within the WTO. But any action outside WTO rules would invite retaliation by China and a more uncertain trade battle.

Mr Trump this week said he might be open to rejoining the Trans-Pacific Partnership, the grand trade project negotiated by his predecessor, after abandoning it as one of his first acts in office. US officials have also stressed that they are open to reviving a negotiation with the EU and other bilateral deals. But it is not clear any discussions are in the pipeline.

At home, the administration will continue to face pressure from Mr Trump's Republican party, which has served as one of the main checks over the past year on its trade policy. Will Hurd, a Republican congressman from Texas who backed the TPP, warns that a big crisis in Nafta could end the rally in the stock market — something the president has taken such great pride in. He also insists that a passive US leaves the door open for China to push its agenda.

"I would rather the US be involved in shaping the rules how trade is done in different regions of the world — rather than the Chinese," he says. "It is pretty clear the rest of the world will continue to move forward with or without us."

If the Trump administration does spurn new efforts at trade liberalisation it will be turning its back on what many economists believe to be one of the drivers of global growth in recent decades.

And while Davos attendees queued for hours to see Mr Trump's speech on Friday and took a measure of comfort from his efforts to stabilise the dollar, it would also mean the US was stepping back from its leading role in the global trading and currency system.