

# MARKET INSIGHTS

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## TRUMP'S TRADE WAR:

# America's Imperial Twilight or Dawn of a New Golden Age? A Non-Consensus Call for Interest Rates to be "Lower for Longer"

### The Rise and Fall of the American Empire

Tales of empires are as old as civilization itself. From ancient Mesopotamia to Rome, from the Mongols to the British, history is replete with stories of great powers that rose to dominate vast swaths of territory, only to eventually crumble under the weight of their ambitions. The United States of America, as the preeminent global superpower of the modern era, finds itself at a critical juncture in this age-old narrative.



Free trade gives to the foreign producer equal privileges with us. It invites the product of cheap labour to this market to destroy the domestic labour here.



- William McKinley

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Should a second administration under Former President Donald Trump become a reality, a possible trade war raises the question: Are we witnessing America's imperial twilight or the dawn of a new golden age? While some may balk at characterizing America as an empire, its economic, military, and cultural influence globally bears all the hallmarks of imperial power. Yet, unlike many of its predecessors, the U.S. has demonstrated a remarkable capacity for self-reflection and adaptation, embodied in what scholars call the American Jeremiad tradition.

The American Jeremiad, a rhetorical style rooted in Puritan sermons, combines lamentation over society's failings with hope for redemption and renewal. This uniquely American form of critique has allowed the nation to confront its shortcomings while simultaneously reaffirming its ideals. Through this lens, we can trace the arc of American power from its nascent industrial ambitions to its current position of global leadership—and potential decline or rebirth.

## Hamilton's Vision and McKinley's Legacy

Our journey begins with Alexander Hamilton, one of America's founding fathers and its first Secretary of the Treasury. In 1791, Hamilton presented his *Report on Manufactures* to Congress, laying out a vision for American economic development to shape the nation's trajectory for centuries. Hamilton argued forcefully for government support of manufacturing, recognizing that a diverse economy would be crucial for national independence and prosperity. He proposed measures to nurture American industry, including protective tariffs, bounties (subsidies) for innovation, and infrastructure development.

Hamilton's vision of a robust and diversified economy remains relevant today, even as the nature of industry and commerce has transformed beyond anything he could have imagined. His emphasis on government support for key industries and infrastructure development could serve as a blueprint for addressing modern economic challenges.

Fast forward to the late 19<sup>th</sup> century and we find William McKinley, the 25<sup>th</sup> President of the U.S., implementing

policies that echo Hamilton's vision. McKinley was a staunch advocate of protectionism, believing that high tariffs were necessary to shield American industry and workers from foreign competition. The *McKinley Tariff Act* of 1890 raised import duties to nearly 50 per cent on average to nurture America's growing industrial base and provide well-paying jobs for workers.

While McKinley's approach was controversial even in his own time, it played a significant role in America's emergence as an industrial powerhouse. Today, as the U.S. grapples with challenges to its economic leadership, there may be lessons to draw from McKinley's policies, albeit adapted for the realities of the 21<sup>st</sup> century's global economy.

## The Debt Dilemma and Future Prospects

Now, as we look to the future and consider the possibility of a second Trump administration, the question arises: Can Trump implement a policy that allows the U.S. to set itself up for another half-century of economic prosperity while dealing with the short-term concerns of extreme debt levels?

The challenges are formidable. As of June 2024, the U.S.'s public debt stood at around US\$34.83 trillion. This massive burden poses significant risks to long-term economic stability and growth. The Congressional Budget Office projects that federal debt held by the public will increase from 98 per cent of gross domestic product (GDP) in 2023 to 181 per cent in 2053. By then, net interest costs are projected to surge to almost four times the current 30-year average—surpassing all non-Social Security and non-health care mandatory spending by 2027.

However, lessons from Hamilton to McKinley offer valuable guidance. A strong and diverse economy remains crucial for national prosperity and security. The populist critiques embedded in works like *The Wizard of Oz* remind us of the importance of addressing economic inequality and political corruption. Economists like John Maynard Keynes' warnings about the responsibilities of creditor nations underscore the need for a more balanced and equitable global economic system.

## Policy Recommendations for a Second Trump Administration

A potential second Trump administration would need to craft policies that draw upon these historical lessons while adapting to the realities of the modern global economy, which could involve:

- Targeted investment in critical industries and technologies, echoing Hamilton's vision of government support for strategic sectors.
- A nuanced approach to trade policy that protects American interests while recognizing the global economy's interconnected nature.
- A renewed focus on infrastructure development, both physical and digital, to enhance America's competitiveness.
- Innovative debt management and fiscal policy approaches that balance investment needs with long-term financial sustainability.
- Policies to promote innovation and entrepreneurship, recognizing that economic leadership is dependent on staying at the cutting edge, in an era of rapid technological change.

The key will be implementing these policies to address short-term economic challenges while laying the groundwork for long-term prosperity. This requires a balanced approach between stimulating growth and managing debt, protecting American interests, and maintaining beneficial international economic relationships.

## The American Jeremiad and the Path Forward

Ultimately, the fate of the American empire depends on its ability to heed these lessons and adapt to new realities. With its capacity for self-criticism and renewal, the Jeremiad tradition offers a powerful tool for navigating this evolution. By confronting its failings honestly, while reaffirming its highest ideals, America may chart a course that avoids the pitfalls that have befallen past empires.

As we stand at this historical crossroad, the choices made in the coming years will determine whether the U.S. gracefully transitions to a new role in a changing global order. The alternative—a rapid and potentially destabilizing decline—would have profound consequences for America and the entire world, underscoring the gravity of the decisions at hand.

The story of the American empire is still being written. Whether it's remembered as a brief moment of hegemony or as a transformative force that helped shape a more just and sustainable world order remains to be seen. What is clear is that the decisions made today will echo through history, shaping the lives of future generations. As inheritors of a grand experiment in self-governance and global leadership, Americans bear a heavy responsibility to rise to the challenges of our time, guided by the wisdom of the past and an unwavering commitment to our highest ideals.

## China's Response to a Second Trump Administration

The trade war between China and the U.S., initiated during Trump's first term, saw both countries imposing tariffs and adopting economic strategies to counter each other. With the 2024 U.S. presidential election approaching, the prospect of a second Trump administration raises questions about China's response, especially given Trump's proposal to impose 60 per cent tariffs on Chinese imports.

### China's Manufacturing Prowess and Trade Dynamics

China's entry into the World Trade Organization (WTO) in 2001 marked a significant shift in the global economic landscape, catalyzing rapid urbanization and infrastructure development. Over the years, China has evolved into a manufacturing superpower, exporting vast quantities of goods, as well as deflation to the West due to its ability to produce goods at lower costs.

China's dominance in auto production and electric vehicles (EVs) exemplifies its industrial ascendancy. Leveraging extensive supply chains, technological advancements, and government support, China has become a leading player in the global automotive market.

Strategic investments in battery technology and EV manufacturing have positioned China at the forefront of the green mobility revolution.

China's advancements in artificial intelligence (AI), supported by vast data and state investment, have raised global concerns due to the geopolitical significance of this technology. AI is not just an economic asset but also a tool for national security and strategic influence. The implications of China potentially leading in AI suggest that trade wars and technological rivalries are just heating up.

China's recent decision to tighten restrictions on the export of civilian drones reflects its strategic maneuvering in the face of mounting international scrutiny and its response to the Russian invasion of Ukraine. Concurrently, the U.S. is contemplating restricting China's access to advanced AI memory chips and related equipment, recognizing the need to engage key allies in navigating this intricate landscape.

#### **Potential Impact of Trump's Proposed Tariffs**

If Trump imposes a 60 per cent tariff on Chinese imports, it could significantly impact China's economy. Analysts predict a potential slowdown in GDP growth by 0.5 percentage points, with risks of deflation and further economic contraction. The indirect effects on consumption and investment could exacerbate these issues, posing a "major downside growth risk" to China, according to Goldman Sachs.

#### **China's Response Strategies**

In anticipation of potential economic disruptions from a second Trump administration, China is likely to employ several strategies:

1. **Stimulus measures:** Implement economic stimulus measures, although these might not fully offset the impact and could lead to long-term issues.
2. **Diversification of export markets:** Actively develop alternative export markets to reduce reliance on the U.S., with China's share of global exports reaching record highs despite the trade war.

3. **Technological self-sufficiency:** Invest in domestic industries and reduce reliance on foreign technology, including significant investments in sectors like semiconductors and high-tech manufacturing.
4. **Pulling forward demand:** Accelerate purchases of certain goods to avoid future tariffs, which could lead to a temporary boost in imports but might result in slower growth in the latter half of 2025.

#### **Geopolitical and Trade Dynamics**

Both the Trump and President Joe Biden administrations have focused on reducing reliance on Chinese imports and addressing trade imbalances. While Biden has maintained and even increased some tariffs on Chinese goods, Trump's proposed tariffs are more extensive and could lead to significant economic and geopolitical shifts. The U.S. industrial policy aims to retain its leadership in innovation, further straining U.S.-China relations.

China is preparing for the potential escalation of trade wars and tariff hikes under a possible Trump presidency by employing the above-mentioned strategies. Investors should brace for a return to trade wars in late 2025, with potential impacts on global markets and economic growth.

### **What Should Investors Expect**

#### **Trump's First Trade War: Seven Lessons Learned**

During Trump's first administration, capital markets responded negatively to his trade war policies, particularly the tariffs imposed on Chinese imports.

Key impacts included:

1. **Stock market volatility:** The S&P 500 experienced significant drops, with nearly a 16 per cent decline between March 2018, when the first tariffs were announced, and December 2018.
2. **Sector-specific impacts:** Companies in industries directly affected by tariffs, such as manufacturing and agriculture, saw their stock prices decline more sharply.

3. **Investor uncertainty:** The trade war created uncertainty in financial markets, leading to periods of risk-off sentiment and increased volatility.
4. **Global repercussions:** Stock markets worldwide were affected, with many international indexes experiencing declines in response to escalating trade tensions.
5. **Currency effects:** The U.S. dollar strengthened against the Chinese yuan, partially offsetting the impact of tariffs on Chinese exporters.
6. **Sector rotation:** Investors shifted towards domestically focused companies and sectors perceived as less vulnerable to trade disputes. After a short growth scare, secular growth should continue its march higher.
7. **Bond market reaction:** Treasury yields fell as investors sought safe-haven assets amid heightened economic uncertainty. Sovereign bonds are the place to be, but it's important to watch the reaction of high-yield bonds.

Overall, while there were some short-term rallies and sector-specific benefits, the broader impact of the trade war on capital markets during Trump's first term was predominantly negative, characterized by increased volatility and economic uncertainty.

### Looking Ahead

Investors should expect the U.S. Federal Reserve to cut interest rates in September. While this response is late, and despite the yield curve being inverted and economic growth appearing as a mirage generated by extreme government spending, the private sector is already contracting. Investors will likely ignore the dark clouds on the horizon of a rapidly slowing economy and attribute the interest rate cuts to inflation heading back to the two per cent target. This implies a risk-on stance until early 2025.

The risks for investors going into 2025 include:

- The fiscal crisis, which must be addressed. Historically, the post-Second World War periods of

fiscal consolidation typically led to a growth scare.

- The possibility of a renewed Trump trade war could significantly decelerate economic growth in late 2025, leading to a correction in risk assets in 2026.

For now, interest rate cuts by the Federal Reserve will likely be cheered as a response to inflation heading back to two per cent, rather than to growth concerns. However, when markets—which are forward-looking—conclude that there is significant evidence of a growth slowdown, likely by late spring 2025, this will shift sentiment. Until then, expect a risk-on environment with the S&P 500 potentially reaching 6,500 and interest rates close to two per cent by 2025.

## What About Harris's Progressive Economic Plan and the "Lower for Longer" Interest Rate Outlook?

Vice President Kamala Harris's economic plan is a far-left progressive platform focused on income redistribution and significant fiscal spending. It includes measures to expand social welfare programs, such as affordable housing initiatives, price controls, taxes on capital gains, health care reforms, and tax policies aimed at reducing income inequality. These proposals align with the progressive wing of the Democratic Party and have drawn comparisons to Modern Monetary Theory (MMT)<sup>1</sup>. Critics warn her plan could lead to a credit crisis akin to the market reaction to Liz Truss's mini budget in the U.K., potentially causing a revolt in credit markets.

Separately, the global economic environment is experiencing a shift back to pre-COVID-19 conditions, where the transmission mechanism for monetary policy is broken. It may take some time for investors to realize that interest rate cuts will not be that stimulative. Yes, we would be going back to an era defined by the liquidity trap, where rate cuts do not stimulate economic growth. But don't be surprised if consensus incorrectly assumes that a few rate cuts can fix all our problems, leading to a rally in interest-rate sensitive assets.

Central bank rate cuts, which typically take 18 months to take effect, will not be felt until early 2026. The four-year

<sup>1</sup> Macroeconomic theory that countries which spend, borrow and tax in a currency they fully control (such as the U.S. the U.K., Canada and Japan) are not constrained by federal government spending as they can simply print more money.

global liquidity cycle predicts interest rates to bottom in mid-2026. My call is for the federal funds rate and the Bank of Canada overnight rate to go below two per cent, suggesting interest rates remain lower for longer. Investors should prepare for low rates well into 2027.

In this environment, consider secular growth companies, gold and bitcoin. We are re-entering an era of secular stagnation and deflation—nothing has changed. To be clear, we are still bullish on risk assets until late 2025, with an S&P 500 target north of 6,500. However, as the U.S. faces a high debt-to-GDP ratio of 125 per cent and a fiscal deficit of seven per cent, fiscal sustainability remains a concern.

If Harris wins the race for president, investors need to implement defensive strategies in early 2025.

## Conclusion

The twilight of the American empire is a complex narrative shaped by historical precedents, economic policies, and an evolving global landscape. As the U.S. navigates this critical juncture, we must consider whether we are on the brink of a rebirth, as predicted by theories like the Fourth Turning—which emphasize the impact of extreme demographic shifts and the rise of populism—a recurring theme in U.S. economic history.

Historical lessons from figures like Alexander Hamilton, William McKinley, and the Jeremiad tradition offer valuable insights for crafting a path forward. By

balancing short-term economic challenges with long-term strategic goals, America can strive to maintain its leadership in a changing world, ensuring a legacy of prosperity and stability for future generations.

William McKinley once stated, "Under free trade, the trader is the master and the producer the enslaved person. Protection is but the law of nature, the law of self-preservation, of self-development, of securing the highest and best destiny of the race of man." This perspective underscores the importance of Trump's belief that protectionist policies safeguard domestic industries and labour against global competition. Embracing such principles can fortify the U.S. economy while adapting to the shifting dynamics of international relations, preserving its status as a worldwide leader.

A second Trump administration could adopt McKinley's policies. Trump has publicly admired McKinley's tariff approach, believing it contributed to America's wealth—an important consideration given the need to address the nation's extreme debt levels. This outcome would align with the four-year presidential cycle, suggesting the possibility of a significant market correction in 2026. Based on historical precedents, risk assets should perform well into late 2025, with the old rule of "buy the rumour, sell the news" in mind. If Trump's new trade policy is implemented, a significant drawdown, like that in 2018, could occur. This forecaster anticipates a possible 2026 event. Until then, it's risk on.

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