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**From:** Thomas Jr., Landon [REDACTED]  
**Sent:** 11/29/2016 6:33:42 PM  
**To:** Jeffrey Epstein [jeevacation@gmail.com]  
**Subject:** Fwd: My Thoughts on Currencies

**Importance:** High

The smartest/most amusing piece of research I have read so far on Trump/global economy. You should pass on to DJT brain trust on economy/markets

----- Forwarded message -----

**From:** Eurizon SLJ Capital Limited <[research@research.sljmacro.com](mailto:research@research.sljmacro.com)>  
**Date:** Tue, Nov 29, 2016 at 10:51 AM  
**Subject:** My Thoughts on Currencies  
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## ***My Thoughts on Currencies***

Stephen L Jen (London)

November 29, 2016

**Bottom line.** Some retracement in the market trends we've seen since November 8 makes sense, in light of the magnitudes of the moves as well as the upcoming event risks (Italian referendum, OPEC meeting, and the FOMC meeting). But I think none of these events will likely surprise the markets, and President-Elect Trump will likely continue to drive the markets, extending the recent trends. By the way, he has left the US Treasury Secretary post last to be filled, and it is the most important appointment for the markets as it will both reflect and influence key policies

on trade, tax cuts, and infrastructure spending. (1) The doves at the Fed have been silenced as, under President Trump, the US policy mix will likely be less lop-sided and the emphasis will be on Arrow 3, with Arrow 1 being downgraded. I think the effective demotion of the Fed has just begun. Its independence will likely be challenged, as it should be, in my personal view. November 8 marked the beginning of the end of the financial repression in the US. (2) Generating outsized economic growth will be key to settling several important inconsistencies in macro. I will elaborate on this point below. But the market trends witnessed since November 8 will not be sustained unless Mr Trump's policies indeed lead to significantly higher nominal GDP growth. (3) The mainstream media remain negative on Mr Trump, but this will keep the hurdle low, and in turn pressure President Trump to deliver early in 2017 and thus for him to impress favourably. A shift away from identity politics, in my view, based on my personal experience from Taiwan, should lead to positive economic progress. Investors won't need to wait long for there to be more concrete announcements on the various parts of Arrow 3, including both the content of the policies as well as their sequencing. (4) FWIW, my two policy recommendations to the reformers are (i) design an effective global taxation scheme to properly tax multi-national corporations and (ii) adopt industrial policies to help countries focus on their comparative advantages. The US, UK, Japan, and Italy are all prime candidates to do (ii). (5) The dollar is already moderately over-valued, but this will not prevent it from strengthening further, especially against the EM currencies. Think in terms of 'growth alpha' and 'growth beta.' Much of EM, including China since February of this year, have not possessed 'growth alpha' and have continued to rely on 'growth beta' vis-à-vis the rest of the world. I struggle to think of key reforms that EM countries have embarked on in recent years: even countries like France and Italy have undertaken more reforms than most EM countries. Squeezed by (i) a more hawkish Fed, (ii) a China that will continue to soft land, and (iii) a potentially more inward-looking US, EM will struggle without 'growth alpha.' I think we may be entering into a period of differentiation among the EM markets: those that have 'growth alpha' will be rewarded while those that continue to rely on 'growth beta' will not. (6) The world according to Trump will be more Darwinian for countries and less Darwinian for US citizens. This notion applies to investing in EM, to countries' growth prospects, and to international competition – (potentially) very different from the last few years, when 'the Fed was the only game in town' and everyone and everything floated higher by central bank liquidity... In any case, the dollar should be in a good position to thrive, I think.

**Economic Olympics.** The markets are no longer driven only by the Fed and central bank policies, but by forward-looking policy inclinations. The 'false economy' that central banks have nurtured will gradually be replaced by real

economies. In my view, Mr Trump's victory will have many social, geopolitical, and economic consequences, but for investors I think he will start a period of 'Economic Olympics', whereby the federal governments around the world will take more responsibility and be more proactive to help their 'national teams' to become more competitive in this globalised world. (1) Free trade is in theory good for economic growth. But there are other policies (such as well-directed R&D, efficient investment, an effective educational system) that are also extremely important for long-term growth, but have been ignored in the past 15 years because of the globalisation fad. A slowdown in trade globalisation might not be bad for the global economy, if policy makers replace this engine of growth with other structural improvements. But while globalisation is more about 'growth beta', other types of structural reforms are about 'growth alpha' and federal/central governments around the world will need to make a greater effort at leading the economies to prevent them from falling behind. This is like a government-led program to win Olympic medals, without doping by central banks. (2) A client kindly brought to my attention an interesting report done by the Harvard Business School that touches on the idea mentioned above ('Problems Unsolved and a Nation Divided: the State of US Competitiveness 2016'). In it, several sensible and consequential points were made: *'The pressing need for a national economic strategy... Given the significant challenges facing the American economy, the U.S. needs a national economic strategy more than at any other time in recent history. A strategy is an integrated set of priorities that builds on strengths while acknowledging and tackling weaknesses... The U.S. lacks an economic strategy, especially at the federal level. The implicit strategy has been to trust the Federal Reserve to solve our problems through monetary policy... A national economic strategy for the U.S. will require action by business, state and local governments, and the federal government. All three levels have a crucial role to play in restoring competitiveness... Taking leadership in improving U.S. competitiveness is a pressing imperative for business leaders. Many companies have failed to invest enough in improving the business environments in the regions in which they operate...'* This report from the HBS also reiterates some recommendations they made in 2012: *'[Our] Eight-Point Plan consists of the following policy recommendations: simplify the corporate tax code with lower statutory rates and no loopholes; move to a territorial tax system like all other leading nations'; ease the immigration of highly-skilled individuals; aggressively address distortions and abuses in the international trading system; improve logistics, communications, and energy infrastructure; simplify and streamline regulation; create a sustainable federal budget, including reform of entitlements; and responsibly develop America's unconventional energy advantage.'* Interestingly, Mr Trump has discussed many of the same points. I personally think that, so far, identity politics has distracted from his

message on economic reform. It is likely, I believe, that the focus of the general public will be moved to these critical economic reforms. (3) I repeat a point I've made in the past, that because the mainstream media and most scholars are still so skeptical of Mr Trump's policies, the hurdle for him to clear and impress positively is very low. Ironically, such general hostility will probably work in favour of the Trump Administration. 5 days after the surprise election victory, the press declared that Mr Trump's transition plan was in hopeless disarray, only for Mr Trump to announce one cabinet appointment every day – ahead of the schedule of Presidents Obama and Bill Clinton when they got elected. (4) We will likely see a less radical President Trump. We have already seen this on various issues (the Wall, prosecuting Ms Clinton), and my guess is that the trade policy will be more restrictive, but the changes will be nuanced at the same time. The appointment of the next Treasury Secretary will convey an important message. (5) I personally think that various countries will likely adopt industrial policies, as a substitute for slower trade globalization. Already, the UK's PM May announced an ambitious industrial strategy, with a focus on technology. The government is committed to investing in R&D through the Industrial Strategy Challenge Fund. Regular readers of our work should also know that that is what I would recommend for Japan to consider. I just came back from a trip to Singapore, and understand that the government there is also struggling to find the best strategy to deal with the next phase of economic development, now that the growth model based on trade and finance may be coming to an end. I think the US should also contemplate its own industrial policy. The title of this section is 'economic Olympics' to convey the notion that the world is in competition, not just along the axes of cheapness of labour and technology. There are different disciplines (analogous to the various sports in Olympics) in which any country can excel, if the efforts are appropriately focused. Instead of being mediocre in many events, countries should seek to win the gold medal in their best events...

**5%-plus nominal GDP growth in the US in 2017?** There are several inconsistencies in the market trends: (1) a strong dollar and strong US equities; (2) protectionism and a strong dollar (Mexico, for example, has gotten 10% cheaper so far this month, and China is also cheaper. The greater the threats of protectionism against these countries, the cheaper are their costs of production...); (3) higher yields and strong equities; (4) Mr Trump does not like Chair Yellen or the Fed but he still needs and prefers low interest rates. The only variable that can address these inconsistencies is 3-4% real economic growth and 5%-plus nominal GDP growth in the US. While it is unlikely that 5% nominal GDP growth is sustained over time, the atmospherics will stop the talk about 'r-star' and help support interest rates in the US. 2017 may very well see 5%-plus nominal GDP

growth, and, in the event, the 10Y UST yield at 2.34% would not seem too high.

**The dollar will continue to smile.** Previously, we made the suggestion that the US dollar is on the right side of the Dollar Smile against the majors, but it is on the left side of the Dollar Smile against the EM currencies. Reaganomics-Lite should be positive for the dollar, even if the US' twin deficits could widen. 'America First' means that there will be a bifurcation in economic prosperity, that economic strength in the US will no longer translate, with the same elasticities as before, into prosperity in many parts of EM. (1) The dollar has begun a consolidation phase this week. But my guess is that it will be temporary and shallow, partly because the data (ISM and NFPRs) will be sufficiently strong to justify another Fed rate hike on December 14. The weekly claims data remain extraordinarily strong, while the second derivatives in the data in much of EM have ceased to be positive. (2) Further advances in the dollar, however, will of course depend on the policy announcements and delivery by the Trump Administration, as well as an apparent lack of an economic strategy in other countries. (3) Yield differentials have helped the dollar advance vis-à-vis the JPY and the EUR. However, I should note that the EMU economies are not doing that badly, though credit demand remains weak. PMI remains well above 50 and inflation has bounced away from zero. The main factor – other than yield differentials - weighing on the EUR is the risk that we will see more political uncertainty in Europe. (4) I came across an editorial arguing that Mr Trump's protectionist policies would hurt the dollar's international standing. While this may be a popular view – that the US, as a savings deficit nation, needs a globalised world to finance its external balance –I contest this conclusion. I think it will be extremely difficult for the international status of the dollar to be supplanted, even with Mr Trump as the President. The dollar losing its hegemonic status has been a popular thesis by many academics over the last twenty years – precisely the period when the dollar's international and reserve currency status has *risen*. In many ways, the sturdiness of the dollar's global status has surprised some people, because globalisation is supposed to lead to a multi-polar world where the US loses its dominance. That is certainly true for the real economy, but exactly the opposite has happened for the dollar. This is a point I've tried hard to make over the years, that financial globalisation is uni-polar, even though trade globalisation is multi-polar. Look at how the rise in the dollar is hurting, disproportionately, the high-yield and EM currencies. Further, which currencies might replace the dollar? The EUR itself is still in an existential crisis; nothing needs to be said about the JPY; China could not even dare opening up its capital account. In fact, Beijing has just issued even more 'strict controls' on overseas investment, after experiencing some USD207 billion in outflows in Q3 2016. Just because President Trump's prospective trade policy may not be politically correct

does not imply that there will be a demise of the dollar, or that fewer people in the world would speak English in protest. If anything, I'm worried that a sharp rally in the dollar could trigger another financial crisis in EM... Don't get me wrong, I do not believe the dominance of the dollar is good for the global financial/monetary system. But it is a trend that is difficult to reverse, unless the structural integrity of the EUR is enhanced, and the foundations of the RMB market are improved. Increasing returns to scale have made English/dollar popular, and it will be increasingly difficult to challenge their roles as the world internationalizes. (5) The BIS recently published an interesting and important paper ('The Dollar, Bank Leverage and the Deviation from Covered Interest Parity,' by H.S. Shin et al., BIS WP 592) on how a stronger dollar could lead to a tightening in lending conditions in the rest of the world, including EM. *'[T]he value of the dollar plays the role of a barometer of risk-taking capacity in capital markets. In particular, it is the spot exchange rate of the dollar which plays a crucial role... [T]he strength of the dollar is a key determinant of bank leverage... Our results point to the financial channel of exchange rates, through which fluctuations in the strength of the dollar set in motion changes in capital market intermediation spreads that respond at a high frequency... [I]t is when the domestic currency appreciates, financial conditions in that country loosen, and CIP deviations narrow... [A] strengthening of US dollar has adverse impacts on bank balance sheets, which, in turn, reduces banks' risk bearing capacity.'* The findings of this paper are consistent with two of the points made above, that we may re-enter a phase that is not that positive for EM currencies and that the dominance of the dollar as an international currency is having unintended consequences for the rest of the world, out of line with the local fundamentals.

**Trump and Europe.** Political and social pressures have returned to Europe, and could continue to accentuate the centrifugal forces in the region. There are many risk events on the horizon, including the Austrian Presidential election on December 4 (the worry here is a victory for Mr Norbert Hofer of the far right party), the Italian referendum on Constitutional reform on December 4 (while a 'no' outcome is largely priced-in, an actual 'no' outcome may trigger a series of events in Italy that might pose some downside risks to Italian banks and in turn other European banks), the Dutch parliamentary election on March 15, 2017 (the worry here is further advances by the far right party led by Geert Wilders), the first round of the French presidential election on April 23 and the second round on May 7, UK local elections on May 4 (this will be the first major electoral test for PM May), and finally German regional elections on May 7 and 14 and the parliamentary election in September. (1) I don't think the direction of causality runs from Trump to Europe, but that the underlying forces propelling both Brexit and Trump are the same forces that are pushing the political centre of mass to the right in Europe. This direction of causality is

important to appreciate, I think, because if one believed that the direction of causality is the opposite, that Trump *causes* other changes that would have been avoidable if Ms Clinton had won, one would come up with the wrong conclusions on what to do to stop the global shift in sentiment. (2) *The Economist* had a special edition last week on the rising nationalism in the developed West, as if it's an unfounded, random and sinister event that needs to be suppressed by all means necessary. For various reasons, the political left is in decline in the developed West. Look at the UK's Labour Party and the US' Democratic Party. In France, only 1 out of 20 people approves of Hollande's performance. (3) The Presidential race in France is now between the Centre Right (Mr Fillon from the Republican Party) and the Far Right (Ms Le Pen from National Front). The pendulum in Europe, in my view, will swing to the right, and possibly overshoot, as pendulums tend to do... which is not good, but an unavoidable consequence of the pendulum having overshot to the left in the past... In any case, with the Republican primary being out of the way, the campaign will start in earnest, with the first round of the Presidential elections to take place in April and the second round in May. FWIW, Mr Fillon looks like a stronger candidate than Mr Sarkozy to challenge Ms Le Pen. France, under Mr Fillon, could very well enter a period of economic reform and rejuvenation, I am guessing. In short, Mr Fillon's victory last weekend could be a major positive for France, I think.

**The trouble with macroeconomics.** The rebellion against the establishment has also begun in the nerdy field of macro economics, led in part by Prof Paul Romer of the Stern School of Business. He, of course, has made enemies in the field with his view – a view I share: *‘For more than three decades, macroeconomics has gone backwards. The treatment of identification now is no more credible than in the early 1970s but escapes challenge because it is so much more opaque. Macroeconomic theorists dismiss mere facts by feigning an obtuse ignorance about such simple assertions as "tight monetary policy can cause a recession." Their models attribute fluctuations in aggregate variables to imaginary causal forces that are not influenced by the action that any person takes. A parallel with string theory from physics hints at a general failure mode of science that is triggered when respect for highly regarded leaders evolves into a deference to authority that displaces objective fact from its position as the ultimate determinant of scientific truth.’* Group think has become a serious impediment to advances and renewals in this important field. Misguided policies have also had significant consequences for people's lives around the world.

**Trade globalization.** There will likely be a shift from unconditional, uncontrolled, and unmanaged trade globalisation, i.e. ‘free trade’, to ‘fair trade,’. Trade globalisation of the type that we have just experienced

exchanged rising economic and political inequality for overall prosperity. We have simply reached a point where this rising inequality is no longer sustainable in democracies. This is not too different from what Beijing has been struggling with – to slow down the headline economic growth rate in exchange for more balance in various parts of the economy, in order to allow its development to be more sustainable. The parallels in the West seem quite clear to me. Fighting against this shift in the West, as most mainstream media seem to be doing, is tantamount to those in China who are fighting against the economic slowdown. (1) TPP is effectively dead, even though there are some who are urging that TPP goes ahead without the US. But I think multilateral trade pacts are in jeopardy. The Trump Administration still wants to have trade arrangements, but they will be bilateral and done with countries deemed friendly to the US. (2) The UK is in a great position to deal with the Trump Administration because all the UK needs is a bilateral trade arrangement that won't take as long to work out, compared to a multilateral trade arrangement. The UK just went from the 'back of the queue' (which was an insulting declaration by President Obama, conspicuously using the word 'queue' to make sure the Brits understood him) to the 'front of the line.' (3) China was never a part of the TPP discussions. In fact, TPP was designed from day one to marginalise China, to replace the current trade arrangement based on WTO rules to something that puts China at a disadvantage. This is why Beijing is not unhappy with the Trump Administration's desire to terminate the TPP discussions. (4) 'America First' does not only mean 'world second,' that the US will take actions to benefit the US even if these policies come at the expense of the rest of the world. It also means that policies will be aimed at addressing the inequality and inequity in the US, even if it means that the overall effects on the US may be negative. (5) In sum, I don't think trade globalisation will reverse. But it will slow down dramatically and be substituted with a different web of bilateral arrangements. I think this is a positive development, as the previous model of global growth was unsustainable, even if it generated the biggest aggregate prosperity for the world. (6) The next US Treasury Secretary will likely be instructed by President Trump to label China as a currency manipulator. While this would be a verdict without basis, in my view, such a finding could be used as an excuse to escalate the talks of protectionism.

**Some musings...** (1) President Obama just awarded his last round of Presidential Medals of Freedom (America's highest civilian honour) to Michael Jordan, Ellen DeGeneres, Robert de Niro, and others. Many of these award recipients were vocal critics of Mr Trump. My views on politics really don't matter... But for what it is worth, the reason why I have been more vocal than I should have been about Brexit and the US Elections is related to my own personal experience. I have witnessed how a previous harmonious society could very quickly degenerate into a permanent state of



ethnic hatred, *through identity politics*. This happened in Taiwan, where I grew up. When I was a child, I was fluent in Mandarin and Taiwanese, as most of the children I was friends with were not recent immigrants from Mainland China like my family was. There were no social conflicts, as far as I recall, until the pro-independence movement riled up those who considered themselves ‘Taiwanese’ against the ‘Mainlanders’ like myself. Some of my Taiwanese childhood friends are no longer on speaking terms with me, simply because I’m a ‘Mainlander.’ Taiwan’s economic development came to a sudden halt, as people were in a constant state of feeling mistreated by the other group. The pendulum would swing from one side (green) to the other (blue), each time a President is found to have committed blatant and large-scale corruption. The politicians won, but the people lost. This is one reason why I deeply resent identity politics and fear that the proponents don’t truly understand how dangerous this game really can be. In contrast to the prevalent view, I believe identity politics are themselves divisive. Economic cycles and political cycles come and go, but people can hate each other for generations. Look around the world; I think we can find plenty examples of irrational hatred between ethnic groups, ironically because one group felt they were wronged by another and the political discussions got hijacked by overly zealous politicians. (2) I love Michael Jordan and have nothing against Ellen DeGeneres, but think Robert de Niro made a fool of himself in that video. While this may not interest President Obama, Mr Joe Sutter just passed away: he was the ‘Father of the Boeing 747’, the lead engineer that designed and built the first B-747 in 1969. Maybe one day someone will do a movie about him, and the actor playing him could win the Presidential Medal of Freedom... (3) An artist in China made a sculpture of a black swan (see the photo below), which was placed in a shopping mall in Beijing on the other side of the street from the headquarters of CSRC (China Securities Regulatory Commission) – the government agency in charge of the securities markets and the agency that intervened to support the Chinese equity markets. This sculpture was quickly removed by government agents, within 3 hours of it being placed there. Months earlier, there were two sculptures of bears (mama bear and a baby bear) that were placed outside the same mall, and they were also removed quickly... Maybe I was wrong for belittling artists and entertainers: they may have the power to bring down the USD9 trillion equity markets in China with a small sculpture...



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