**Global economic challenges for Donald Trump  
  
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* Quadrennial panels offer “Advice for the new Administration”
  + I feel the need this year to acknowledge that advice from us “experts” and “elites” is unwanted by Mr. Trump and his supporters.
    - Just to show that we understand.
  + That said, the Trump Administration will encounter international events and constraints that it did not figure on in the campaign,
  + a common pattern, though much more extreme this time.
* Of course international trade, the US trade deficit, and the Chinese exchange rate were big issues in the campaign
  + Let’s start with his promise immediately to name China a manipulator of its currency.
    - Mr. Trump might have to confront the reality that if China moved to a freely market-determined exchange rate as he and other US politicians have been asking, the RMB would get weaker, not stronger.
      * For more than two years, the PBoC has been intervening to fight RMB depreciation, not to encourage it.
        + It has sold dollars and bought RMB, not the other way around.  
          [graph]
      * Similarly, Chinese authorities have recently tightened controls on capital outflows, not inflows.
    - A weaker RMB would of course help China’s net exports to the US, not reduce them.
* The US trade balance
  + [Little-known fact:] The US trade deficit as a share of GDP has been narrowing for the last 10 years [graph]
  + Mr. Trump’s policies are likely to set the trade deficit back on a deteriorating path
    - even if he doesn’t stop China from intervening in the foreign exchange market.
    - But does go ahead with what seem to be his fiscal plans.
  + I refer to plans for massive tax cuts and big increases in spending (including military and infrastructure investment).
    - It is hard to predict what the carryover will be from statements in the campaign to actual policies.
    - But Congress is likely to support this sort of fiscal expansion.
    - Repeats of what Ronald Reagan and George W. Bush did.
  + The budget deficit will reduce national savings which would worsen the current account deficit.
    - An example of the “twin deficits” that we saw under Reagan and Bush.
* Through what causal channel would the trade balance worsen?
  + First, the fiscal expansion will put upward pressure on interest rates, especially since we are already essentially at full employment.
    - Of course the Fed had already been expected to raise interest rates Dec.14.
    - Recent developments augur more interest rate hikes in 2017 and 2018.
    - The new Administration will probably oppose the increases
      * Notwithstanding that during the campaign the candidate attacked the Fed for keeping interest rates too low.
      * Hopefully the Fed’s independence will hold, as it did under Volcker.
  + It will also put upward pressure on the dollar.
    - Because higher interest rates attract a capital inflow,
      * as in the classic Mundell-Fleming model :
      * BD ↑ => NS↓ => i rate ↑ => $ ↑ => TD↑
    - Mr. Trump is doing more to depreciate other currencies against the $ than currency manipulation does.
  + Indeed the increases in US interest rates and the value of the dollar have already gotten underway, ever since the election. [graph]
* “How does the importance of free trade fit in and can the US continue its leadership in promoting trade?
  + In the long run, a reversal of US-led globalization will do damage both to our economy and to our geopolitical position.
  + Would a sharp increase in import tariffs, even if inconsistent with our international obligations improve the trade balance?
    - Possibly, in the short term.
    - But the fall in imports is likely to be offset by a fall in exports.
      * If Mexicans’ income falls, their imports from us will fall.
      * If our inputs of labor intensive auto parts from Mexico fall, our exports of finished autos are likely to fall.
      * If Mexico retaliates against our tariffs by raising its own, as it is entitled to do, our exports to it will fall.
  + The net effect on the trade balance depends on the macroeconomic factors already considered: a fiscal expansion is likely to worsen the trade balance.