# Weekly Market Insights

**August 13, 2018**

# China, Turkey and the Economy!

America's first direct encounter with China came on the heels of the American Revolution. In 1783 after a long delay due to weather, the Empress of China, under command of John Green, sailed out of New York harbor bound for China.

Coincidently, the date was 22 February, which was George Washington's fifty-second birthday.[1] Thus began a long mutually profitable trading relationship.

Today, close to two hundred and thirty five years later, they stand at the precipice of a trade war, partially inspired by a confused view of their own national narratives. These narratives are inspired by a romantic nostalgia that in China's case, has developed for the past three centuries, while for the United States, just in the recent past. China's belief is that they were unjustly displaced as the celestial kingdom, while the United States believes that they have lost greatness, hence "Make America great again". China is convinced that their lost greatness is due to empirical expansion by the West, and some Americans think their greatness has been taken from them by unfair trade practices. Neither stands up to serious scrutiny. It is the danger of nostalgia affecting memory. The opposite of memory is not forgetfulness but history. China's pre-colonial history was not an uninterrupted path of peaceful expansion. There were at least five dynasties and at least one successful invasion, which was by the Mongols in 1271. Towards the end of imperial rule, corruption was rampant and led to the collapse of the last dynasty.

In the United States, the feelings of lost greatness are fueled by the devastation of the great recession. But clearly, the world continues to revolve around the United States both economically and militarily.

The break in U.S. - China relations came after the communists won the Chinese Civil War and Mao Zedong defeated Chiang Kai-shek and took complete control of China on the 1st of October 1949. He then closed China's doors to the West, only to be reopened after Mao's death and the ascendency of Deng Xiaoping. Deng followed a policy of improving China's economy without showing any aggressive tendencies. This came to an abrupt end with President Xi. China is now a strong competitor to the West in every sense. Why take so much space to discuss China? Because China influences the wellbeing of the world. China and the rest of the world must come to an understanding. China is a very large and important country and they will remain a very important part of the global economy, but a romantic yet flawed view of the past does not justify unfair trading practice and intellectual property theft.

Turkey is the latest country that threatens the global economy. This past week the equity markets appeared to be on the brink of achieving a new high. Then crisis struck. Turkey was having serious economic problems: high inflation, large budget deficits and out of control debt. Much of the debt was denominated in foreign currencies. Then catastrophe struck. In a well published dispute with Turkey involving a U.S. preacher on trial in Turkey, Mr. Trump announced he would double tariffs imposed on Turkey's exports of steel and aluminum. This sent the Turkish Lira into a freefall. The global equity markets responded by falling rapidly. The reason for the dramatic response is that large quantities of Turkish debt are held by European banks. The frightening memories of 2007-2008, when the debt problem went through the entire banking system

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because of well-hidden connectivity and drove the world into recession, were revived. Turkey's debt problems don't appear to have anywhere near the severity of the earlier crises, but the reaction is not surprising.

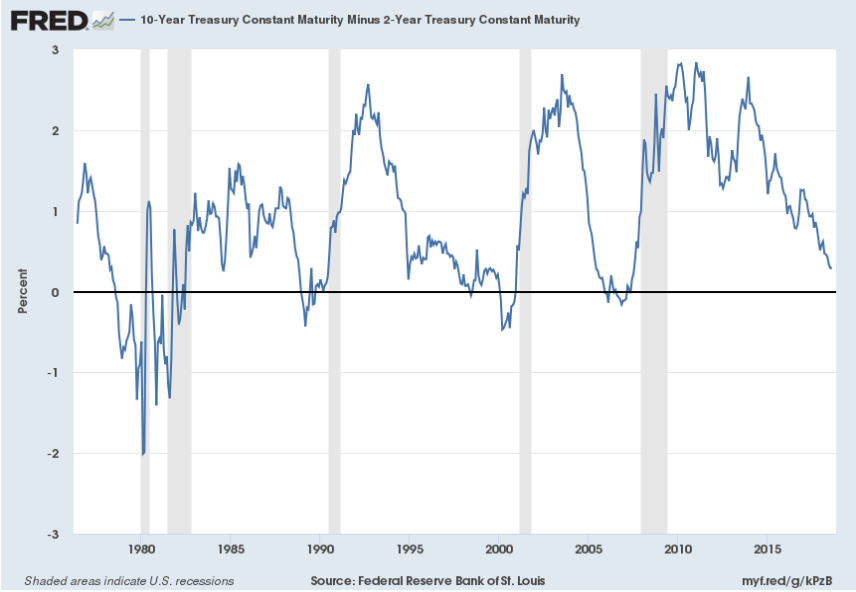
Meanwhile on the domestic front, nothing has occurred to change our view. Economic indicators remain positive buoyed by strong employment growth and wages are beginning to pick up. We see prices, not just of labor but many products, picking up. The latest release of the Producer Price Index showed surprising strength, partially due to tariffs. The U.S. dollar of course is strong. We say of course because the dollar remains the safe haven during any economic crisis real or imagined. The current bounce is due to the Turkish debt crisis. All this leads us to believe the Fed will stick to its guns and continue to gradually raise interest rates.

We have added a chart of the yield curve. We, along with everyone else, have written about it. The reason it is important is it can be an indicator of an approaching recession. When short interest rates exceed long rates, the economy tends to falter. This, of course, is not infallible and the timing is variable, but it certainly bears our close attention.

We have written in the past that the personal tax changes have added a boost to growth. The open question remains, how long? It will certainly be less powerful in 2019 than in 2018.

Even though the United States economy is far less dependent on the international sector than most other countries, the international economics may be the best indicator for the time being.

**10-Year Treasury Constant Maturity Minus 2-Year Treasury**

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[1] When America First Met China, Eric Jay Dolin, Liveright Publishing, 2012

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