AozoraStep

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DISCLAIMER

Tariffs, Turmoil & the 1929 Echo – a Coherra interview with David Herrmann

VIDEO INTERVIEW HERE

THE 1929-33 ANALOGY
STRUCTURAL SIMILARITIES TO TODAY ARE HARD TO IGNORE

- High government debt to GDP (>100% now vs. 100-200% in 1920s/30s UK)
- Rivalry between superpowers (US and China now vs. UK and US in 1920s/30s)
- Strong decades of globalisation that had peaked (trade is 25% of global GDP now vs. 11% in late 1920s)
- Moving towards new technologies (electrification now vs. ICE and oil in 1920s/30s)
- Moving to new forms of energy (from oil and gas to renewables now vs. from coal to oil and natural gas in 1920s/30s)
- High inequality (top 1% owns 30% of all household wealth now vs. top 1% owned 12-19% of total share of income in the 1920s)
- High speculation (cryptocurrencies are worth over $3trn vs. high borrowing of businesses and individuals to buy stocks in 1920s)
- Monopolisation in form of few companies with large market share (the magnificent 7 account for over 1/3 of U.S.'s 500 largest market capitalization now vs. Ford, GM and Chrysler accounted for 70%/85% of all vehicles by 1920s/1940s, US Steel 50% market share)
- Interest rates of around 4-5%
- A pandemic (Covid vs. Spanish Flu)
- Conflicts (Ukraine and Gaza war now vs. WW I and II then)
- Trade and migration restrictions after prior free reign (back in the 1920s the British insisted on free trade while the US and Germany turned to tariffs)
- Political extremes between far left and far right, no center

Source: https://eh.net/encyclopedia/the-u-s-economy-in-the-1920s/

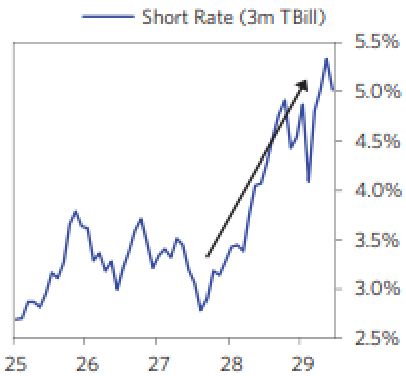
THE 1929-33 ANALOGY

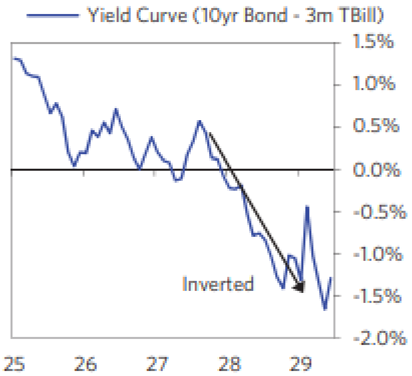
INTEREST RATES AND YIELD CURVE DYNAMICS ARE REMARKABLY SIMILAR

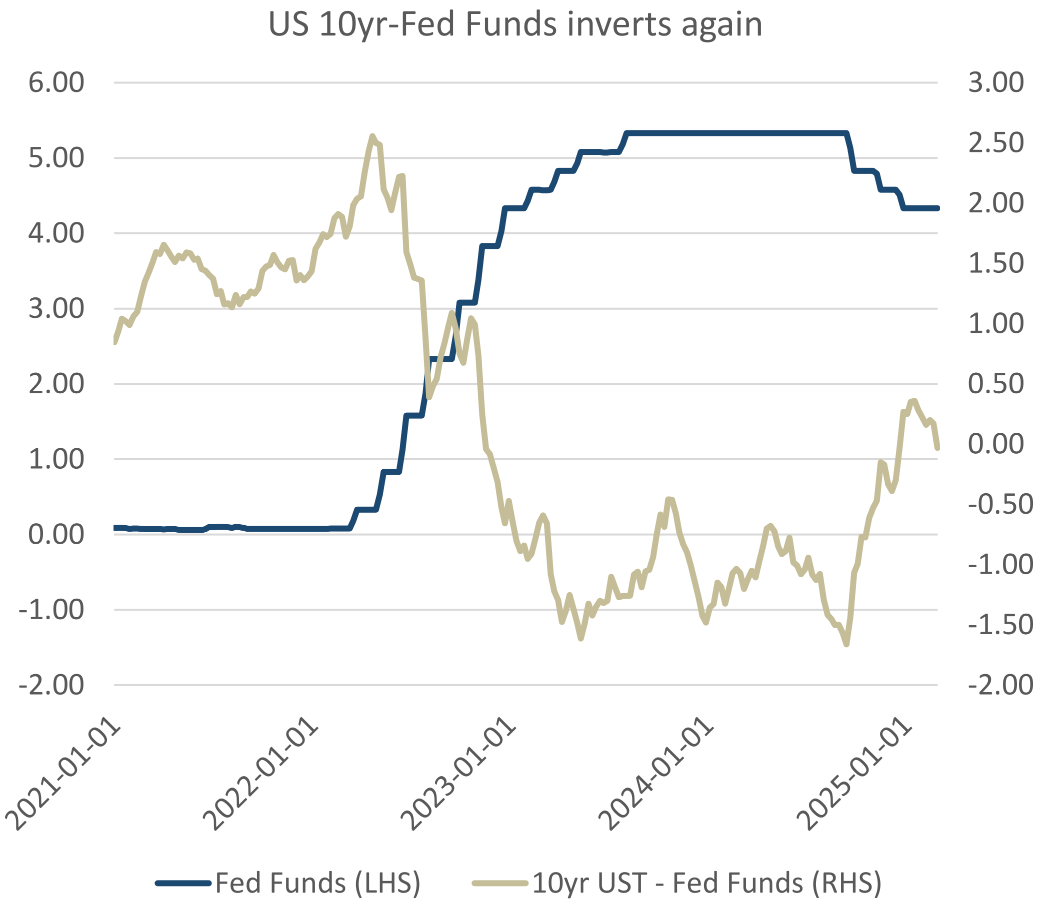
Late 1929: The Top and the Crash

Tightening Pops the Bubble

In 1928, the Fed started to tighten monetary policy. From February to July, rates had risen by 1.5 percent to five percent. The Fed was hoping to slow the growth of speculative credit, without crippling the economy. A year later, in August 1929, it raised rates again, to six percent. **As short-term interest rates rose, the yield curve flattened and inverted, liquidity declined, and the return on holding short duration assets such as cash increased as their yields rose. As loans became more costly and holding cash became more attractive than holding longer duration and/or riskier financial assets (such as bonds, equities, and real estate), money moved out of financial assets, causing them to fall in value. Declining asset prices created a negative wealth effect, which fed on itself in the financial markets and fed back into the economy through declining spending and incomes. The bubble reversed into a bust.**

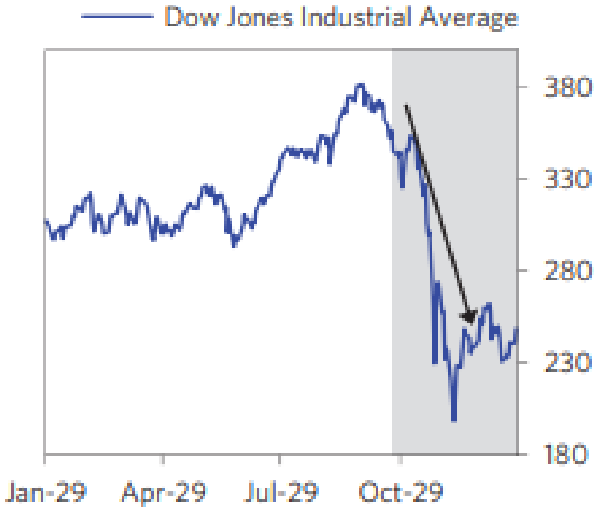






THE 1929-33 ANALOGY

THE CURRENT MARKET CRASH HAS FURTHER TO GO IF HISTORY WAS A GUIDE



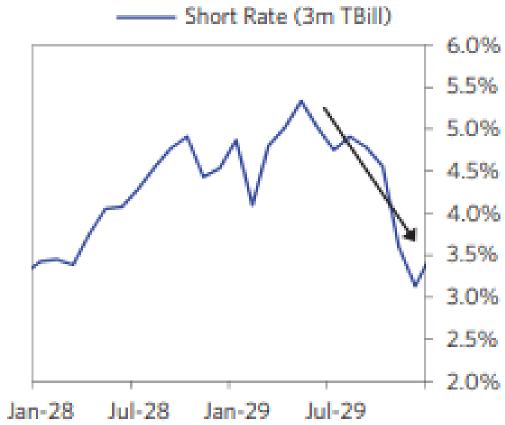
- Stocks dropped 2.5% when congress approved initial Smoot-Hawley tariff in May 1929. Then tariffs were rewritten, stocks rallied, as industrial tariffs were set to be lowered. On 21st Oct 1929, legislation was changed from lower tariffs to higher tariffs again and stocks crashed

- Initial correction suggest we are only half-way through the first crash

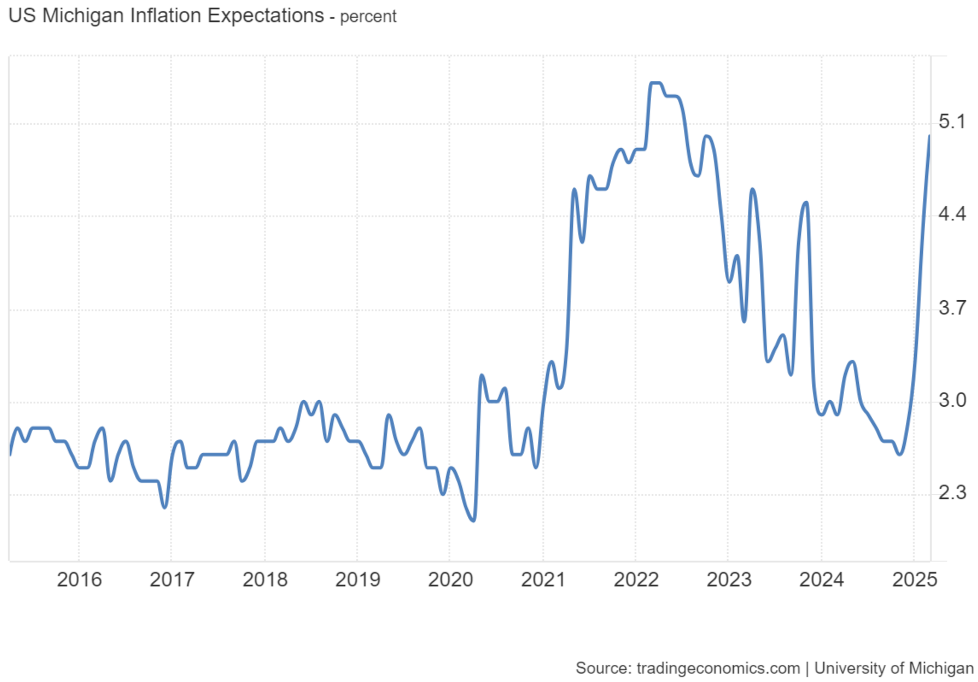
THE 1929-33 ANALOGY

IN 1929, THE FED CUT RATES BY 1.5% IN A MONTH

As mentioned, the New York Fed aggressively provided liquidity during the crash. Within a month, it cut its discount rate from 6 percent to 5 percent and then cut it again, to 4 ½ percent.

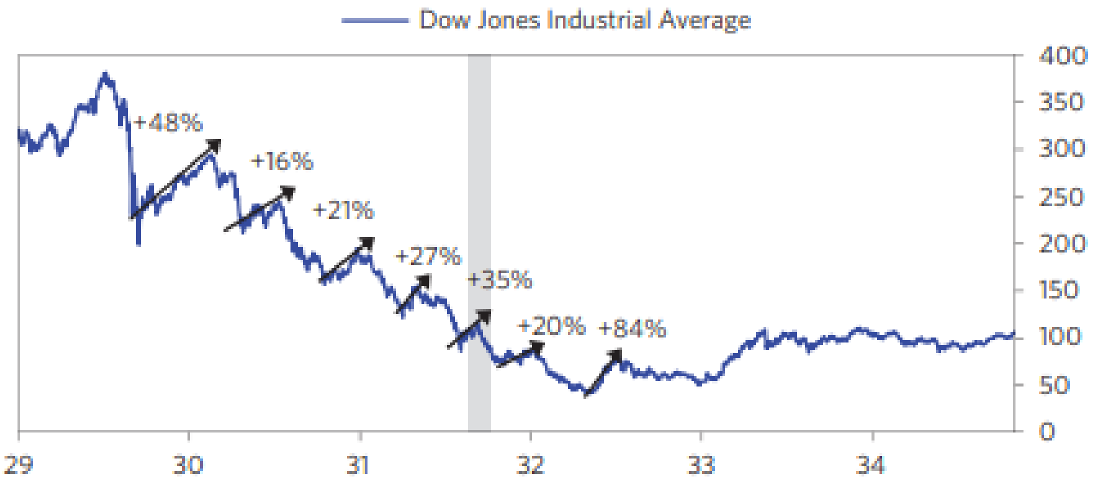


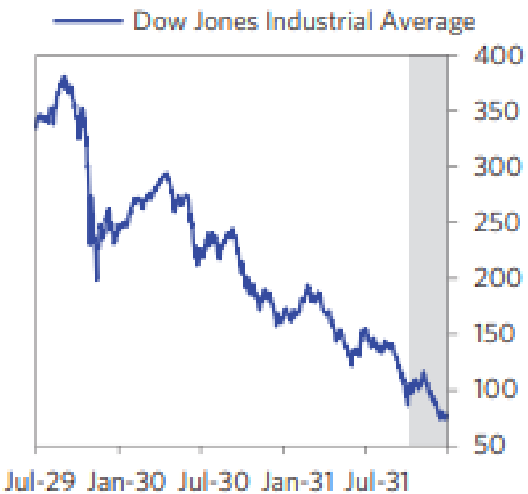
- Due to 1yr ahead inflation expectations rising, the Fed is less willing to cut rates this time (5yr ahead are also rising to 3.9%, highest in decades)

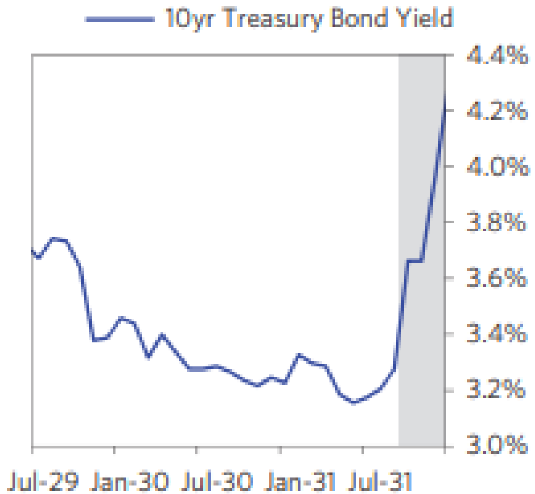


THE 1929-33 ANALOGY

THE DOWNTURN WAS LONG-LASTING AND ALSO INCLUDED HIGHER LONG-END YIELDS LATER ON IN THE CRISIS





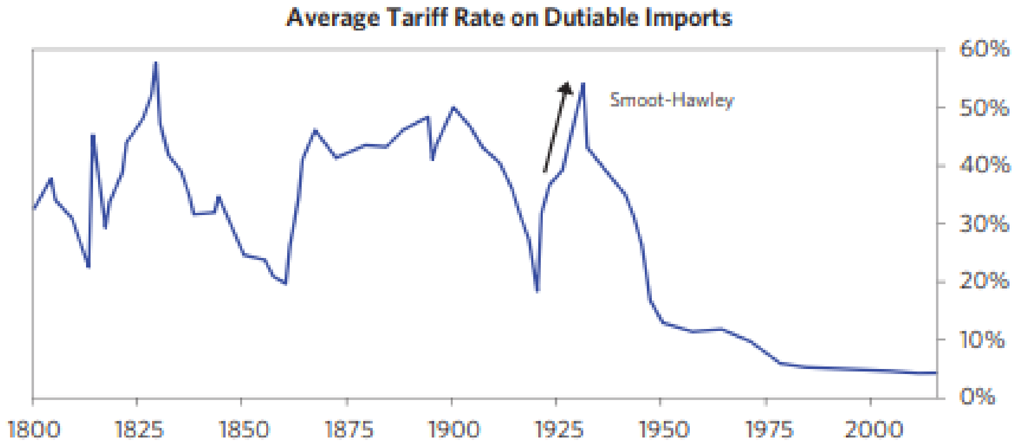


- Despite lowering rates during the crash in 1929, the Fed remained relatively restrictive thereafter due to the gold standard
- In 1931, a run on the Sterling began and the UK went off the gold standard and Sterling depreciated by over 25%
- This had spill over effects for the US, and in H2 1931 we had stocks declining and long end government bond yields rising at the same time
- The Fed only began QE in 1932, after Congress gave them these additional powers
- Second Half of 1932, the market bottomed out as Roosevelt was voted into office, who began unwinding the tariffs and left the Gold Standard

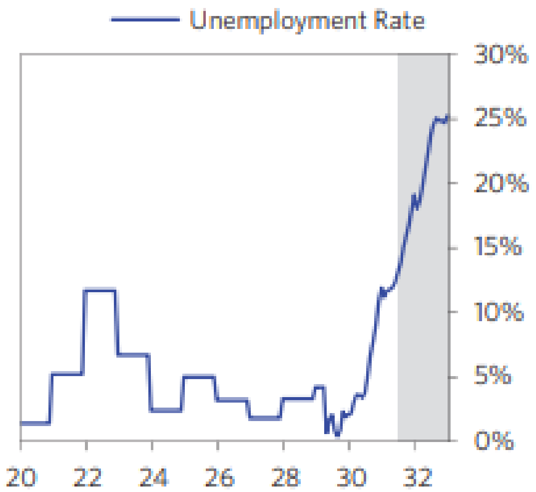
Source: https://www.bridgewater.com/big-debt-crises/principles-for-navigating-big-debt-crises-by-ray-dalio.pdf, FRED St. Louis

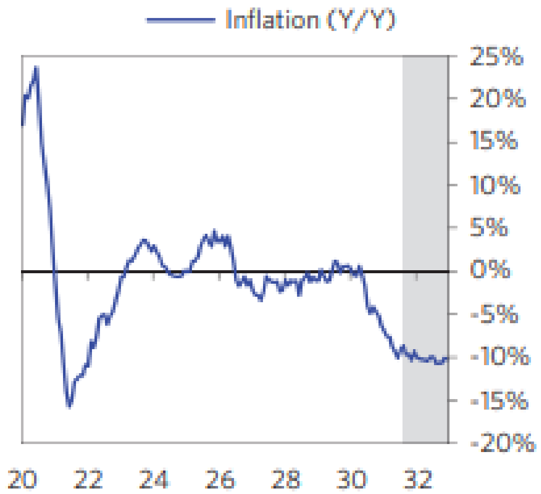
THE 1929-33 ANALOGY

THE QUESTION OF TARIFFS LEADING TO HIGHER INFLATION



Source: Irwin, "Clashing Over Commerce: A History of US Trade Policy"

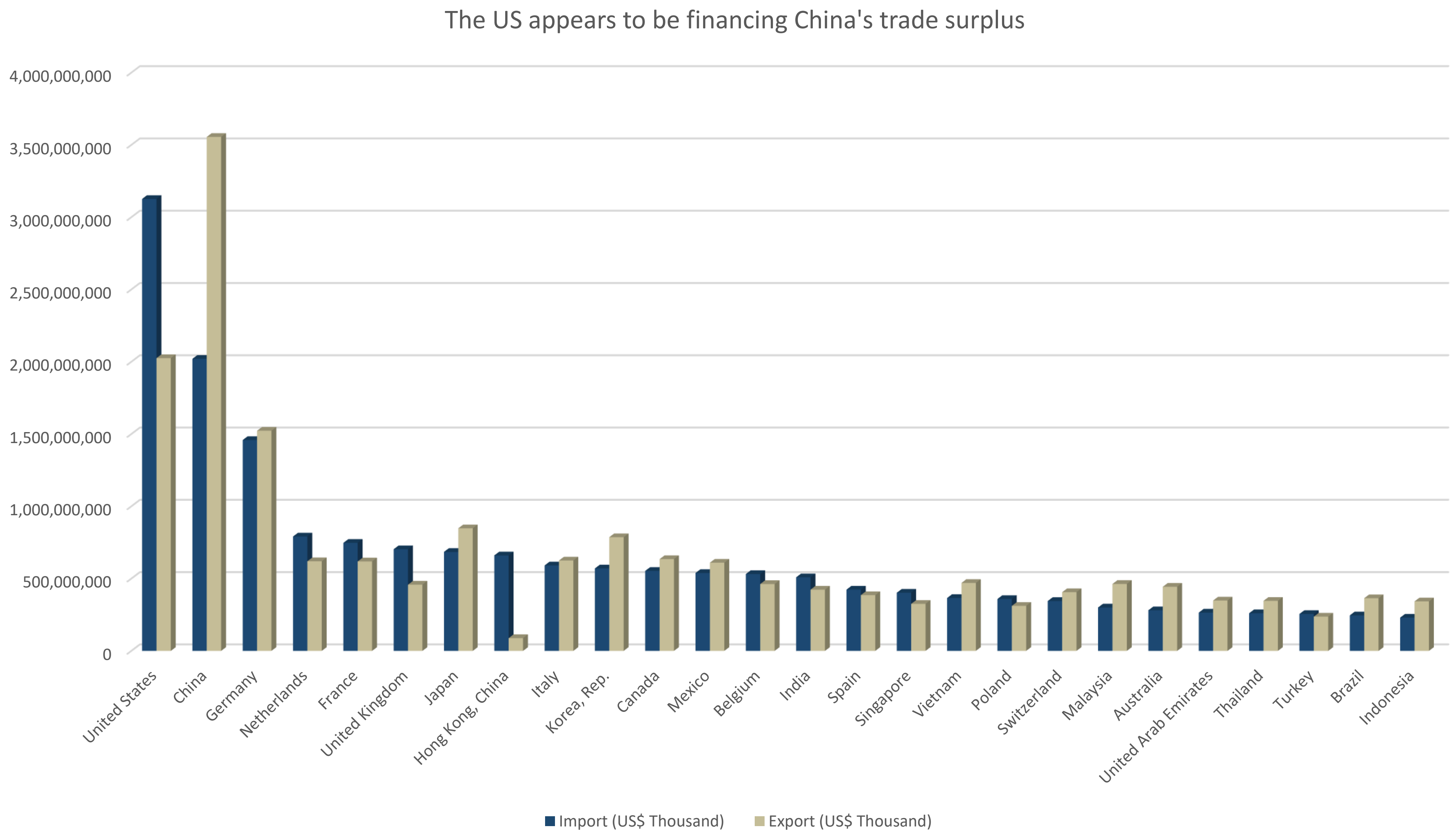




- The collapse in trade and impact on the economy from the tariffs in 1930 was deflationary, not inflationary as many expect them to be today
- Global trade as % of GDP was 11% in 1929 and 5% in 1935. Today this figure is 25%
- Trade makes up 38% of Chinese GDP compared to 27% of US GDP (2023)
- US imports accounted for 4.5% of GDP in 1930. Today this figure is 14%

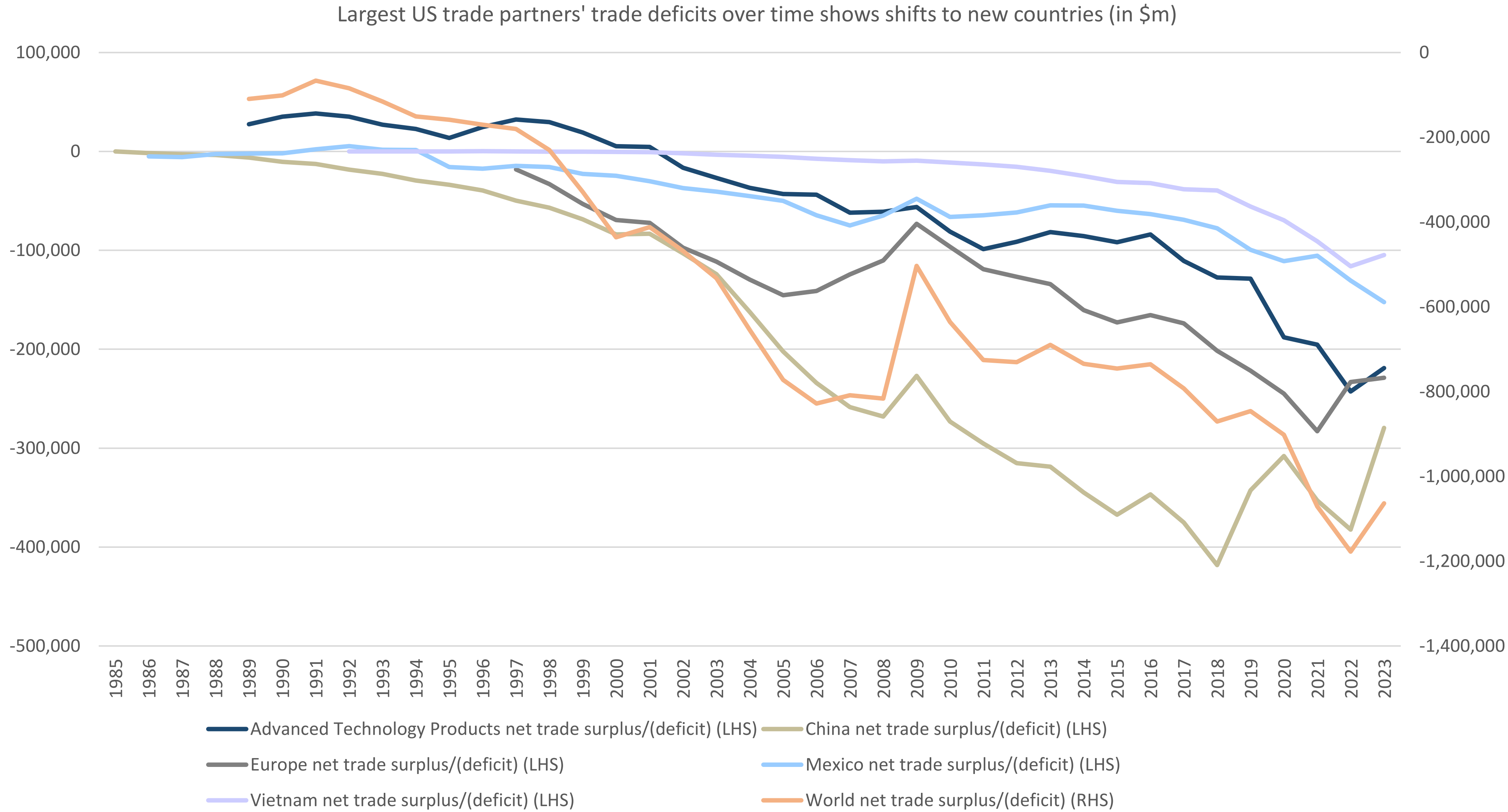
- The tariffs today are specifically targeting China
- Other nations could face strong deflationary impact, especially if they set up new free trade agreements
- The US's share of world GDP was 30% in 1930. Now, this figure is 26%

THE FIGHT FOR WORLD LEADERSHIP
CHINA HAS OVERTAKEN THE US IN OVERALL TRADE



TRADE DIVERSION

SINCE TRUMP'S 2018 CHINA TARIFFS, TRADE DEFICIT WORSENED WITH OTHER COUNTRIES



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Source: US Bureau of Economic Analysis

PHARMACEUTICAL TARIFFS COME NEXT

CHINA AND INDIA IS SOURCE OF NEARLY 60% OF TOTAL PHARMA IMPORTS TO US IN TERMS OF VOLUME, BUT LESS THAN 10% IN VALUE

Top Ten U.S. Sources for Pharmaceutical Imports by Weight 2023

#	Source	Imports 2023 (kg)	Share of Total Imports (%)
1	China	217,224,446	31.50%
2	India	179,910,580	26.10%
3	Germany	38,899,115	5.60%
4	Italy	26,304,262	3.80%
5	Spain	24,169,277	3.50%
6	Switzerland	24,062,952	3.50%
7	France	19,853,500	2.90%
8	Ireland	19,780,522	2.90%
9	United Kingdom	13,690,196	2.00%
10	Israel	12,455,212	1.80%
	World Total	690,456,126	100.00%

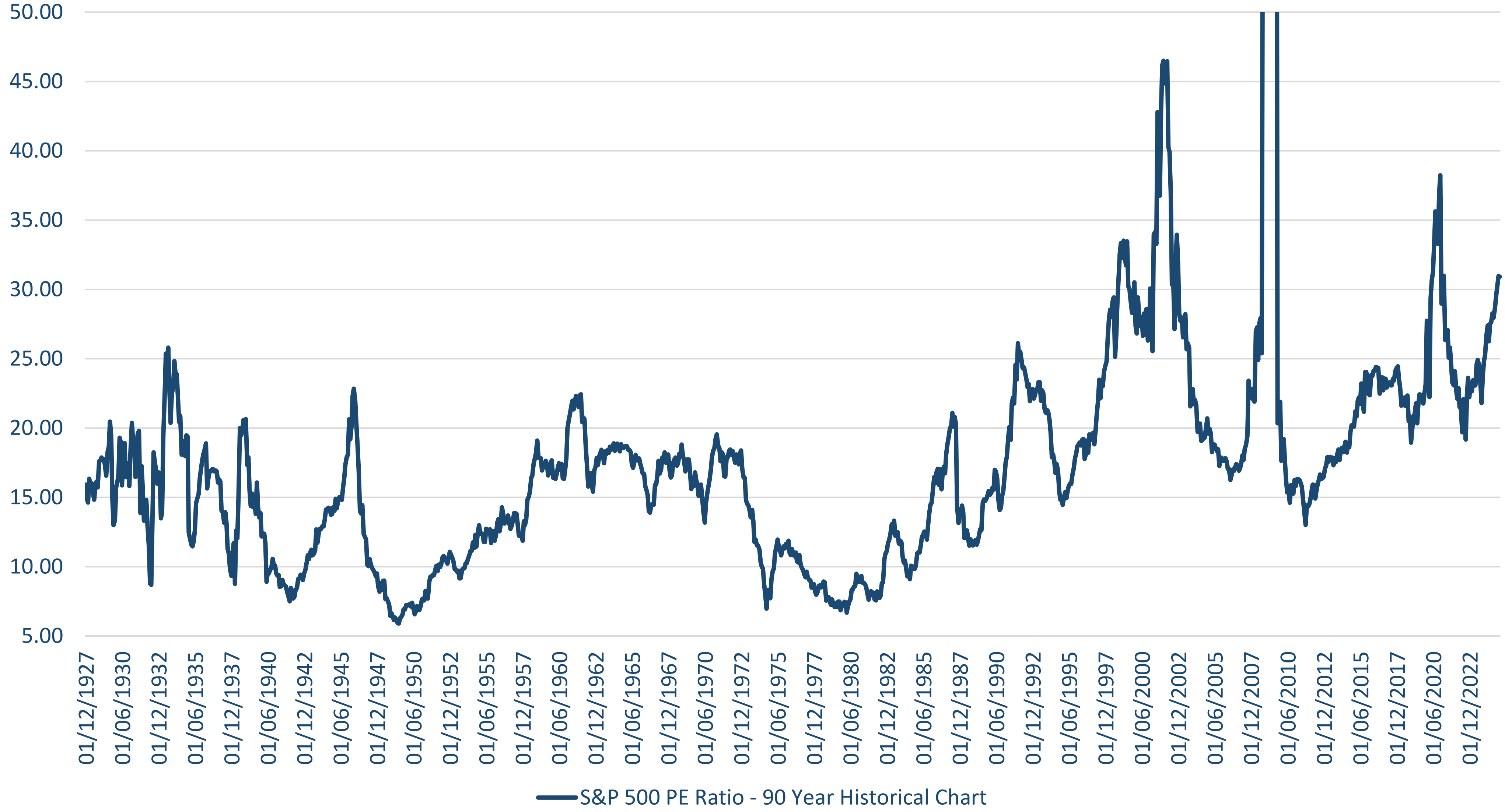
Top Ten U.S. Sources for Pharmaceutical Imports by Value 2023

#	Source	Import Value in $m 2023	Share of Total Imports (%)
1	Ireland	51,503	24.70%
2	Germany	20,059	9.60%
3	Switzerland	15,786	7.60%
4	India	11,265	5.40%
5	Netherlands	10,799	5.20%
6	Italy	8,794	4.20%
7	China	7,796	3.70%
8	United Kingdom	7,709	3.70%
9	Canada	6,251	3.00%
10	Denmark	5,833	2.80%
	World Total	208,547	100.00%

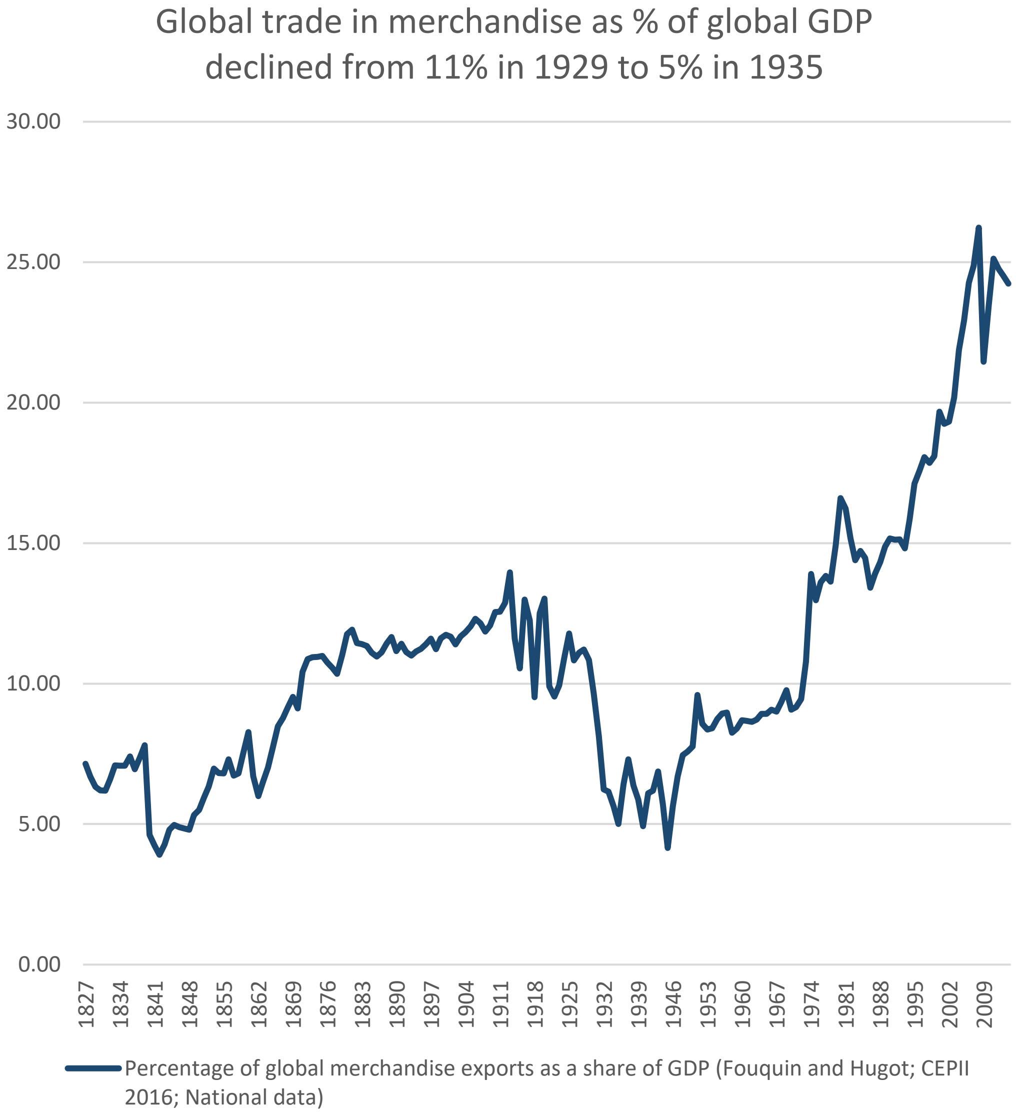
S&P 500 PE RATIO IS AMONGST THE HIGHEST EVER

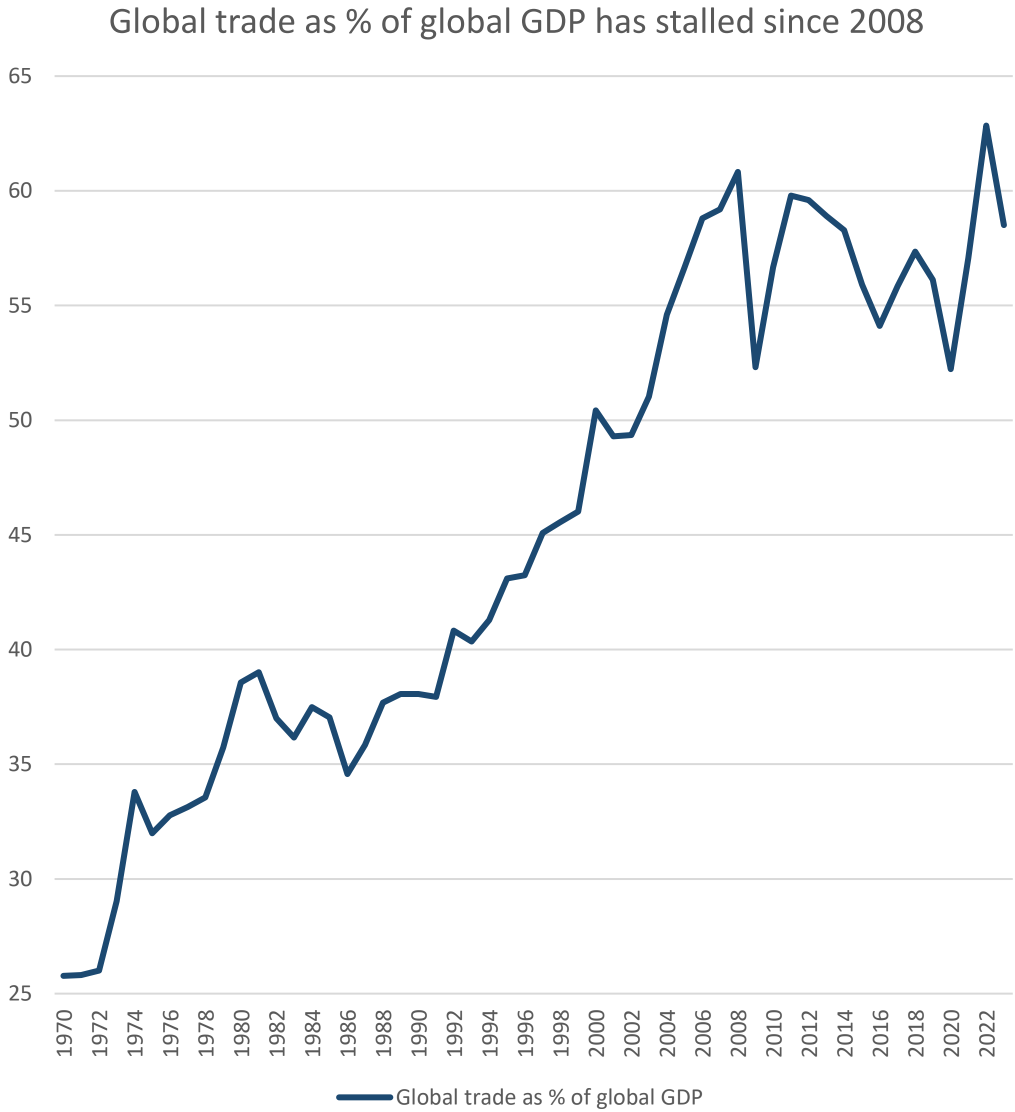
EARNINGS EXPECTATIONS WILL BE TOUGH TO REALISE

S&P 500 PE Ratio is at highest since 1999 (excl. recessions)



A DECLINE IN GLOBAL TRADE IS DANGEROUS
TRADE MAKES UP A MUCH LARGER PORTION OF GDP THAN IN THE PAST





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Source: OurWorldInData.org, World Bank Group

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