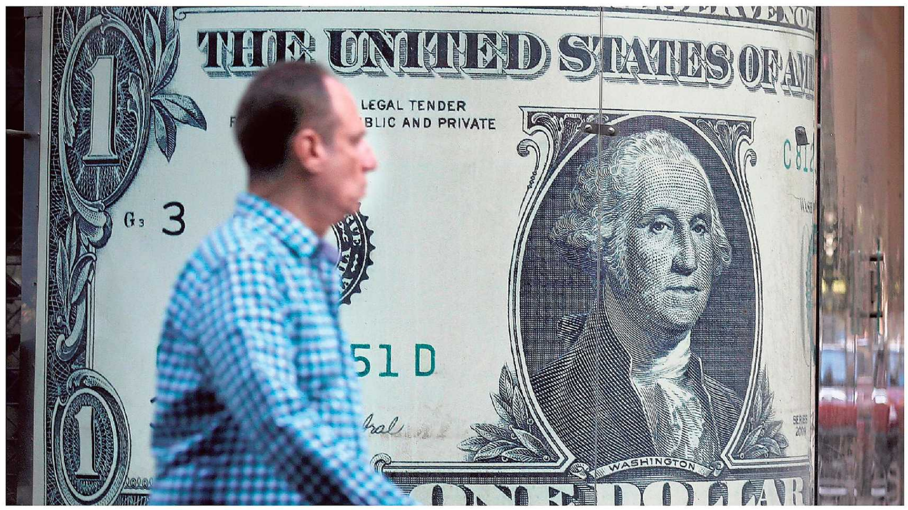
STATES OF MATTER

Trillion-dollar fallacies

SUKUMAR MURALIDHARAN

The trend of defining targets in the American currency comes at a time when the dollar itself is grappling with trust issues



On a slippery slope US President Donald Trump's run-ins with Iran, China and the EU have affected the dollar's status as global reserve currency REUTERS/MOHAMED ABD EL GHANY

After a Budget presentation that left most experts scratching their heads for its arithmetical evasions and inconsistencies, finance minister Nirmala Sitharaman schooled fellow parliamentarians on how her target for the economy was the magic number of $5 trillion within five years.

Sitharaman took pride in discarding the practice of fetching Budget documents to the Lok Sabha in a briefcase. Her choice of a red silk wrapping ostensibly reflected best Indian tradition. And she swatted away all questions about the dubious budgetary arithmetic by committing the government to a target defined in a foreign currency.

There was rich irony there and yet Sitharaman drew eager emulation from at least two Indian chief ministers. States as widely dispersed as Uttar Pradesh and Odisha are now aboard the bandwagon of estimating targets in trillion dollar terms, though without the overweening ambition of targeting multiples of that amount.

For ordinary folk worried about the day's earnings, a trillion is a figure beyond imagination. A trillion dollars is the market valuation that iconic Silicon Valley company Apple achieved early last year, with other giants of the new information age, Amazon, Microsoft and Facebook close behind. Unconnected to corporate earnings, these trillions are about ambitious bets on future earnings.

The new age seemingly demands that older accounting conventions be discarded. There is room for worry though, over how far the shedding of traditional book-keeping practices, that clearly distinguish between assets and liabilities on one side, and costs and revenues on the other, is endangering economic stability.

The promise of fabulous earnings that these valuations convey is continually buffeted by the stock-markets.

For US President Donald Trump, stock-markets are the ultimate validation. The growing public outrage over his serial offences against basic civility is brushed aside with a reference to the great economic success story he is scripting.

Company reports filed in the stock-markets speak of a contraction in earnings. Yet the markets just recently rose to an unprecedented high, on the basis of a halfway promise from the US Federal Reserve that it was inclined to fractionally cut interest rates.

That promises to unleash a flood of cheap money into the markets, pumping up stock values. But it could potentially threaten another trillion dollar entity that today drives the global economy. As Trump's recklessly conceived tax cuts for the rich come into effect and all his efforts to cut entitlements and welfare spending are blocked by public resistance, the US Treasury is preparing for the sale of long-term debt instruments to finance a deficit that for the second year in a row, could top the trillion- dollar mark.

There is a major source of worry here. When US treasury bonds are auctioned, bidders normally queue up to offer higher than face value because of the iron-clad assurances they carry. In two successive quarters now, US treasury bonds have been attracting higher bids for short-term rather than long-term instruments. This inversion of the yield curve violates economic common sense, since long-term investments are expected to yield better. It also suggests diminishing confidence in the US treasury as a guarantee of value.

The reasons are not difficult to guess. The US national debt of $21 trillion has been built on confidence on its eternal role as the pivot of the global economy, and also its good faith in keeping promises. There have been various occasions in the recent past when faith has been shaken, but Trump's roguish stampede over all international covenants, has created an unprecedented crisis of confidence.

Media leaks of classified cables sent by Britain's ambassador in the US lay bare the diminution of global confidence in the Trump administration's ability to maintain trust with international partners. Irked by Trump's pulling out of a treaty his predecessor had crafted with Iran, the European Union has spoken about an alternative payments mechanism that would sideline the US dollar as global reserve currency. Russian President Vladimir Putin has joined the chorus, deprecating the "weaponisation" of the dollar.

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The markets meanwhile have been grasping at straws. After a meeting with Chinese president Xi Jinping at the G20 summit in Osaka early in July, Trump signalled a temporary truce in the tariff war he had launched on the specious ground that China's trade surplus with the US was an act of theft. That brief reprieve was cause for celebration in the markets, which seemingly do not need much to fuel an irrational exuberance. With the electoral cycle in the US now shifting into high gear, the markets could delay the inevitable shake-down in the expectation of gaining a favourable outcome from the 2020 presidential polls. To bet on it though, would perhaps be as risky as an investment in the markets today.

SUKUMAR MURALIDHARAN teaches at the school of journalism, OP Jindal Global University, Sonipat