

US exceptionalism at the tail end of its cycle

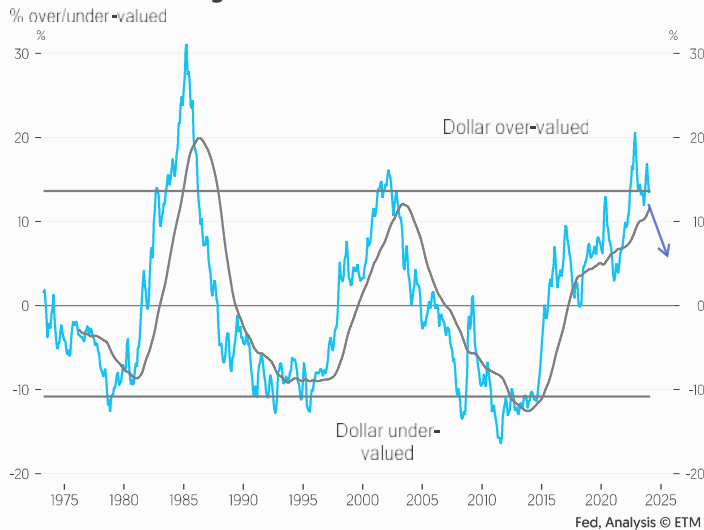
Key points

- US exceptionalism has been a theme that was emphasised through the COVID-19 pandemic. It showed that the US authorities have privileges most others do not and that the US can implement policy positions that ordinarily would lead to disastrous consequences such as hyperinflation. The US deployed this privileged position to great effect, and the result has been a resilient economy that has withstood the monetary tightening everyone thought would be impossible.
- The US has enjoyed a virtuous cycle that has encouraged flows into the US, generated strong GDP growth given the circumstances and resulted in a USD that has outlasted virtually all the bearish forecasts. However, when one understands some of the factors that have helped generate this result, one can't help but feel uneasy at the thought that some of these drivers might not extend much beyond 2024.

BASELINE VIEW: While US exceptionalism has bolstered the USD's performance for now, some of the drivers of the strength in the USD and the US economy will fade as the year unfolds. Paying attention to these drivers is of critical importance in understanding when the dynamics for the USD-ZAR and domestic interest rates might change. The second half of 2024 holds many potential risks for the US economy and the USD.

US Dollar has surprised in the length of its appreciation

Real Dollar Exchange Rate



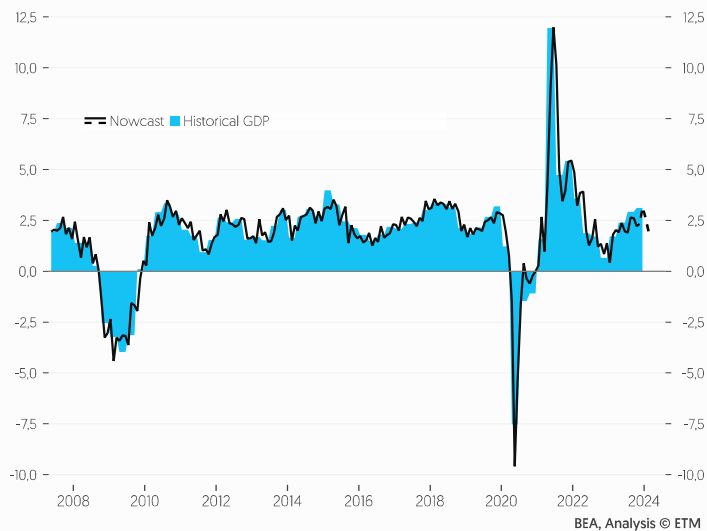
Surprisingly, the USD has managed to remain overvalued against most currencies for an extended period of time. What investors believed was the start of a reversal in 2020 turned out to be little more than a breather before the next leg higher emerged. In that time, the trade-weighted USD has surged to some of its most overvalued levels since the mid-1980s, which is exceptional. It has given rise to the term “US exceptionalism” because it has only happened twice in the past forty years and because it bucked the trend of many other developed economies worldwide.

Such developments have far-reaching consequences for other countries worldwide, least

of all because they impact the value of their currencies, which in turn influences inflation, which determines how central bank policies will adjust. It is, therefore important to understand the dynamics that led to this and to try to gauge how long this might last.

US economy also surprises in its strength

United States: GDP nowcast



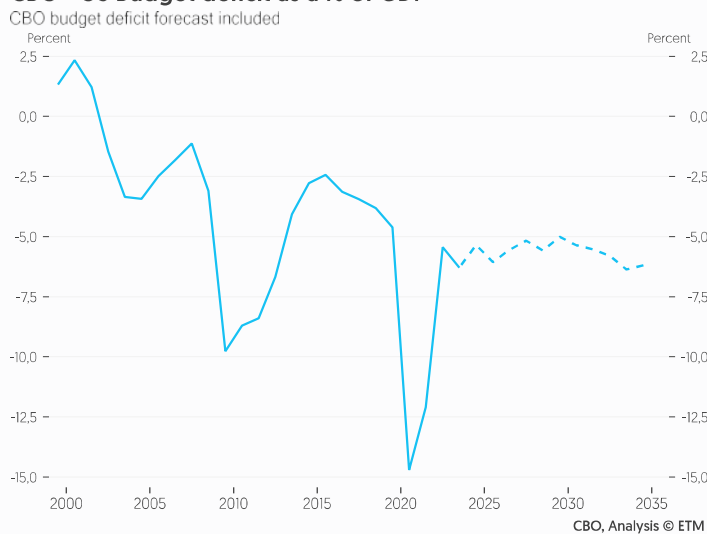
The resilience of the US economy has surprised in equal measure and is a significant reason why the USD may have surprised in the way it has. After so many rate hikes and the Fed retaining its conservative stance on US interest rates, one would be forgiven for thinking that the US business cycle should've rolled over by now.

After all, the US also experienced a surge in the cost of living. It also experienced buoyant fuel prices, and the Fed is shrinking its balance sheet, thereby draining liquidity out of the economy and the banking system. Furthermore, the banks themselves have struggled more recently with banking stress indicators, all pointing to a

distressed environment that could well lead to a contraction in the credit cycle. After all, the M2 money supply has been contracting in y/y terms for over a year now and remains heavily constrained.

Reason 1: US Government has provided immense support

CBO - US Budget deficit as a % of GDP



One cannot talk about US exceptionalism without including the state's role. The US government was one of the most active in responding to the Covid pandemic. It quickly mobilised its resources to ensure that it preserved the economy's capital structure and that the banks did not have to deal with a collapse in balance sheets through a sharp correction in house prices.

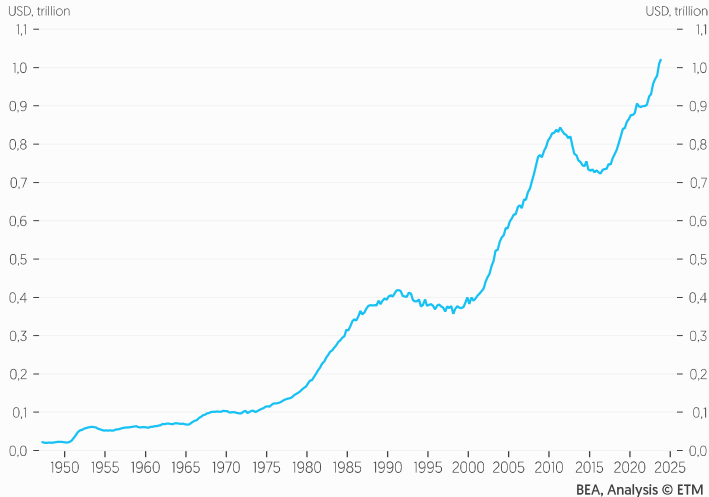
They stimulated the economy very directly by assisting households and businesses, resulting in a budget deficit that exploded. The budget deficit has since narrowed, but not to pre-Covid levels, and according to the Congressional Budget Office's forecasts, it will remain extremely wide for the

foreseeable future.

However, a consequence of this has been the enormous support offered to the US economy, which would go a long way to explaining why GDP growth has held up in the face of tighter monetary policy.

Reason 2: Surging military spending

US, GDP in Consumption Expenditures & Gross Investment, National Defense, SA, AR, USD



Reason 2 is closely related to Reason 1. Some of the budget deficit is being angled towards defence. Spending on defence accounts for roughly 12% of the annual budget, which implies that the US has prioritised spending on defence and is, therefore, a key channel through which the US government can stimulate the US economy.

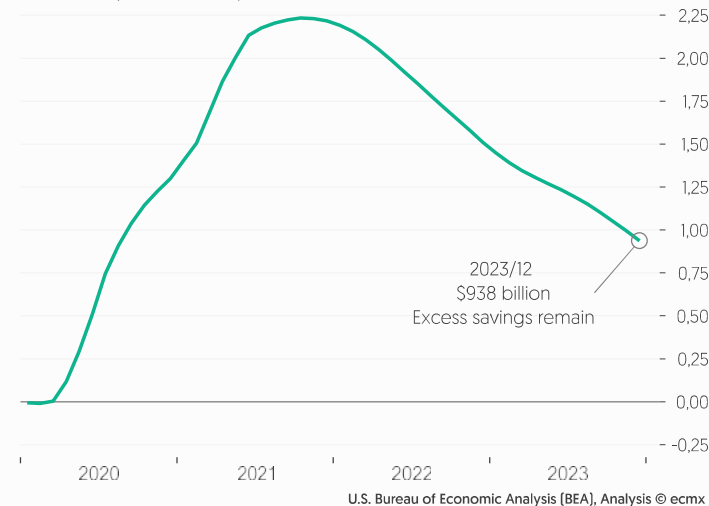
Currently, the US is involved in two wars and is sending tremendous quantities of military equipment and ammunition to Ukraine and Israel. One should not consider these packages as direct payments to these countries but rather as packages aimed at US military-related companies that will benefit greatly from the US's involvement.

The longer these wars roll on, the greater the degree of stimulation the US economy will enjoy.

Reason 3: Excess savings remain elevated

US, 2020 Savings drawdown

USD, Trillion (excess natural)

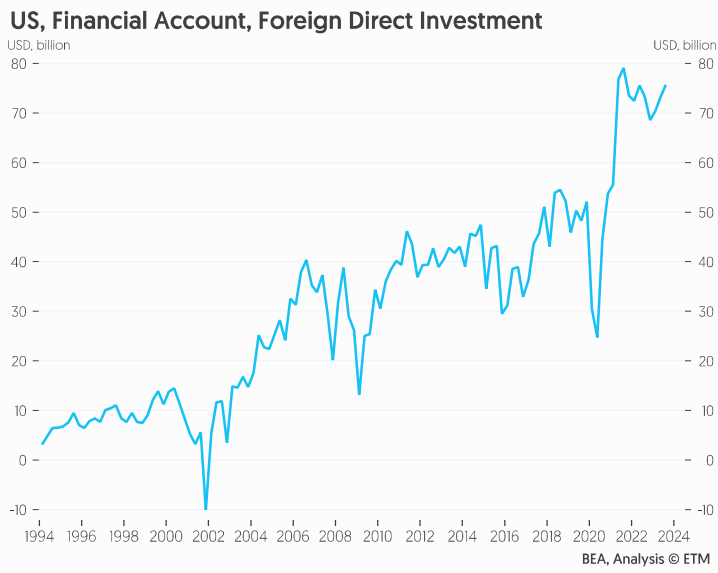


One of the delayed consequences of the fiscal stimulation applied during the pandemic is that the US government boosted excess savings within the private sector. It has provided an enormous buffer households have drawn on as monetary policy has normalised and protected overall consumptive demand.

Judging by the accompanying chart, the trend in excess savings may be lower, but it still stands at over \$900bn. That is a significant buffer that can still be drawn on and will have a material influence in keeping the consumptive element of the US economy well supported.

The expectation is that the benefits of this buffer will steadily unwind through the year but could extend as far as Q3. At this point, some of the support will have faded, and the US economy may become more sensitive to a cyclical downturn.

Reason 4: Constant inflows



US exceptionalism reflects the ability of the US authorities to implement policies most other countries cannot. Part of this exceptionalism is afforded to the US because the USD is considered the world's reserve currency, which means that any USD printing in the US does not remain contained within the borders of the US to spike inflation, although the effects of the stimulation that is generated out of this money printing can.

It implies that the US can behave differently to most other countries and can generate an economic reality that is better, at least in the short run. For now, the US has exploited that exceptionalism and created an environment where GDP growth is enhanced and interest rates

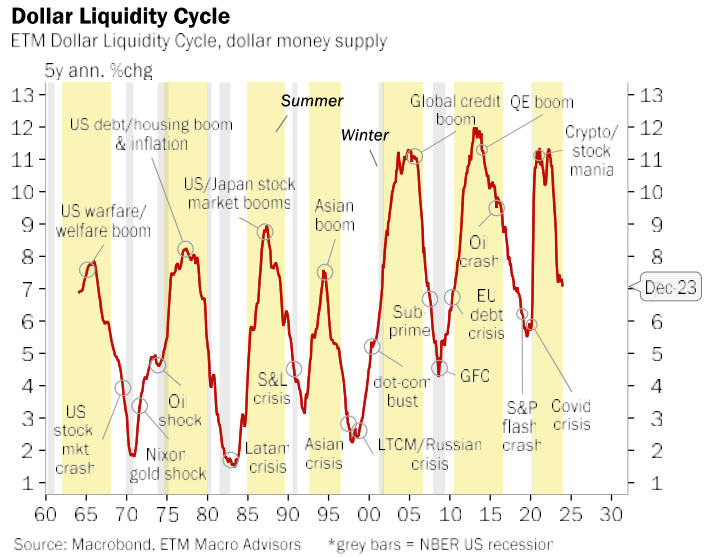
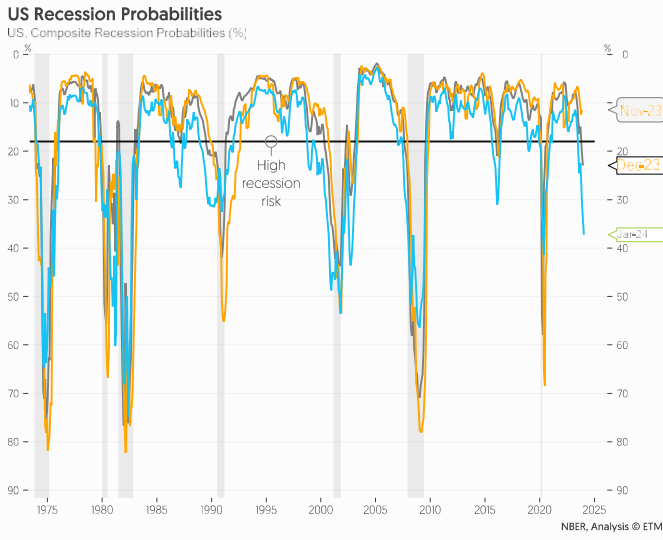
remain elevated. As a result, the US can attract a lot of inflows, and because of this, the USD retains much of its resilience. How long that lasts is the burning question that demands an answer.

Conclusion:

There is no evidence that the US is about to experience a hard landing. The labour market remains strong, job openings have picked up, and weekly jobless claims remain comfortable. The unemployment rate remains comfortable and consistent with full employment conditions, and there is no burning need for companies to rationalise costs. However, history shows that it can do so more dramatically when the cycle turns. Against this backdrop, there are a few things to consider that might turn the current tailwinds into headwinds.

1. Excess savings will be depleted, and the support for the economy will wane
2. A Trump presidency may well usher in more conservative fiscal policy that will also detract from GDP growth
3. Trade relations with the US may well come into the spotlight if Trump resumes his strategy with China
4. And Trump has also indicated that he would like to see the wars in Ukraine and Israel finished
5. Add to that the pent-up effects of high interest rates, a contraction in money supply, tightening liquidity conditions due to quantitative tightening and the leading indicators that point to a US slowdown might well materialise.

The danger period for the US economy would be H2 2024 when many of these events fall due. One must guard against turning complacent because of the ongoing phase of US exceptionalism.



Analysts:

George Glynos

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