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THE COUNCIL FOR THE UNITED STATES AND ITALY

CONSIGLIO PER LE RELAZIONI TRA ITALIA E STATI UNITI

This week at Project Syndicate: **Mohamed A. El-Erian** hopes that mounting bilateral economic tensions will not preclude cooperation on major global challenges and **Stephen S. Roach** explains why the newly approved EU rescue fund represents another nail the coffin of US dollar hegemony. Please find below the complete version.

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"IS A CHINA-US "RIVALRY PARTNERSHIP" POSSIBLE?"

(Project Syndicate, July 21, 2020)

***Mohamed A. El-Erian**, Chief Economic Adviser at Allianz, the corporate parent of PIMCO where he served as CEO and co-Chief Investment Officer, was Chairman of US President Barack Obama's Global Development Council. He is President Elect of Queens' College (Cambridge University), senior adviser at Gramercy, and Part-time Practice Professor at the Wharton School at the University of Pennsylvania.*

One must hope that China and the United States will eventually arrive at an understanding that great-power competition does not preclude cooperation to resolve major global challenges. The main challenge will be to avoid a damaging derailment during what is likely to be a long and bumpy journey toward this destination.

LAGUNA BEACH – Not a day seems to pass without further evidence of the mounting economic tensions between China and the United States, the world's two largest economies. This growing antagonism will have a bigger immediate impact on China than on the US, as bilateral decoupling fuels a broader ongoing process of deglobalization. And the negative spillover effects for a subset of other countries – which I call the dual-option economies – could be particularly significant.

Even from a purely economic perspective, it is hard to envisage any durable abatement of Sino-American tensions in the near future. And that is before factoring in national-security issues, let alone those relating to technology and human rights.

The economic and financial implications of COVID-19 are uniting three segments of the US economy in decoupling from China. This dynamic is unlikely to abate anytime soon and will be mutually reinforcing, meaning that one plus one plus one adds up to more than three.

For starters, the US government recently escalated a long-running tit-for-tat conflict by imposing bilateral economic and financial sanctions on China, with explicit bipartisan backing from Congress. The blame game over the pandemic serves to reinforce the tougher US stance, which is unlikely to change, regardless of the outcome of this November's presidential and congressional elections.

America's corporate sector also will drive decoupling, as more US firms look to tilt away from efficiency and toward resilience. This entails "near shoring," "reshoring," or "localization," which implies moving Western supply chains out of China. Some industries, such as pharmaceuticals and technology, will likely come under pressure from governments in the US and elsewhere to do the same.

This does not mean that Western multinationals will abandon China anytime soon. Most will instead look to move toward an "in China for China" model. But this approach will lessen these firms' involvement in the country, increase their vulnerability, and limit their ability to inform and influence outcomes that affect them.

US households will contribute to the decoupling, too. With the recovery from the deep coronavirus-induced recession likely to be slow, and the global economy in a highly desynchronized phase, part of the recent jump in US unemployment is likely to prove frustratingly slow to reverse.

Although this multifaceted decoupling process will create economic headwinds for both the US and China, its impact is likely to be asymmetrical. Specifically, China is more vulnerable, because it still needs the global economy to facilitate its impressive development process. The issue here is not so much China's short-term growth performance, given that a V-shaped recovery is already underway. Rather, economic decoupling threatens to complicate the country's highly challenging middle-income transition, which has proved to be the trickiest stage of the development process for many other economies.

Decoupling will also make it costlier for China to sustain some of its recent international economic ventures, such as the signature Belt and Road Initiative (a massive transnational infrastructure investment program) and its large-scale lending to many developing countries. In particular, the Chinese government may find it harder to push back against the narrative that too many of these alliances are transactional and one-sided, and not strategic enough.

Finally, rising Sino-American tensions may have major implications for dual-option countries such as Australia and Singapore, which have maintained strong national-security links with the US and equally strong economic ties with China. While the cost of this dual-option strategy has been low so far, it will now likely rise, as is already increasingly the case in technology. These countries will have to consider the possibility that they will be asked to choose between the two leading global powers – something that I suspect they would be unwilling and unprepared to do. Although this is the most important foreign-policy question facing many governments, so far it has generated relatively little discussion.

All these factors point to an unusually uncertain macroeconomic and microeconomic outlook that is ever more vulnerable to policy mistakes and market accidents. The preferred destination for all is what former Google CEO Eric Schmidt calls a "rivalry partnership" between the US and China, whereby healthy competition does not preclude the cooperation and shared responsibility that are critical to tackling major global challenges such as climate change and pandemics. The challenge will be to avoid a damaging derailment during what is likely to be a long and bumpy journey toward this goal.

"FROM AMERICAN TO EUROPEAN EXCEPTIONALISM"

(Project Syndicate, July 22, 2020)

Stephen S. Roach, *a faculty member at Yale University and former Chairman of Morgan Stanley Asia, is the author of Unbalanced: The Codependency of America and China.*

An overvalued US dollar is ripe for a sharp decline, owing to America's rapidly worsening macroeconomic imbalances and a government that is abdicating all semblance of global – or even domestic – leadership. And the European Union's approval of a joint rescue fund is likely to accelerate the euro's rise.

NEW HAVEN – Those are tough words to swallow for a hardcore Euroskeptic. Like many, I have long been critical of Europe's Economic and Monetary Union as a dysfunctional currency area. Notwithstanding a strong political commitment to European unification as the antidote to a century of war and devastating bloodshed, there was always a critical leg missing from the EMU stool: fiscal union.

Not anymore. The historic agreement reached on July 21 on a €750 billion ($868 billion) European Union recovery fund, dubbed Next Generation EU, changes that – with profound and lasting implications for both an overvalued US dollar and an undervalued euro.

Unlike the United States, which appears to be squandering the opportunities presented by the epic COVID-19 crisis, Europe has risen to the occasion – and not for the first time. In July 2012, in the depths of a seemingly fatal sovereign debt crisis, then-ECB President Mario Draghi vowed to do "whatever it takes" to defend the beleaguered euro. While that pledge solidified the European Central Bank's credibility as an unshakable guardian of the single currency, it did nothing to address the greater imperative: the need to trade national sovereignty for a pan-European fiscal transfer mechanism.

The July 21 agreement accomplishes just that. And now the EMU stool finally has all three legs: a common currency, one central bank, and a credible commitment to a unified fiscal policy.

Of course, the deal is far from perfect. Significantly, it requires unanimous consent from the EU's 27 member states – always a nail biter in today's charged and polarized political environment. And there was a major tug of war over the composition of the EU fund, which will comprise €390 billion in one-off COVID relief grants and €360 billion in longer-duration loans. While the devil could lurk in the details, the bottom line is clear: the Next Generation EU plan will draw critical support from large-scale issuance of pan-European sovereign bonds. That finally puts Europe on the map as the backer of a new risk-free asset in a world that up until now has only known only one: US Treasuries.

Europe's fiscal breakthrough drives an important wedge between the overvalued US dollar and the undervalued euro. Recent trading in foreign-exchange markets now seems to be catching on to this. But there is a long way to go. Notwithstanding a surge in June and early July, the broad euro index remains 14% below its October 2009 high in real terms, whereas the dollar, despite weakening in recent weeks, remains 29% above its July 2011 low. My prediction of a 35% drop in the broad dollar index is premised on the belief that this is just the beginning of a long-overdue realignment between the world's two major currencies.

I fully recognize that currency calls have long been the trickiest macro forecasts of all. Former US Federal Reserve Chairman Alan Greenspan famously put them on a par with coin tosses. Still, sometimes it pays to take a stab.

My bearish view that an overvalued dollar is ripe for a sharp decline reflects two strains of analysis: America's rapidly worsening macroeconomic imbalances and a government that is abdicating all semblance of global leadership. The July 21 breakthrough in Europe, and what it means for the euro, only deepens my conviction.

On macro imbalances, the precipitous decline in US domestic saving that underpinned my original argument now seems to be well under way. The initial pandemic-related spike in personal saving now seems to be receding, with the personal saving rate falling from 32% in April to 23% in May, while the federal budget deficit is exploding, spiking to $863 billion in June alone – almost equaling the $984 billion shortfall for all of 2019. And, of course, the US Congress is just days away from enacting yet another multi-trillion-dollar COVID-19 relief bill. This will put enormous pressure on already-depressed domestic saving – the net national saving rate was just 1.5% of national income in the largely pre-pandemic first quarter of 2020 – and put the current account on a path toward a record deficit.

The comparison with Europe is particularly compelling from this perspective. Whereas the International Monetary Fund expects the US current-account deficit to hit 2.6% of GDP in 2020, the EU is expected to run a current-account surplus of 2.7% of GDP – a differential of 5.3 percentage points. With the US entering the COVID crisis with a much thinner saving cushion and moving far more aggressively on the fiscal front, the net-saving and current-account differentials will continue to shift in Europe's favor – putting significant downward pressure on the dollar.

The same is true from the standpoint of global leadership, especially with America pushing ahead on deglobalization, decoupling, and trade protectionism. Moreover, I was particularly impressed by Europe's latest efforts to address climate change — not only framing Next Generation EU to be compliant with the Paris climate agreement, but also earmarking close to one-third of its broader budget package for green infrastructure and related spending initiatives. US President Donald Trump has unfortunately gone in precisely the opposite direction, continuing to dismantle most of the environmental regulations put in place by President Barack Obama's administration, to say nothing of having withdrawn from the Paris accord in early 2017.

The COVID containment disparity is equally striking. New cases in the US soared to a record daily high of 67,000 in the week ending July 21 – up a staggering 208% from mid-June. In the EU-27, the daily count of newly confirmed infections has remained roughly stable since mid-May, at a little over 5,000. Given that the EU's population is 35% larger, America's abysmal failure at containing the coronavirus is all the more glaring on a per capita basis. Moreover, the expansion of coronavirus testing in the US is actually decelerating just as the infection rate is exploding, undermining the Trump administration's vacuous justification that more testing is driving the rise in infections. With Europe's much deeper commitment to public-health policy and enforcement, whose currency would you rather own?

American exceptionalism has long been the icing on the cake for the Teflon-like US dollar. Those days are gone. As the world's most unloved major currency, the euro may well be headed for an exceptional run of its own. Downward pressure on the dollar will only intensify as a result.

ABOUT THE COUNCIL FOR THE UNITED STATES AND ITALY

The Council for the United States and Italy is a private non-profit organization, founded in Venice in 1983 by Gianni Agnelli and David Rockefeller, who served as honorary presidents until 2003. Marco Tronchetti Provera followed them as Chairman, then Sergio Marchionne until 2018. Domenico Siniscalco is the current Chairman, Gianni Riotta Executive Vice Chairman. The Council for the United States and Italy promotes and creates economic relations between Italy and the United States, linking them to Europe, Asia and Africa through knowledge and free trade. Its members are leaders in the economy, industry, finance, technology, services, consulting, law and culture - a team in which economic growth is viewed as promoting humanity and wealth as a cultural value to be shared.