John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday July 29, 2020

The COVID-19 virus has infected every region of the world. Our news, understandably, tends to stay focused on the United States and our battle to contain the virus. What we are missing is news from other regions and news on the role of the United States in the global virus battle.

Last week European Union leaders agreed to a recovery plan funded by the region's first ever issuance of common debt. Some call this a historic development. It definitely is significant. Until now the euro currency has been the only real bond among the EU member countries. As we have seen, individual members can get over their head in debt. Greece is a familiar case. Until the pandemic hit the EU, the fiscally strong members, like Germany, kept their financial distance from the weak like Greece. COVID-19 knows no boundaries. The virus can migrate from one country to another. All of a sudden Germany and other fiscally strong EU members have to face the fact that helping Italy, Greece and Spain fight the virus and its economic fallout is in their best interests.

Last week's announcement was about a plan for 1.8 trillion euros in spending to fight the pandemic-induced economic contraction. The EU will also borrow 750 billion euros for a recovery package. The EU Parliament and national legislatures must approve the package. That will be a hard sell for strong countries that have been reluctant to subsidize others' bad behavior. (Sounds a lot like the battle here at home about subsidizing bad fiscal behavior by some states.) But the highly contagious virus is such a common threat that approval of the debt is expected.

In March foreigners sold huge quantities of long-term Treasuries. That has been wrongly interpreted as an indication of a loss of confidence in the U.S. dollar. Data from the Bank for International Settlements (BIS) shows the opposite, namely that the dollar's role as the world's reserve currency grew at a record rate in the opening quarter of this year. That data, claims on the U.S. official sector by non-U.S. banks, includes U.S. Treasury debt as well as claims on the Federal Reserve. What are "claims" on the Federal Reserve? Deposits by foreign central banks are "claims" on the Federal Reserve, just as bank deposits are liabilities for any bank. In the first three months of this year such claims rose $564.49 billion. That accounted for more than half of the growth in claims on governments and central banks everywhere in the world. It was also larger than any quarterly increase in bank claims on the official sector globally ever recorded. Foreign banks' reserves at the Federal Reserve rose by $320 billion in the quarter, accounting for the lion's share of the increase.

In dollar terms, the eurozone's economy is around 60% the size of the U.S.'s, but growth in claims on the eurozone official sector ran to more like a third of the U.S. figure. Growth in cross-border claims on the governments and central banks of developing economies barely registered, running to a measly $18.88 billion. And that includes the Chinese yuan. Clearly investors do not see the yuan as a safe haven in this turbulent time.

The U.S. dollar's share of global foreign exchange reserves is 62%, which is often taken as a measure of the dollar's importance internationally. The BIS data, if anything, indicate that the foreign reserves measure understates the dollar's role as a safe haven.

As in past times of global financial turmoil, the United States turns out to hold the dominant position during this unprecedented pandemic crisis.

The U.S. economy rebounded in May and June after a dismal plunge in April. Now there are signs that the virus is on the rise again with daily new cases nearing 70,000. That is believed to be the consequence of reopening parts of the economy, especially bars and restaurants. The Federal Reserve board will meet again this week. The Fed is not likely to announce any changes to its monetary policy. Interest rates will stay low. The Fed will keep buying bonds. But when chairman Powell comments after the meeting we should be prepared for a dour tone. After last month's meeting he said, "assuming that the disease remains or becomes pretty much under control, I think what you see is…an expansion that builds momentum over time."

That bit of optimism looks to be premature. A national Federation of Independent Business monthly survey found 23% of respondents in early July saying they'd be out of business within six months "under current economic conditions."

Congress and the President are at work negotiating yet another stimulus package. They are expected to have the package ready by the end of this month, before the Congress' August recess. That will underpin the economy for a few more months.

Pfizer says there could be a vaccine as early as October. Moderna and AstraZeneca also have reported good news on their vaccine development efforts. All in all, there are more than 100 vaccines in development worldwide. Once a vaccine is approved and available, economic conditions will quickly change for the better.

Of course, some businesses will not survive. Some jobs will be permanently lost. Hopefully come November voters will choose pro-growth politicians to lead us through the post-virus recovery. The answer to the new mountain of government debt is to have the economy grow at a rate faster than the deficits. That is how we got out from under a mountain of debt after World War II. Governments, after all, are not like human beings. They can live on for centuries, allowing plenty of time to outgrow a mountain of debt. The difference between economies that are successful in the long run and those, like Greece, that run into a debt trap and financial crisis is policies that foster real economic growth. It is distressing to see the rise of left-socialist ideas in the United States. Those ideas have never worked. Instead they have dragged economies down, Venezuela being an example.

No one wants the U.S. to become the next Venezuela. Let’s hope that comes through in November and we are launched on a new pro-growth agenda.

I will have the next market review and update one week from today on Wednesday August 5, 2020.

All the best,

John Dessauer