Lead Left Interview – Tim Hopper (Part 2)

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This week we continue our conversation with Tim Hopper, managing director and chief economist for TIAA-CREF. Tim has over 20 years of experience writing and speaking about the global economy. Prior to joining TIAA-CREF, Mr. Hopper held various leadership positions in global banking and real estate. He also served as a senior economist with the Federal Reserve Bank of Dallas for over 10 years. ***Second of two parts – View part one***

TLL: Which raises the question, where are we in the economic cycle?

Tim Hopper: The length of the business cycle depends less on time and more on exactly what bubble is forming, and how long that bubble will take to build. It's the Fed's job to reanimate an economy after a recession, but to do so in a manner that doesn't provide too much stimulus or create distortions. Of course QE has created distortions which need to be addressed very carefully.

TLL: Do you think, for example, 17 million new auto sales is a sign of a bubble?

TH: Not necessarily. This is a sign that manufacturing is returning to the economy, but also shows that the fleet of cars on the road is extremely old and we are going through a replacement cycle.

TLL: Let's turn to China. Give us your view of what's going on there.

TH: The important question to answer with regard to China is whether its slowing is cyclical or a trend, and is it dampening to the global economy? Certainly their growth rate is slowing, but given the sheer size of their economy, it has to slow. China is also trying to retool from a manufacturing and export-driven economy to one that's more balanced to meet consumer demand from a growing middle class. This is not like the old Soviet style of command and control. China is accounting for the change of consumer patterns and tastes. I would call China a managed capitalist economy, which is a good thing.

TLL: Where's the trajectory of their economy headed? Why were markets spooked in August?

TH: Look, as the economy gets bigger, its growth rate will naturally slow. But this process of liberalizing and changing will also impact that growth rate – imagine changing capital flows, exchange rate regimes, currency flows, interest rate and bond markets – all at once. Sometimes you will make a mistake, and that's what we say this summer.

TLL: Why did they try to manipulate their stock market?

TH: It's a long walk to reform, and they stumbled. They don't understand how markets work, and their reaction to the stock market route proved it. When you have a bubble in equity markets, it's going to deflate – you can't stop that. And that deflation isn't over. Not until the market reaches a floor supported by earnings.

Their second stumble related to the change in the parity rate setting mechanism, the process by which they controlled the value of their exchange rate. They were trying to address a criticism coming from the IMF. But the change spooked markets and caused the currency to depreciate quickly. This is another lesson they need to learn. You can't just go about making changes to regulation without some measure of transparency and preparing markets for that change.

TLL: How far does the devaluation have to go?

TH: It will continue. The problem is that the rest of the world assumes the worst, which creates the uncertainty.

TLL: Outside of China, what's the outlook for other emerging markets?

TH: If you look back to 2003-2008, there was a shift in central bank reserves, from the developed to emerging markets. This, of course, weakened the dollar, created higher inflation and growth in emerging market countries, and higher commodity prices. That process is now reversing itself. Slower growth in the EM has been going on for a number of years. When market observers complain about global growth, they're really referring to EM.

TLL: So Tim, what's been your biggest surprise in this economy?

TH: If you think about the current cycle, all we hear about is a lower potential growth rate, a lost business cycle and the "New Normal", referring to how slow growth will be from now on. But economies go through cycles. My "Aha moment" came when I put this shifting reserve story together with commodity prices, the dollar, trade and growth. The US economy is repatriating manufacturing jobs at lower costs thanks to lower oil prices. Guess what, that will boost productivity and help keep inflation in check. Reserves are sloshing around the world's central banks like water in a bathtub, and today the flow is moving back towards DM markets. That means a stronger dollar, faster potential growth and stronger purchasing power for US consumers. The next five to ten years will see the reversal of the negative trends we are so focused on right now.

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