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Lead Left Interview – Mickey Levy

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This week we chat with Mickey D. Levy, chief economist for US and Asia, Berenberg Capital Markets. Mickey is a long-standing member of the Shadow Open Market Committee and conducts research on a wide range of global economic, financial and policy issues.

The Lead Left: Mickey, believe it or not, it's been almost exactly one year since your last visit with us. I assume where we are politically today isn't something you anticipated back then.

Mickey D. Levy: I certainly did not anticipate this. But over the last year, my traditional optimism about the US economy has been challenged and I have become increasingly frustrated with economic performance and the way policymakers on all levels of government seem to be pursuing policies that in my mind have been heading toward further slowdown in potential growth and not really addressing the critical issues facing broad ranges of people. From an economist's vantage point, it has been easy to understand the mounting public frustrations.

TLL: Looking at your commentary the day before the election, you did (like the rest of us) think markets would have a negative reaction to a Trump win. Why didn't that happen?

ML: Just prior to the election I recommended that investors should sell a "relief rally" generated by a Clinton victory and buy stocks following a sell off generated by a Trump victory. My rationale was that the realities of a Clinton victory–expectations of eventually slower potential growth as a consequence of higher spending, taxes and regulations–would begin to weigh on markets, while Trump would at least pursue policies that were designed to lift growth–and I also argued that the role of the Presidency and the Washington bureaucracy would tone down some of his erratic and abusive behavior.

TLL: In your recent post-election commentary, you state that "global portfolio managers will focus on the fundamentals." What asset classes will benefit from that focus?

ML: We're seeing that now: the rise in the stock market, the US dollar and bond yields are reflecting expectations of stronger growth. The higher bond yields have pushed up financial stocks. Infrastructure-related stocks are betting a boost from expected government spending increases. Investors are expecting that export-related manufacturers may be constrained by the stronger US dollar. Other industries like health care and pharmaceuticals have moved up after lagging under the weight of the "Hillary Effect".

In credit markets, the rather sharp rise in US Treasury bond yields reflecting expectations of stronger economic growth and some risks to higher inflation have dominated. But yield spreads of credit products should remain narrow based on expectations of sustained economic expansion with stronger growth.

TLL: The economy has been stuck in the 2% range since 2010. Will that accelerate in the next four years?

ML: I expect growth will pick up, but not to the 4% rate that President-elect Trump has touted. Most importantly, sustained *potential growth* would be lifted if the new Administration enacts true corporate tax reform and some income tax modifications along with reduced regulations and a well-designed infrastructure spending program. Estimates of potential growth have receded from 2.6% in 2007 to between 1.8% (the Fed) to 2.0% (the Congressional Budget Office) presently, which is a huge downward change. Any reversal of that trend would really benefit sustained economic performance. In particular, corporate tax reform and some easing of burdensome regulations likely would boost business investment spending. This would have positive feedback effects on productivity, which would feed back into profits and wages.

TLL: We've had many investors ask whether Trump's support of deregulation will compel banks to come back into leveraged loans. What's your take on that?

ML: I expect the general thrust of bank regulation will change: I anticipate higher capital adequacy standards and maybe even leverage caps, but an easing of the burdensome micro regulations that have been imposed by Dodd-Frank. This will benefit all banks, particularly medium and smaller sized ones. I'll leave to the experts what that means for leveraged loans.

TLL: A related question: will the Congress repeal Dodd-Frank?

ML: I do not expect a full repeal of Dodd-Frank, but I do anticipate a significant streamlining of its complex web of burdensome regulations. With a Trump Administration and Republican-controlled Congress, banking legislation similar to the "Financial Choice" proposal by Jeb Hensarling, Chairman of the House Ways and Means Committee that is now pending in Congress seems likely to be enacted. This would raise capital requirements based on all assets (that is, largely do away with Basel III risk-weightings) which effectively would involve imposing leverage ratio caps on banks, with far fewer regulations.

TLL: What impact do you think less regulation will have on middle market lending? Specifically, will banks reverse course and start pursuing this business?

ML: If this happens, middle market lending should flourish. Banks that have sufficient capital would be freed of a lot of burdensome paperwork and compliance, and this would reduce their costs of making such loans and encourage them to originate more. So, yes, I do see this as a positive step for middle market lending. This would be particularly advantageous to medium and small sized banks that now face higher costs of complying with regulatory burdens as a percentage of their operating costs than do larger banks.

To be continued the week of Dec 5

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