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Perpetual Stimulus and The Macroeconomic Implications of Political Dysfunction

Richard Harris | June 2025

Governments around the world are currently caught in a political tug-of-war that has made fiscal spending cuts or "belt-tightening" almost impossible, as the consequences are too severe should economies and their respective consumer's start to deteriorate.

Regardless of campaign statements, elected politicians cannot or will not cut spending, leaving the proverbial hot potato to central banks like the Federal Reserve, forcing them to continue printing money and incur more debt to keep the system running, leading to bigger deficits, higher debt and "easy money" as the new normal.

Voters also rarely want to cut benefits, and every government program (healthcare, retirement, farm support, etc.) has loyal supporters. Politicians are reluctant to cut them, to keep the popular vote. Therefore, spending is often increased or taxes lowered to win the favour of voters, even if deficits increase. The reality: since 2020, G7 countries have only implemented one-sixth of the promised spending cuts; most have been scaled back or cancelled. The bottom line is that austerity is not only unpopular but also politically toxic for any party that has the "cojoners" to attempt it. So the only alternative is to continue deficit spending, leading to a ratchet effect in which spending increases more in times of crisis but never fully declines or normalizes to previous levels.

Central Bank "Independence"

When governments borrow more money than investors want to lend, central banks quietly step in and buy up the excess debt. Economists call this fiscal dominance, where governments essentially put pressure on the central bank's monetary policy. Essentially, the yield curve in the

When the Fed buys these excess bonds, new reserves are made available to banks in the form of new money, which boosts the prices of goods, services and assets. Something we have all borne witness to in recent times.

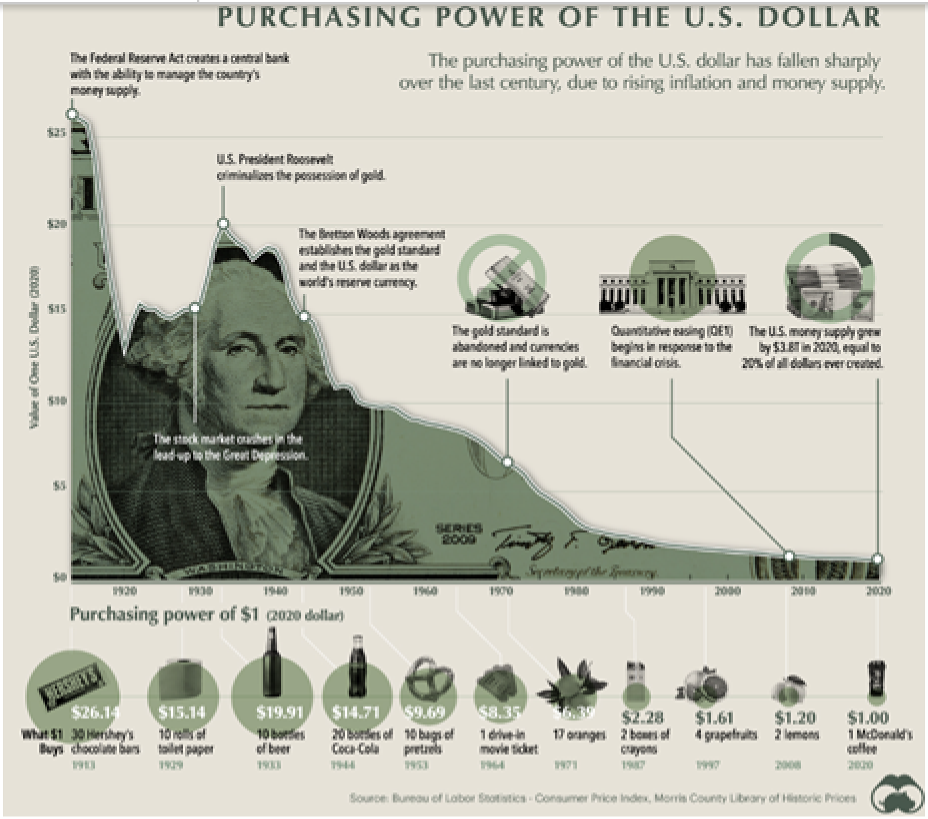
The Impact on Markets and Hard Assets

Stock prices and real assets effectively track money supply growth better than corporate profits, which has led to a dramatic multiple expansion of financial markets and valuations that are much higher than what would have been considered “fair value” a decade ago. Portfolios filled with assets that love easy money, such as technology stocks, real estate, gold and cryptocurrencies, have ultimately benefited from this oversupply of money in the economy. This leads to a compounding dynamic where markets are now anticipating, and pricing in perpetual deficit spending, often ignoring the fundamental dynamics that were used to price risk assets in the decades prior to this new regime.

The Debasement of Currencies

Currency debasement is what happens when a government creates money faster than the economy grows. In the past, kings did this by secretly mixing cheaper metals into gold and silver coins. Today, it happens when central banks print extra money or buy up huge amounts of government debt. The result is that each dollar, euro or rand slowly loses purchasing power, making food and other essential goods more expensive over time. While this makes it easier for governments to pay off their debts, it acts as an invisible tax on savers and, if taken too far, can undermine confidence in the currency itself.

We have used the following chart in previous newsletters but thought it would be appropriate to publish it again as it summarizes the debasement of the US dollar since 1913 (note that the data is only valid until 2020, after which the situation has worsened).



The Dollar as the Global Reserve Currency

In view of the above, many readers will ask themselves: why hasn't all this borrowing led to a much weaker US dollar? This is because the dollar has an ace up its sleeve, as around two thirds of global currency reserves are still parked in dollars. Assets are predominantly priced in dollars and American stock markets hold almost half of the world's market value. Eight of the world's ten largest companies are American and represent the deepest markets of all. There is simply no close substitute as competing payment systems from emerging markets handle only a fraction of global trade, so most transactions are still denominated in dollars.

The result is that the dollar remains stable (although it has lost around 10% in value since Trump took office), allowing Washington to keep tapping the stimulus packages. This exorbitant privilege leads to what economists refer to as American financial exceptionalism: The depth of the US capital market acts as economic armour, **at least for now**, as there are many theories of competing reserve currencies or trading blocs that may threaten this in the decades to come, and the first six month of 2025 might be an early taste of what's to come.

The Road Ahead

Political gridlock seems to be the new status quo, where governments continue to spend money to maintain or win votes, and where any attempt to cut that spending angers the electorate. As this spending continues, central banks eventually step in with "cheap money" to save the economy and avoid financial crises. The markets anticipate this and continue to rise.

Is this sustainable in the long term? Probably not. If investors become more concerned about governments' ability to repay their debt and service interest rates, borrowing costs could that happens, the easiest political course is to keep stimulating.

Trump's new "One Big Beautiful Bill" was passed by the senate on the 1st of July with a close-call 51-50 decision. The bill is a tax and spending package that permanently extends the 2017 Tax Cuts and Jobs Act, eliminates taxes on tips and overtime, implements a 15% middle-income tax cut, and trims $1.2 trillion from Medaid and food assistance. It also allocates $170 billion for border security, raises the debt ceiling by $5 trillion, scales back clean-energy credits, and is projected to add $3.3 trillion to the national debt over the next decade. An interesting move given the fiscal austerity movement announced at the beginning of the year, the "Department of Government Efficiency" (DOGE), which was mandated to cut spending and reduce the government deficit by as much as $2 Trillion.

Should this perpetual stimulus continue in its various forms, currency diversification will be crucial. Active management is likely to be beneficial over the next decade as cracks begin to form in indebted countries and other markets benefit from the US's "exceptional" position being challenged. Sufficient hedging of portfolios will also play an important role. Those brave enough to take exposure to new, volatile asset classes such as cryptocurrencies and artificial intelligence (even at low exposure levels) could benefit by staying ahead of new industries and technologies. The global landscape is evolving before our eyes, and at a pace that has never been seen before.

Market and Economic Update - June 2025

In June, US and global equity markets rebounded strongly after early- month volatility driven by tariff uncertainties and geopolitical tensions, in particular the escalation of the conflict between Israel and Iran, which briefly unsettled markets when the US launched attacks on Iranian nuclear facilities. As the conflict de-escalated, equities recovered, supported by positive trade policy developments, including a temporary pause in tariff escalation and a US-China trade truce. Despite ongoing concerns over tariffs and inflation, these factors fuelled renewed optimism in the market and led to gains by the end of the month: The S&P 500 rose by 4.96%, the Dow Jones by 4.32% and the Nasdaq gained 6.27%.

US economic data published in June was mixed and some indicators pointed to a slowdown: Payrolls rose by 139,000 with no change in unemployment and strong wage growth, but both the manufacturing and service sectors contracted, retail sales fell by 0.9% and housing starts hit a five-year low. Despite these pressures, consumer sentiment improved from a very low level. The consumer price index (CPI) rose less than expected at 2.4%, while the core consumer price index remained unchanged at 2.8%. Core personal consumption expenditures (PCE), the Federal Reserve's preferred measure of inflation, rose by 2.7%, more than expected. The US Federal Reserve kept interest rates unchanged for a fourth consecutive meeting, maintaining its cautious stance, while the US dollar index fell by 2.5% in June, its worst start to a year since 1973 (down 10.7% year-to-date).

European equity markets delivered mixed results in June, weighed down by trade tensions, geopolitical risks and sector-specific challenges. The German DAX fell by 0.37% and the Euro STOXX 50 by 1.16%. Caution prevailed ahead of the Trump administration's deadline to impose

January 2022.

Sentiment towards China improved in June when talks with the US in London led to a renewed 90-day tariff exemption and China agreed to ease export restrictions on rare earths. Equity markets responded positively: Hong Kong rose by 3.36% and the Shanghai Composite by 2.41%. While the Chinese purchasing managers' index for the manufacturing sector remained below 50, the purchasing managers' index for the non-manufacturing sector climbed above 50, indicating growth in the service and construction sectors. The market expects further government stimulus measures to boost domestic demand and stabilise the property market.

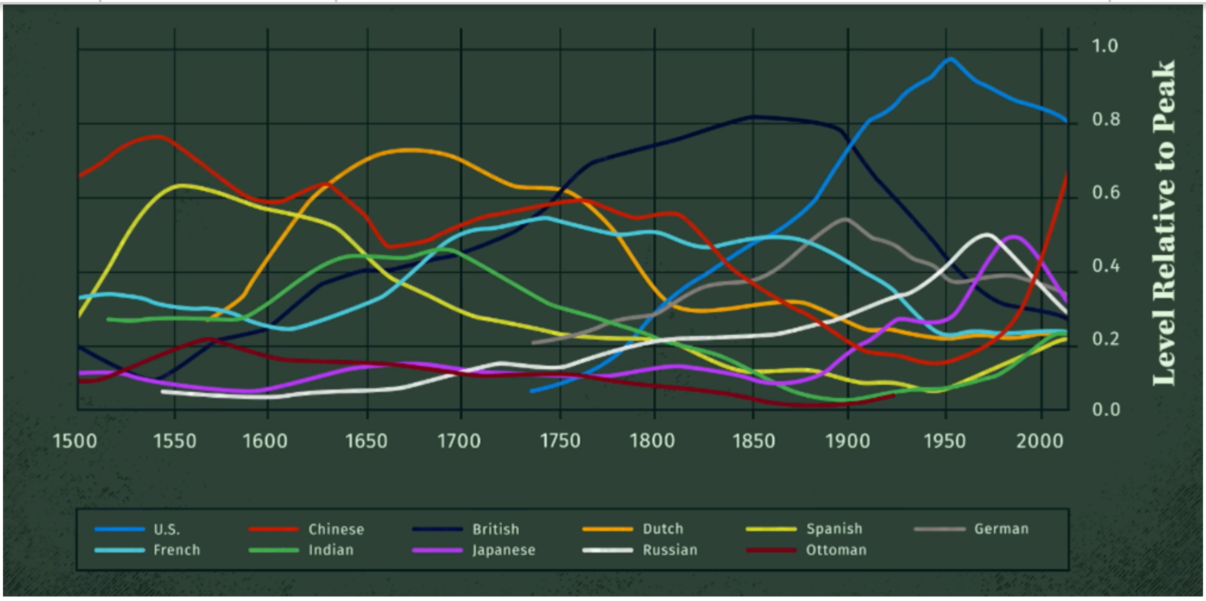
On the commodities front, gold had a subdued month after a strong start to the year, rising by 0.4%, while platinum surged 28.5% due to increased Chinese imports, a supply deficit and renewed investor interest in the precious metal. Brent crude gained 5.8% month-on-month due to the 12-day conflict, which began with an attack by Israel on Iran's nuclear facilities and drove oil prices to over $80 per barrel before falling to $67 following Trump's announcement of a ceasefire between Iran and Israel.

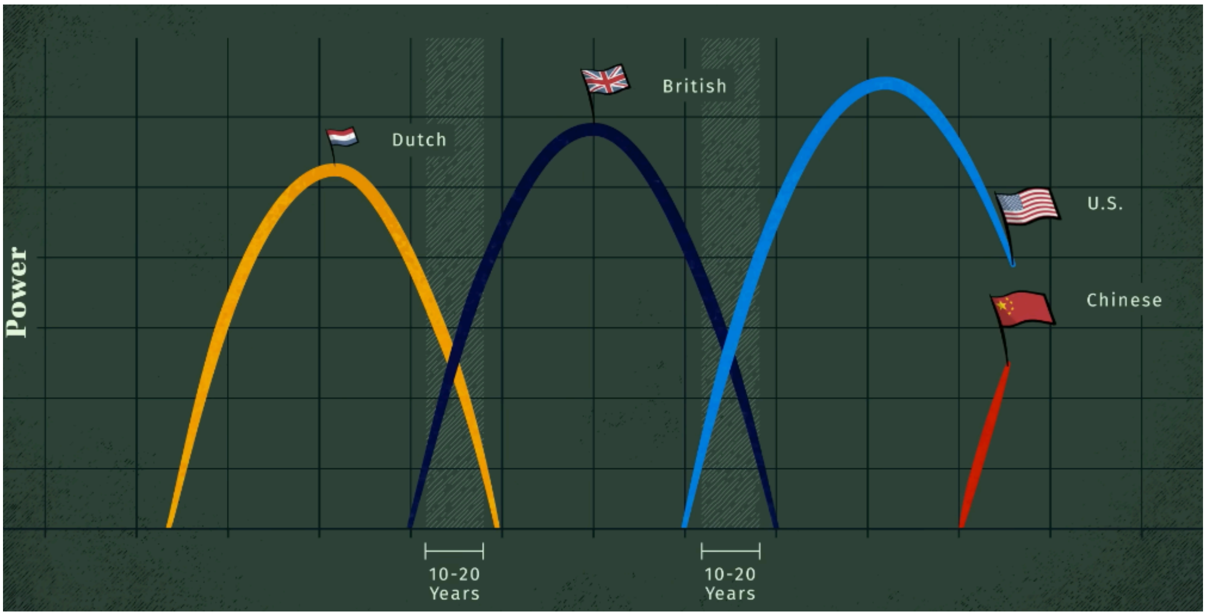
South Africa posted its first consecutive primary budget surplus in 16 years, with a R48.9 billion surplus (0.7% of GDP) for the year ending March 2025, reflecting improved fiscal discipline and tailwinds from strong performances in commodities. Political tensions rose after President Ramaphosa dismissed DA Deputy Minister Andrew Whitfield without explanation, which weighed on the government of national unity. The JSE All Share Index gained 2.33% in June, driven by a 19% rise in platinum miners, with precious metals miners contributing more than half of the year's return. Meanwhile, the government's 10-year borrowing costs fell below 10% for the first time since early 2022 and the rand gained 1.6% against the US dollar as the greenback weakened.

Chart (s) of the month – The Rise and Fall of Empires

The charts below (from Ray Dalio's fourth turning video) show how major world empires have risen and fallen in predictable 80-100 year cycles that correspond to the pattern of social change according to the Fourth Turning theory. The theory was originally developed by Neil Howe and many asset managers and economists have since familiarised themselves with the concept.

According to the Fourth Turning Theory, we are currently in a crisis phase that began with the 2008 financial crisis and is likely to last until around 2030. This means that we could be witnessing the end of American dominance and the rise of China as the next major power. The charts suggest that what we are experiencing today - including global tensions, economic instability and the collapse of institutions - is part of a natural historical cycle in which old systems collapse, and new ones emerge, just as happened when previous empires handed over power to their successors.





“Successful investing is having everyone agree with you… later.” **- Jim Grant**

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