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R&R Weekly Column
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US Tariffs: The Return of Protectionism and Trade Wars?

The announcement of U.S. President Trump to introduce tariffs on import of steel (25%) and aluminum (10%) follows by only a few weeks Treasury Secretary Steve Mnuchin's statement (subsequently softened) that a weak dollar would be good for the U.S. and marks a new element of discontinuity with the economic international order that the U.S. themselves have contributed to build in the last few decades, based on multilateralism and a free trade/free market doctrine. Once again, the clearest (analytical) response from Europe came from ECB President Draghi, during the press conference following ECB's Governing Council meeting in March, when he said that this latest move by the U.S. administration was dangerous from a number of perspectives: (1) it seems reintroducing the concept that decisions on international trade can be taken unilaterally rather than multilaterally; (2) it opens up the risk of retaliation by the affected countries (3) it could have a long-lasting impact on confidence able to derail the global recovery; (4) it introduces elements of geopolitical uncertainty, because, if this is how the U.S. treats its "allies," how is it going to treat its "enemies?"; (5) it might represent another another leg of the "lingering" currency wars discussed in our previous column. In fact, protectionism could result into the strengthening of the dollar if the Fed normalises its monetary policy faster than previously to counter increasing inflation due to tariffs; but tariffs could also result into a weaker dollar if they signal a "policy view" on desired dollar weakness, if they cause retaliation and if they change the investors' perception about how safe and attractive US assets are.

There are various reasons why Trump might be launching such a dangerous initiative. On the one hand, he continues speaking to his own electorate, by saying that tariffs will help protect jobs and factories in the U.S. (even if the actual effect is likely to be the opposite), ahead of mid-term elections later this year. It is also possible that President Trump is using these tariffs as a negotiating tactics on other tables: for example, the decision to carve out Canada (the largest exporter of steel to the US) and Mexico from the tariffs is a signal sent to the two countries with which the U.S. is re-negotiating NAFTA: if they "behave" in those negotiations, they will be exempt from the tariffs that the U.S. is now imposing on other economies. If they don't "behave," they will also be included in the list of affected countries. The main concern about these developments is the potential for retaliatory actions, in particular from the EU, the bloc of countries mostly affected by this decision. Unfortunately, history teaches us that when the world goes down the route of increased protectionism and currency wars at the time the political scene is dominated by autocratic leaders, the endpoint is not a favourable one: at the very least, we could see a reduction in global trade, which could pose a sudden halt to the ongoing synchronised global expansion and eventually a reduced global output potential (as globalisation might have increased inequality within countries, but has also dramatically reduced differences in economic performance between countries).

But things can go even more wrong, if we add a geopolitical dimension. Protectionism tends to create spheres of influence, and with them geopolitical fault-lines and tectonic plates that eventually collide, if not appropriately governed. At the time in which the UK is leaving the EU, Italy observes the rise of populist parties, and the 2019 European elections are likely to stage again the success of anti-system movements, we seriously run the risk of witnessing a further shift of the global macro and geopolitical situation towards the danger zone.

Our Recent Publications:

- ***Monetary Affairs: BOC Preview: On Hold Given Negative Economic Surprises*** *by Joseph Shupac and Brunello Rosa, 6 March 2018*
- ***ECB Drops Easing Bias, Amid Dovish Press Conference*** *by Brunello Rosa, 8 March 2018*
- ***Italian Election 2018: A Radical Political Regime Change*** *by B. Rosa and N. Roubini, 5 March 2018*

The Week Ahead

US - February CPI will be published (*c:* 2.2% y-o-y; *p:* 2.1%). Retail sales numbers will also be released (*c:* 0.4%; *p:* 0.3%).

Germany - On March 14, the new German government will take office. On March 4, the SPD members approved a CDU-SPD coalition government.

Russia - The electoral campaign will come to an end. On March 18, the first round of vote will likely result in the election of Putin for a new six-year term.

The Quarter Ahead

US -Possibly softening their stance on trade. The tariffs on steel and aluminium imports will take effect in two weeks. Canada and Mexico were exempted, and other countries are expected to be fully or partially exonerated via exemptions and/or quotas.

Europe - The economic recovery will continue to offset concerns over political risk. In January, EZ retail sales increased by 2.3% y-o-y (*c:* 2.0%; *p:* 2.1%). On March 4, Italy's general election resulted in a fragmented parliament led by Eurosceptic-populist parties.

North Africa - The risk of social unrest will increase. Last week, Tunisia's central bank raised its benchmark interest rate to 5.75% (*p:* 5%), after February CPI came out at 7.1% y-o-y (*p:* 6.9%), a 25-year high.

Korean peninsula - Tensions will de-escalate. North Korea's President Kim Jong-Un will hold meetings with South Korea's Moon Jae-Il and US President Trump, probably in May.

GCC - The financial situation of Qatar is improving steadily. In January, FX reserves at the QCB increased to a five-month high of USD 17.7bn, fuelled by a 30% y-o-y rise in exports. Foreign funding is returning to the country (USD 5.3bn inflows in January) reducing pressure on interest rates.

Appetite for EM debt will remain strong. Last week, USD 12.9bn and EUR 1.4bn were raised (*p:* USD 7.7bn and EUR 0.5bn), mostly by China, Russia and Slovenia. EM fixed income inflows accelerated (USD 2.1bn, from 1.4bn the week before), while equity inflows decelerated (USD 4.2bn, from 5.4bn the week before).

Oil prices will decline. Last week, Brent oil price increased by 1.7% w-o-w (to USD/bbl. 65.5). Rising inventories and production in the US —where crude output is expected to surge beyond 11 mn bpd by late 2018—will likely bring prices to USD/bbl 55-60 by year-end.

Last Week's Review

US - February employment data rose the likelihood of a 25bps hike in March. Data were consistent with a policy rate hike this month: *a)* non-farm payrolls beat expectations (*a:* 313k m-o-m; *c:* 205k; *p:* 239k); *b)* average hourly earnings rose 2.6% y-o-y (*c:* 2.8%; *p:* 2.8%); and *c)* the unemployment rate remained at 4.1% (*c:* 4.0%; *p:* 4.1%). Stock markets reacted with gains: the S&P500 rose by 3.6% w-o-w. US 10-year bond yields increased by 3 bps w-o-w, to 2.89%. The USD strengthened marginally against a basket of currencies (DXY up 0.2% w-o-w). The likelihood of a 25-bps hike at the next Fed meeting (March 20-21) stands now at 89% (*pw:* 83%), while the likelihood of "at least four hikes in 2018" rose from 24% to 35% (*CME Group).*

Europe - The ECB moved a further step towards ending QE. The ECB dropped an explicit comment to expand QE in the event of disappointing growth, triggering a temporary EUR rally. Later, the ECB downplayed the change, reversing the appreciation: the EUR/USD declined by 0.1% w-o-w, to 1.231. The Eurostoxx 600 rose by 3.1% w-o-w.

Turkey - Moody's downgraded the country's sovereign rating. Moody's cut to Ba2 (*p:* Ba1)—with stable outlook—reflects "weaker institutions" and the "increased risk of an external shock". CPI decreased to 10.3% (*p:* 10.4%), and the CBT reacted by leaving the policy rate unchanged.

China - Inflation accelerated to a four-year record. February CPI increased to 2.9% (*c:* 2.4%; *p:* 1.5%). The Caixin services PMI moderated to 54.2 (*c:* 54.3; *p:* 54.7), mostly due to the new year holiday.

Other DM central banks kept their policies unchanged*: a)* in Japan—where Q4 2017 growth beat expectations (*a:* 1.6% q-o-q ann.; *c:* 0.9%; *p:* 0.5%)—the BoJ made no policy changes; *b)* in Australia, the RBA left rates unchanged at 1.5%; and *c)* in Canada, the BoC kept the 1.25% policy rate unchanged, due to trade-related uncertainty.

Pablo Gallego Cuervo *and* ***Renata Bossini*** *contributed to this Viewsletter.* *The picture in the front page comes from this website*

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Abbreviations, Acronyms and Definitions

a	*Actual*
bn	*Billion*
BCB	*Central Bank of Brazil*
BoC	*Bank of Canada*
BoE	*Bank of England*
BoJ	*Bank of Japan*
bpd	*Barrels per day*
bps	*Basis points*
c	*Consensus*
CB	*Central bank*
CBK	*Central Bank of Kuwait*
CBO	*US Congressional Budget Office*
CBR	*Central Bank of the Russian Federation*
CBT	*Central Bank of the Republic of Turkey*
CDU	*Christian Democratic Union of Germany*
CNY	*Chinese Yuan*
CPI	*Consumer Price Index*
CPC	*Communist Party of China*
CSU	*Christian Social Union in Bavaria*
DFMGI	*Dubai Financial Market General Index*
DJIA	*Dow Jones Industrial Average Index*
d-o-d	*Day-on-day*
DXY	*US Dollar Index*
EC	*European Council*
ECB	*European Central Bank*
EIA	*US Energy Information Agency*
EM	*Emerging Markets*
EP	*European Parliament*
EUR	*Euro*
EZ	*Eurozone*
Fed	*US Federal Reserve*
FOMC	*US Federal Open Market Committee*
FRB	*US Federal Reserve Board*
FX	*Foreign exchange*
FY	*Fiscal Year*
GCC	*Gulf Cooperation Council*
GBP	*British pound*
GDP	*Gross domestic product*
GOP	*Grand Old Party (US Republican Party)*
IMF	*International Monetary Fund*
IPO	*Initial public offering*
JPY	*Japanese yen*
k	*thousand*
KRG	*Kurdistan Regional Government*
LN	*Northern League*
M5S	*Five Star Movement*
m-o-m	*Month-on-month*
mb/d	*Million barrels per day*
MENA	*Middle East and North Africa*
mn	*Million*
MPM	*Monetary Policy Meeting*
M5S	*Five Star Movement*
OECD	*The Organization for Economic Cooperation and Development*
Opec	*Organization of Petroleum Exporting Countries*
p	*Previous*
pw	*Previous week*
PCE	*Personal Consumption Expenditures*
PM	*Prime minister*
PMI	*Purchasing managers' index*
pps	*Percentage points*
QCB	*Qatar Central Bank*
QE	*Quantitative easing*
q-o-q	*Quarter-on-quarter*
RBA	*Reserve Bank of Australia*
SAAR	*Seasonally Adjusted Annual Rate*
SHCOMP	*Shanghai Stock Exchange Composite Index*
SPD	*Social Democratic Party of Germany*
tb/d	*Thousand barrels per day*
tn	*Trillion*
TRY	*Turkish Lira*
UAE	*United Arab Emirates*
UK	*United Kingdom*
US	*United States*
USD	*United States Dollar*
USD/bbl.	*USD per barrel*
UST	*US Treasury bills/bonds*
VAT	*Value added tax*
VIX	*Chicago Board Options Exchange Volatility Index*
w-o-w	*Week-on-week*
y-o-y	*Year-on-year*
y-t-d	*Year-to-date*
YPG	*People's Protection Units (Kurdish militia in Syria)*
ZAR	*South African Rand*