# MAKING SENSE OF *THIS* WORLD 18 February 2019

***R&R Weekly Column***
***By Brunello Rosa***

## Trump's Never-Ending Trade Wars: Germany Is Next In Line

On March 1th, the truce between US and China that was agreed to regarding their bilateral trade war will officially end, as will the time available to reach an agreement to avoid increasing tariffs from 10% to 25% on USD200bn of Chinese exports to the US. Officials from both sides seem to suggest that a deal might be in sight, nevertheless a number of issues will remain open. Most important of these is that any agreement will be temporary, as the underlying "cold war" between the US and China will continue to be waged on different battlefields, as we have discussed in previous columns and research papers. In particular, the two countries will continue to compete intensely over technology (as the ongoing Huawei case proves).

In addition, the implementation of any plan to reduce the bilateral trade imbalance between China and the US will not be frictionless. Regardless of whether China agrees to import more from the US, or export less to the US, there might be severe consequences on global trade flows, technological transfers, CNY and USD valuations, the level of Chinese reserves of US Treasuries, long-term US Treasury yields and, ultimately, global price and financial stability. The optimal strategy of pursuing global free trade with flexible exchange rates on a multilateral basis (for example by continuing to push China towards greater openness of its capital account) does not seem at hand in an increasingly protectionist world dominated by strongmen.

However, let us assume for the time being that some sort of deal between US and China is achieved by March 1st. Will this mean peace at last in the global economy? To the contrary, it will probably mean that, with one front temporarily closed, Trump will instead start devoting its full attention to another "trade war" close to his heart: the international auto sector, the most notable victims of which would be European and Asian producers, were the US to raise tariffs. In fact, President Trump will soon receive a report from the US Department of Commerce addressing his question of whether imports of cars pose a threat to national security. It is not yet known what the report, expected to be sent by February 17th, will recommend the president to do, but it is very likely that it will offer a range of options, including imposing quotas or voluntary export restrictions, or tariffs. The one thing that Trump managed to obtain with the transformation of NAFTA into USMCA is less favourable conditions for producers to export cars to the US. He is likely to want to adopt a similar stance towards other car producers, particularly German ones.

In fact, it is almost certain that among the biggest losers of the upcoming round of trade wars will be Germany, the economy of which – as we discuss in our recent trip report – is already suffering from a deteriorated external environment. The slowdown in Germany is affecting the entire Eurozone economy, with the more fragile countries, such as Italy, having already entered a recession. At the Munich Security Conference just concluded, the US and Germany have further exposed the fact that they have opposing views regarding global security, as expressed by Chancellor Merkel and Vice-President Pence. We would not be surprised if a US trade war with Germany over the auto sector become just another example of geopolitical diplomacy, fought with different weapons.

***Our Recent Publications***

- *TRAVEL NOTES – ITALY: Risks Re-Emerging After The Truce, by Brunello Rosa, 15 February 2019*
- *TRAVEL NOTES – Germany's Economic and Political Uncertainties Are Rising, by Nouriel Roubini and Brunello Rosa, 14 February 2019*
- *POLICY COMPASS- Brexit Update: Getting to A Deal (One Way or Another), by Brunello Rosa and Nouriel Roubini, 13 February 2019*

## *Looking Ahead*

### *The Week Ahead: Global Growth Slowdown To Continue*

***In the US,*** consumers might be less willing to spend, as signaled by the decline in December's retail sales (Retail sales Dec. a: -1.2% m-o-m; c: 0.2%; p: 0.1%).

***In the EZ,*** February's manufacturing PMI is expected to remain flat (EZ Markit manuf. PMI Feb., c: 50.3; p: 50.5). Inflation is expected to remain stable at 1.4% (p: 1.4%).

***In Germany,*** as investor confidence declines, the economic sentiment is expected to deteriorate (ZEW survey Feb. *c:* -18.4; *p:* -15.0).

### *The Quarter Ahead: Brexit and China-US Trade Talks at The Forefront*

On March 1st, ***the US-China trade-war*** truce will officially end. After high-level talks, both governments signaled that they may be approaching a deal. President Xi Jinping stated: "the meetings achieved important progress". If no deal is reached, tariffs on USD200bn of Chinese imports will increase to 25% (p: 10%).

***In the UK,*** the probability of no-deal Brexit is rising. By rejecting (303 votes to 258 — a majority of 45) a motion to support PM May's Brexit strategy, lawmakers weakened the PM's negotiating position with the EU. Large manufacturers urged the EU to: *i)* delay Brexit by six to 12 months, or *ii)* "*make a clean break from Britain on March 29*", supporting the PM's proposal to ensure an orderly UK departure.

## *Last Week's Review*

### *Real Economy: Global Slowdown Ongoing, Geopolitical Risks Remain High*

***In the US,*** bipartisan lawmakers agreed to a spending deal of USD1.4bn, including physical barriers along the US-Mexico border - less than the USD5.7bn President Trump had demanded. To secure additional funding, President Trump declared "national emergency" - a move likely to spark controversies. The impact of the tax cuts passed in 2017 resulted in a higher-than-expected deficit, as reported in December's monthly budget statement (a: USD -14bn; c: USD -11bn; p: USD -205bn). ***January CPI fell to 1.6%*** (c: 1.5% y-o-y; p: 1.9%) given low energy prices; by remaining below the Fed's 2% target, it provided support to the Fed's "patience on potential rate hikes."

***In the US,*** the probability of no Fed hikes in 2019 is at 98% (p: 97%); the probability of a rate cut declined to 10% (p: 18%).

***In the EZ***, data keep signalling a growth deceleration. Industrial production fell by 4.2% in December (c: -3.2% y-o-y; p: -3.0%).

***In Germany,*** the economy stalled, falling short of entering a technical recession (a: 0.0%; c: 0.1%; p: -0.25).

***In the UK,*** growth and production disappointed (GDP Q4 a: 1.3% y-o-y; c: 1.4%; p: 1.6%; Industrial Production December a: -0.9% y-o-y; c: -0.4%; p: -1.3%). Inflation declined below the BoE's target for the first time in 2 years (January CPI a: 1.8% y-o-y; c: 1.9%; p: 2.1%).

***In China,*** trade data showed stronger-than-expected exports (a: 9.1% y-o-y; c: -3.2%; p: -4.4%). Inflation fell to 1.7% (CPI January c: 1.9% y-o-y; p: 1.9%).

### *Financial Markets: Lower Risks And CB Liquidity Are Supporting Asset Performance*

Global stocks ticked higher as fears over global trade and the possibility of another US government shutdown receded.

***Global stocks rose w-o-w*** (MSCI ACWI, 1.9%) driven by the US (S&P 500, +2.5%) and the EZ (Euro Stoxx 50, 3.4%). EM indices declined (MSCI EMs, -0.5%). Volatility fell below historical averages (VIX S&P 500, 1.2 points to 14.9, *52w avg.:* 17.0; *10y avg*.: 18.1).

***Fixed-income indices remained flat*** (BAML Global bond index, +0.0%). In DMs, German bunds have fallen 14 bps y-t-d to near-zero rates (10Y Bund yield, a: 0.10). In EM fixed income markets, the issuance volume declined w-o-w (a: USD 3.6bn; p: USD10.9bn). In Turkey, the Ministry of Finance hired banks to issue three-year Sukuk bonds.

***Currencies***: the USD rose (DXY, X+0.3%) the EUR fell (EUR/USD, 0.3% to 1.129). The GBP fell against the USD (GBP/USD, 0.4% to 1.289).

***Commodities:*** EIA data showed US oil imports declining by nearly 1 mb/d w-o-w to 6.2 mb/d, increasing confidence in upcoming OPEC production cuts and driving oil prices (Brent) up by 6.7%, to 66.3 USD/bn.

*__Farah Aladsani__ contributed to this Viewsletter.*

*The picture in the front page comes from this website*

## Abbreviations, Acronyms and Definitions

| | | | |
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| *a* | *Actual* | *LN* | *Northern League, Italy* |
| *AKP* | *Justice and Development Party, Turkey* | *M5S* | *Five Star Movement, Italy* |
| *ann.* | *annualized* | *m-o-m* | *Month-on-month* |
| *ARS* | *Argentinian Peso* | *mb* | *Million barrels* |
| *avg.* | *Average* | *mb/d* | *Million barrels per day* |
| *bn* | *Billion* | *MENA* | *Middle East and North Africa* |
| *BoC* | *Bank of Canada* | *MHP* | *Nationalist Movement Party, Turkey* |
| *BoE* | *Bank of England* | *mn* | *Million* |
| *BoJ* | *Bank of Japan* | *NAFTA* | *North-American Free Trade Agr.* |
| *bpd* | *Barrels per day* | *NATO* | *North Atlantic Treaty Organizat.* |
| *bps* | *Basis points* | *OECD* | *Organization for Economic Cooperation and Development* |
| *BS* | *Balance sheet* | *Opec* | *Organization of Petroleum Exporting Countries* |
| *c* | *Consensus* | *p* | *Previous* |
| *C/A* | *Current account* | *P2P* | *Peer-to-peer* |
| *CB* | *Central bank* | *PBoC* | *People's Bank of China* |
| *CBB* | *Central Bank of Bahrain* | *PCE* | *Personal Consumption Expenditures* |
| *CBK* | *Central Bank of Kuwait* | *PE* | *Price to earnings ratio* |
| *CBT* | *Central Bank of Turkey* | *PM* | *Prime minister* |
| *CDU* | *Christian Democratic Union, Germany* | *PMI* | *Purchasing managers' index* |
| *CNY* | *Chinese Yuan* | *pps* | *Percentage points* |
| *CPI* | *Consumer Price Index* | *pw* | *Previous week* |
| *DJIA* | *Dow Jones Industrial Average Index* | *QCB* | *Qatar Central Bank* |
| *DJEM* | *Dow Jones Emerging Markets Index* | *QAR* | *Qatari Riyal* |
| *d-o-d* | *Day-on-day* | *QE* | *Quantitative easing* |
| *DXY* | *US Dollar Index* | *q-o-q* | *Quarter-on-quarter* |
| *EC* | *European Commission* | *RE* | *Real estate* |
| *ECB* | *European Central Bank* | *RBA* | *Reserve Bank of Australia* |
| *ECJ* | *European Court of Justice* | *RRR* | *Reserve Requirement Ratio* |
| *EIA* | *US Energy Information Agency* | *RUB* | *Russian Rouble* |
| *EM* | *Emerging Markets* | *SWF* | *Sovereign Wealth Fund* |
| *EP* | *European Parliament* | *tn* | *Trillion* |
| *EPS* | *Earnings per share* | *TRY* | *Turkish Lira* |
| *EU* | *European Union* | *UAE* | *United Arab Emirates* |
| *EUR* | *Euro* | *UK* | *United Kingdom* |
| *EZ* | *Eurozone* | *US* | *United States* |
| *Fed* | *US Federal Reserve* | *USD* | *United States Dollar* |
| *FOMC* | *US Federal Open Market Committee* | *USD/b* | *USD per barrel* |
| *FRB* | *US Federal Reserve Board* | *UST* | *US Treasury bills/bonds* |
| *FX* | *Foreign exchange* | *VAT* | *Value added tax* |
| *FY* | *Fiscal Year* | *VIX* | *Chicago Board Options Exchange Volatility Index* |
| *GCC* | *Gulf Cooperation Council* | *WTI* | *West Texas Intermediate* |
| *GBP* | *British pound* | *WTO* | *World Trade Organisation* |
| *GDP* | *Gross domestic product* | *w* | *Week* |
| *IMF* | *International Monetary Fund* | *w-o-w* | *Week-on-week* |
| *INR* | *Indian Rupee* | *y* | *Year* |
| *IPO* | *Initial public offering* | *y-o-y* | *Year-on-year* |
| *IRR* | *Iranian Rial* | *y-t-d* | *Year-to-date* |
| *JPY* | *Japanese yen* | *ZAR* | *South African Rand* |
| *k* | thousand | *2y; 10y* | *2-year; 10-year* |
| *KSA* | *Kingdom of Saudi Arabia* | | |