# MAKING SENSE OF *THIS* WORLD

***7 June 2021***

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


## The G7 Agrees On A First Step Towards Corporate Tax Harmonisation

At the end of a long meeting in London, G7 finance ministers agreed last week on the principles for a harmonisation of a global corporate tax regime, which were published in the meeting's final communique. The agreement will be based on two pillars: 1) the allocation of profits among jurisdictions; and 2) a minimum corporate tax rate.

Regarding the first pillar, all multinational companies with at least a 10% profit margin will have to allocate at least 20% of the portion of their profits exceeding this 10% margin to the jurisdiction wherein the profit was generated. This is to avoid the shifting of profits towards jurisdictions with lower tax rates, a practice largely used by multinational organisations to reduce their effective tax bills.

The second pillar, meanwhile, states that countries should have "at least a 15% rate" for their corporate tax. This means that if a country imposes a lower tax rate than 15%, the country of origin of the multinational could itself levy the differential in tax, rendering ineffective the corporation's quest of achieving a lower tax regime.

This agreement to reform the global taxation system, defined by the signatories as "historical" and a "once in a century occasion", has yet to be ratified by the G20 forum; the meeting to do so will take place in Venice on 9-10 July 2021. A further step for its global adoption will be the ratification by OECD countries, as the OECD has been since 2013 the forum in which this critical issue has been discussed. In any case, it will still take years for this agreement to become effective and operational, let alone binding.

Other obstacles may further slow the agreement's adoption. The US, for example, had asked for the immediate suspension of the digital taxes introduced by countries such as the UK, Italy and France, taxes aimed at the US tech giants. The Europeans have refused this approach, as they want to make sure that the agreement is eventually cast into law by US Congress before giving up their only chance to tax a part of the profits by the US tech companies, which have increased massively their profits during the pandemic.

Our impression regarding this agreement is mixed. On the one hand, as we discussed in our previous column, the agreement is certainly welcome as a necessary first step towards corporate tax harmonisation, which if accomplished will reduce the race to the bottom that exists at the global level where corporate taxes are concerned. In a tweet, US Treasury Secretary Janet Yellen said that "the global minimum tax would also help the global economy thrive, by levelling the playing field for businesses and encouraging countries to compete on positive bases, such as educating and training our work forces and investing in research and development and infrastructure." In other words, this agreement could be the cornerstone for starting to reduce inequality within countries, and not just between countries.

On the other hand, we are a bit concerned that the implementation phase of this agreement may be very slow. It could take years before all of the G20 countries, let alone all of the 37 OECD countries, ratify this agreement and put it into law. Meanwhile, large corporations can still find hundreds of other ways to elude paying taxes on their gigantic profits. Thus it seems to us that the agreement of moving at least 20% of the profits above the 10% threshold may be too timid. A much more effective solution would have been a tax based on revenues rather than profits, as revenues are more easily attributable to specific jurisdictions.

Having said all this, it seems to us that the G7 has taken a very important step in the right direction. The other commitments undertaken at this meeting, regarding central bank digital currencies (CBDCs), support to low-income countries, and financing to combat climate change and biodiversity loss, were also significant.

***Our Recent Publications***

- Flash Preview: Bank Of Canada On Hold, With Markets Awaiting Signals From the Bank, *by Brunello Rosa and Fawaz Sulaiman Al Mughrabi, 4 June 2021*
- **GEOPOLITICAL CORNER:** All Politics Is Local: Making Sense Of The Israeli-Palestinian Crisis, *by John C. Hulsman, 1 June 2021*

## Looking Ahead

### The Week Ahead: US Exports To Increase And Japan's GDP Growth Rate Is Expected To Surge

***In the US,*** exports for April are expected to increase slightly to USD 204bn (*p:* USD 200.03m) and imports are expected to slow down to 273bn (*p:* USD 274.48bn*).*

***In Japan,*** final GDP growth rate for Q1 is expected to increase to 2.8% q-o-q (*p:* -1.3%) and annualized GDP growth rate is expected to surge by 11.0% *(p:* -5.1%).

### The Quarter Ahead: Global Food Prices Surge; WHO Approves Sinovac; US-China Relations Deteriorate

***As the global economy rebounds,*** growth will likely be uneven.

***Globally,*** in May, global food prices surged (one closely watched index jumped by 40%), heightening fears that inflation - initially stoked by pandemic disruption - is accelerating. The y-o-y rise in the UN Food and Agriculture Organization's monthly index was the largest jump since 2011.

***Going forward,*** inflation will likely rise across DMs and EMs, as: *1)* higher commodity prices are passed through; and *2)* supply shortages lift prices. Rising inflation will increase inequality: in DMs, the cost of raw materials accounts for only part of the final price paid for products at supermarkets and restaurants. Higher inflation will hit EMs reliant on 'staple goods imports'.

***The WHO validated the Sinovac-CoronaVac COVID-19 vaccine for emergency use,*** providing the "*assurance that it meets international standards for safety, efficacy and manufacturing*". The vaccine's efficacy results showed that it prevented symptomatic disease in 51% of those vaccinated and severe COVID-19 and hospitalization in 100% of the studied cases.

***President Joe Biden is enforcing a new executive order*** that bans investment in 59 Chinese companies - including Huawei effective from August 2. The new decision prevents US "*investments in Chinese companies with suspected ties to the Chinese Communist Party*". With the new sanctions in place, Mr. Biden is reinforcing the hard stance against China's intelligence and security research firms – started during former President Donald Trump's four-year term.

***The US Fed announced that it will begin winding down purchases of corporate assets,*** started during the pandemic to shore up the economy. In a statement, the central bank said *"the facility was crucial to businesses during the depth of the recession, but as the economy rapidly recovers, the time to start winding it down has begun".*

## Last Week's Review

### Real Economy: DM Labor Market Improves, As Consumption And Prices Continue To Spike

***In the US,*** May's labor market data showed: *i)* non-farm payrolls increasing below-consensus to 559k (*c:* 650k; *p*: 278k) – leaving employment about 7.6m jobs below its peak of February 2020; *ii)* average hourly earnings rising above-consensus by 2% y-o-y (*c:* -0.4%; *p:* 0.4%) - as rising demand for labor, driven by a fast recovery from the pandemic, puts upward pressure on wages; and *iii)* the unemployment rate fell more-than-expected to 5.8% (*c: 5.9%; p*: 6.0%), marking the lowest rate since March 2020.

***In the EZ,*** April's retail sales jumped the most on record, due to the low base effect (*a:* 23.9% y-o-y; c: 25.5%; *p*: 13.1%) - but remained below-consensus.

***Still In the EZ,*** the inflation rate accelerated to 2.0% y-o-y (*c:* 1.9%; *p*: 1.6%), reaching the highest reading since October of 2018, with core-inflation rising in-line with expectations to 0.9% y-o-y (c: 0.9%; *p*: 0.7%).

***In Australia,*** in its June meeting, the RBA kept its interest rate unchanged at 0.10%, as expected. Policymakers reaffirmed their commitment to maintaining supportive monetary conditions until at least 2024, when inflation is expected within the 2-3% target.

### Financial Markets: Global Equities And Bonds Rise; USD Gains; Oil Prices Hit 2 Year High

***Market drivers***: investor sentiment improved, as the US job market readings supported the Fed's *"ultra-accommodative stance until the economy has further recovered*".

***Global equities*** rose w-o-w (MSCI ACWI, +0.7%, to 716). In the *US*, the S&P 500 Index rose (+0.6% w-o-w, to 4,230), as: *i)* energy shares over-performed, as oil prices reached their highest level in two years; and *ii)* consumer discretionary shares lagged, weighed down by a fall in Tesla. In the *EZ*, European shares rose (Eurostoxx 50, +0.5%, to 4,089), amid optimism of an economic recovery.

***Fixed Income:*** w-o-w global bonds rose (BAML Global, +0.1% to 293.0) and UST yields fell (-3bps, to 1.56%), after the payroll report showed the US economy in May created fewer jobs than expected.

***FX:*** w-o-w, the USD rose (DXY, +0.1%, to 90.136; EUR/USD -0.2%, to 1.217).

***Commodities:*** Oil prices rose (Brent, 3.2% to 71.9 USD/b), supported by a recovery in fuel demand - the first time in over two years. Gold prices fell (-0.7% to 1,890 USD/Oz) as UST yields retreated further.

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***Farah Aladsani*** *contributed to this Viewsletter.*

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

## Abbreviations, Acronyms and Definitions

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