

MAKING SENSE OF *THIS* WORLD

21 May 2018



R&R Weekly Column
By Brunello Rosa



US - China Trade War On Hold For Now, But Strategic Rivalry Likely To Continue

On Saturday 19 May, US and China issued [a joint statement](#) saying that “there was a consensus on taking effective measures to substantially reduce the United States’ trade deficit in goods with China” and that “to meet the growing consumption needs of the Chinese people and the need for high-quality economic development, China will significantly increase purchases of United States goods and services.” The statement remains extremely vague on the detailed actions that will need to be taken in order to achieve the intended results (for example, there is no mention of the USD 200bn target reduction in deficit – from the current USD 350bn – initially mentioned by the US administration). At the same time, it probably marks the beginning of a truce between the two sides, with a dangerous escalation of tariffs and counter-tariffs being put on hold for the time being.

This is probably good news, at least on a short-term basis, as the combination of rising US Treasury yields, strengthening USD and economic soft patch in key areas of the world economy (e.g. Eurozone and Japan) was already putting the resilience of the ongoing global expansion into question. A full-fledged trade war between two global economic heavyweights would have made the situation much worse, especially for emerging markets, the most fragile of which are already suffering from this dangerous cocktail (especially when domestic policy mishaps are added to the mix, as in the case of Argentina, as [discussed in our recent report](#)).

However, this short-term truce is unlikely to imply the end of the strategic rivalry between the US and China, which instead has just begun. As discussed in [our recent paper on US – China trade tensions](#), what really matters in this story is not the bilateral trade deficit of the US versus China, or the *tit-for-tat* tariff skirmishes of the last few weeks, but rather the beginning of a long-term rivalry (in both the economic and geo-strategic realms) between US and China, which – according to the new US National Security Strategy, defining China as a new “strategic competitor” – needs to be contained. If this interpretation is correct, the trade, technology, FDI, investment tensions between the US and China will likely escalate in the next few years regardless of any short-term agreement.

Even if an agreement to avoid a short-term trade war is eventually reached this year, after further negotiations in coming months, this will not be the end of the serious trade and technology tensions between the two sides that will likely increase and escalate over the next few years. A key battlefield in this technological rivalry between the US and China will be in the Artificial Intelligence area, where the formal goal of China is to become the technological leader by 2030. In this respect, the joint statement provides little (if any) reassurance, given the absence of any serious discussion on intellectual property rights (a major complaint by the US administration), as exemplified by the case of the Chinese telecommunications equipment maker ZTE, which is not mentioned in the statement. In conclusion, whether or not a tactical agreement to avoid a short-term trade war between US and China is reached this year, the strategic economic and geo-political rivalry between the two sides is likely to intensify in coming years.

Our Recent Publications



[ARGENTINA: Macri Tries to Reassure Investors Ahead of G20 Meeting and Presidential Election](#)

[By Brunello Rosa and Renata Bossini, 18 May 2018](#)



The Week Ahead

US - The FOMC May meeting minutes will give further hints on Fed monetary policy intentions. The market-implied likelihood of a 25-bps hike at the June 12-13 FOMC meeting remain unchanged at 100%, while the likelihood of “at least three” and “at least four” hikes in 2018 are at 91% (pw: 90%) and 50% (pw: 46%), respectively (CME).

UK - The April CPI is expected to decrease (c: 2.3% y-o-y; p: 2.5%).

Venezuela - President Maduro was re-elected in the May 20 presidential election.

The Quarter Ahead

EU - Will counter US sanctions on Iran. To counterbalance the re-imposition of US sanctions on Iran, the EU announced a package of measures to be in force before August 6, when the first set of US sanctions take effect.

Chinese “A” shares will be included in the MSCI Global EM Index. On June 1st, 234 firms will be included in the index. In September, a second batch of firms will be added, bringing China’s estimated weight in the index to 0.8%.

Turkey - Ahead of the June 24 presidential and parliamentary election, the country will remain vulnerable. Last week, after President Erdogan’s comments on taking “more responsibility for monetary policy after June elections”, the TRY depreciated against the USD to USD/TRY 4.49 (+3.9% w-o-w). In the next quarter: a) President Erdogan is expected to be re-elected, and an alliance led by his party AKP is likely to get majority in Parliament; b) CBT is likely to hike; CBT’s expectation survey forecasts a 130-150bps policy rate hike in the next three months.

Oil Prices - During the next quarter, will likely remain above 70 USD/bbl, supported by a constrained supply. Brent oil price increased by 1.8% w-o-w (to USD/bbl 78.5). Once US sanctions are launched, Iranian crude exports will fall. Further increases in US shale output will be limited by the ongoing financial difficulties of producing companies: in Q1 2018, in spite of high oil prices, 75% of the top-20 US shale oil producers incurred losses.

Last Week’s Review

US economic cycle is gaining momentum. In other DMs, growth is weakening. In the US, leading indicators continue to beat expectations (Philadelphia Fed May manufacturing index α : 34.4 points—the highest reading since May 2017—; c: 21.0; p: 23.2; April US industrial production α : 0.7% m-o-m; c: 0.6%; p: 0.5%). In other DMs, growth is weaker: Q1 GDP growth was flat for the EZ (α : 0.4% q-o-q; c: 0.4%; p: 0.4%), but fell more than expected in both Germany (α : 0.3% q-o-q; c: 0.4%; p: 0.6%) and Japan (α : -0.2% q-o-q; c: 0.0%; p: 0.1%).

EMs - Pressure is increasing. The Bank of Indonesia increased its policy rate for the first time since 2014 (α : 4.50%; p: 4.25%), while, in India, the RBI policy committee is likely to veer towards a hawkish stance in June, paving the way for a 25bps increase in August. Sell-offs of EM currencies are likely to continue: last week, the Argentinian peso depreciated further (USD/ARS rose by 5.2% w-o-w.)

The economic data flow is supportive of: a) the Fed’s intention to hike interest rates; and b) a stronger USD. The 10-y UST yield rose by 9 bps w-o-w to 3.06%, after peaking at 3.13%—a seven-year high—on May 18. The USD appreciated against: a) a basket of currencies (DXY up by 1.2% w-o-w); and b) the EUR (EUR/USD down by 1.4% w-o-w at 1.177).

US stock markets reacted with losses. Rising rates and EM risks weighed on stocks: the S&P500 lost 0.4% w-o-w, driven by declines in utilities and real estate, i.e.: sectors that are losing attractiveness as bond yields rise. Volatility increased to 13.5 (+0.9 points w-o-w).

Europe - Periphery bond yields increased as Italy’s prospective governing alliance (League+M5S) announced plans to break with EZ economic orthodoxy. 10y bond yields increased in Italy (+36bps, to 2.24%), Spain (+17bps, to 1.44%), Portugal (+19bps, to 1.87%), and Greece (+53bps, to 4.53%).

Iraq - The results of the parliamentary elections show a victory of the Sairoon Alliance, formed by Muqtada al-Sadr and the Iraqi Communist Party. Sadr opposes both the US and Iran.

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Abbreviations, Acronyms and Definitions

<i>a</i>	Actual	<i>JPY</i>	Japanese yen
<i>AKP</i>	Justice and Development Party	<i>k</i>	thousand
<i>ann.</i>	annualized	<i>KRG</i>	Kurdistan Regional Government
<i>ARS</i>	Argentinian Peso	<i>KSA</i>	Kingdom of Saudi Arabia
<i>bn</i>	Billion	<i>LN</i>	Northern League
<i>BCB</i>	Central Bank of Brazil	<i>MSS</i>	Five Star Movement
<i>BoC</i>	Bank of Canada	<i>m-o-m</i>	Month-on-month
<i>BoE</i>	Bank of England	<i>mb</i>	Million barrels
<i>BoJ</i>	Bank of Japan	<i>mb/d</i>	Million barrels per day
<i>bpd</i>	Barrels per day	<i>MENA</i>	Middle East and North Africa
<i>bps</i>	Basis points	<i>MHP</i>	Nationalist Movement Party
<i>c</i>	Consensus	<i>mn</i>	Million
<i>C/A</i>	Current account	<i>MPM</i>	Monetary Policy Meeting
<i>CB</i>	Central bank	<i>NAFTA</i>	North-American Free Trade Agreement
<i>CBK</i>	Central Bank of Kuwait	<i>OECD</i>	The Organization for Economic Cooperation and Development
<i>CBO</i>	US Congressional Budget Office	<i>Opec</i>	Organization of Petroleum Exporting Countries
<i>CBR</i>	Central Bank of Russia	<i>p</i>	Previous
<i>CBT</i>	Central Bank of the Republic of Turkey	<i>pw</i>	Previous week
<i>CDU</i>	Christian Democratic Union of Germany	<i>PCE</i>	Personal Consumption Expenditures
<i>CNY</i>	Chinese Yuan	<i>PE</i>	Price to earnings ratio
<i>CBT</i>	Central Bank of the Republic of Turkey	<i>PM</i>	Prime minister
<i>CPI</i>	Consumer Price Index	<i>PMI</i>	Purchasing managers' index
<i>DJIA</i>	Dow Jones Industrial Average Index	<i>pps</i>	Percentage points
<i>d-o-d</i>	Day-on-day	<i>QCB</i>	Qatar Central Bank
<i>DXY</i>	US Dollar Index	<i>QAR</i>	Qatari Riyal
<i>EC</i>	European Council	<i>QE</i>	Quantitative easing
<i>ECB</i>	European Central Bank	<i>q-o-q</i>	Quarter-on-quarter
<i>EIA</i>	US Energy Information Agency	<i>RBA</i>	Reserve Bank of Australia
<i>EM</i>	Emerging Markets	<i>REER</i>	Real Effective Exchange Rate
<i>EP</i>	European Parliament	<i>RUB</i>	Russian Rouble
<i>EPS</i>	Earnings per share	<i>tb/d</i>	Thousand barrels per day
<i>EU</i>	European Union	<i>tn</i>	Trillion
<i>EUR</i>	Euro	<i>TPP</i>	Trans Pacific Partnership
<i>EZ</i>	Eurozone	<i>TRY</i>	Turkish Lira
<i>Fed</i>	US Federal Reserve	<i>UAE</i>	United Arab Emirates
<i>FM</i>	Future Movement	<i>UK</i>	United Kingdom
<i>FOMC</i>	US Federal Open Market Committee	<i>US</i>	United States
<i>FRB</i>	US Federal Reserve Board	<i>USD</i>	United States Dollar
<i>FX</i>	Foreign exchange	<i>USD/bbl.</i>	USD per barrel
<i>FY</i>	Fiscal Year	<i>UST</i>	US Treasury bills/bonds
<i>GCC</i>	Gulf Cooperation Council	<i>VAT</i>	Value added tax
<i>GBP</i>	British pound	<i>VIX</i>	Chicago Board Options Exchange Volatility Index
<i>GDP</i>	Gross domestic product	<i>WTI</i>	West Texas Intermediate
<i>GOP</i>	Grand Old Party (US Republican Party)	<i>w-o-w</i>	Week-on-week
<i>IMF</i>	International Monetary Fund	<i>y-o-y</i>	Year-on-year
<i>INR</i>	Indian Rupee	<i>y-t-d</i>	Year-to-date
<i>IPO</i>	Initial public offering	<i>ZAR</i>	South African Rand
<i>IS</i>	Islamic State	<i>10-y</i>	10 year
		<i>ZEW</i>	Centre for European Economic Research

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