Rosa & Roubini
ASSOCIATES

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R&R Weekly Column
By Brunello Rosa

The US and China Reach a Truce on Trade, But the G20 Fails to Condemn Protectionism

As we predicted in our column last week, the meeting between US and China that occurred on the sidelines of the G20 summit in Buenos Aires resulted in an agreement that will allow the countries to continue negotiating with one another on trade during the next few months. The US has agreed to postpone by three months its planned increase in tariffs, from 10% to 25%, on $200bn worth of Chinese goods exported to the US; tariffs which would have otherwise gone into effect on January 1st, 2019. As we expected, this meeting was not the place at which a full-fledged agreement could take place, given the unresolved issues that exist between the two countries (especially in terms of the protection of intellectual property and the imbalance resulting from the closed nature of the Chinese economy relative to the American economy) and the deeper technological competition that is underlying their "trade skirmishes" with one another. All the same, this Christmas truce is a welcome development, as it removes one element of uncertainty for market participants on the verge of closing their books for 2018.

In contrast, the communique released at the end of the G20 summit is not likely to be a step in the right direction. Apart from being vague in general, there are three clear commitments the G20 fails to make in it. First, the communique does not explicitly condemn "protectionism" as it used to, but instead only says that world leaders "note current trade issues…recognize the contribution that the multilateral trading system has made", and that the "system is currently *falling short of its objectives* and there is room for improvement." Second, the G20 failed to endorse the UN's Global Compact For Migration after a number of countries, including the US, Hungary, Switzerland, and Italy, explicitly pulled out or showed reservations. The communique simply says that "large movements of refugees are a global concern with humanitarian, political, social and economic consequences. [G20 leaders] emphasize the importance of shared actions to address the root causes of displacement and to respond to growing humanitarian needs." Finally, the G20 communique confirms that Europe remains united in its support for the Paris agreement on climate change, whereas the US has confirmed its withdrawal from the agreement (only one day before the COP24 climate summit in Poland is set to begin), failing to put the weight of the entire G20 behind global environmental commitments.

Somebody willing to see the glass half full could say that at least this G20 meeting ended with less acrimony than did the G7 meeting in Canada in June 2018, where even the pictures taken showed tensions among various world leaders. For those inclined to be optimistic at the beginning of this festive season, one can perhaps focus on a few factors that are now lifting investor sentiment. In addition to this new truce in the US-China "trade war", there is also the more cooperative approach that has recently taken by the Italian government regarding its budget (an attempt to prevent the opening of a excessive deficit procedure by the European Commission early next year), as well as the less hawkish tone taken by US Federal Reserve chairman Jay Powell in his recent speech on financial stability. All of these factors, though somewhat clouded by the possibility of there being a negative reaction should the UK parliament reject the deal between the UK and the EU on the British withdrawal agreement on December 11th, might provide positive support to risky assets as 2018 comes to an end. Still, given the number of risks that remain, investors are likely to stay cautious during the final part of 2018 and into 2019.

Our Recent Publications

- *ECB PREVIEW: We Do Not Expect A Radical Shift In Policy in December, by Brunello Rosa and Nouriel Roubini, 30 November 2018*
- *MARKET VIEWS: Oil Outlook 2019-20: Oil Prices' Gradual Decline To Support Global Growth, Alessandro Magnoli Bocchi and Francisco Quintana, 26 November 2018*

The Week Ahead

In the US, labour market indicators is expected to remain stable. Wage growth is likely to remain unchanged (average hourly earnings November, c: 3.1% y-o-y; p: 3.1%), the number of new jobs will mildly decline (non-farm payrolls November, c: +205k m-o-m; p: 250k) and the unemployment rate will remain at a 49-year low (November, c: 3.7%; p: 3.7%).

No policy rates changes are expected in Canada and Australia. CBs are expected to keep policy rates on hold in Canada (BoC, c: 1.75%; p: 1.75%) and Australia (RBA, c: 1.5%; p: 1.5%).

The Quarter Ahead

Leading indicators show that the US economy will remain strong. Q3-2018 GDP growth remained stable (a: 3.5% q-o-q ann.; c: 3.5%; p: 3.5%) as did headline inflation in November (PCE October, a: 2.0% y-o-y; c: 2.0%; p: 2.0%). Next week, the ISM Manufacturing PMI is expected to rise (November, c: 58.0; p: 57.7). Markets have priced in a hike in December (82.7% likelihood, pw: 74.1) although Fed's Chairman Powell comments reduced the expectations of three hikes in 2019 to 9.2% (from 21.4% a month earlier).

The EZ economy will continue to show signs of deceleration… Last week, inflation fell below expectations (CPI October, c: 2.0%; c: 2.1% y-o-y; p: 2.2%), driven by core prices (Core CPI August, a: 1.0%; c: 1.1% y-o-y; p: 1.1%). Falling inflation increased demand for bonds (Germany 10y yield, -3bps to 0.31%), particularly in Italy (10y yield, -20bps to 0.34%)

… ***while political risks pile up:*** a) In Italy, banks' exposure to government debt has increased: in October: banks bought a net EUR 6.9bn of Italian government bonds, increasing their sovereign holdings by EUR 54bn since May, in sharp contrast to the sustained wave of selling (EUR -68bn) by foreign investors in the same period; b) In the UK, the vote to approve the Brexit deal negotiated with—and already approved by—the EU has been set for December 11. Its approval by the British parliament is not granted, as PM May is still seeking support among Conservative MPs.

US-China trade concerns are likely to linger on. The US and China agreed on postponing the imposition of tariffs—scheduled for January—for three months in order to work on a deal. China—under growing pressure given that its manufacturing sector is approaching contraction levels (NBS PMI November, a: 50.0; c: 50.2; p: 50.2)—committed to increase imports from the US. In parallel, a new NAFTA agreement between the US, Canada and Mexico was signed.

Geopolitical risks are rising… Last week, Russia and Ukraine had clashes off the coast of Crimea, with the latter requesting NATO support. Russia's bonds and the RUB fell to a 2.5-year low

… ***but EMs will continue to enjoy demand from fixed income investors.*** Despite the deteriorating geopolitical environment, Russia announced the upcoming sale of EUR 1bn of 7-year Eurobonds. Strong preliminary demand reduced yield guidance from 3% to ~2.875%. Russia's last international issuance (USD4bn in March) included provisions allowing payments in other currencies if the government was denied access to USD.

Oil prices could decline in the short term. Brent prices stabilized w-o-w (-0.2% to 58.7 USD/b) as markets expect Opec to deliver a moderate output cut in its meeting next Thursday. However, the cut might not materialize, given that: a) KSA is under pressure by the US to maintain output; b) Opec allies seem comfortable with current prices; and c) KSA has stated that the country will not undertake cuts on its own. In the near term, if the decline does not materialize, prices could fall further.

Last Week's Review

Gains across asset classes, lifted by expectations of a shorter-than-expected tightening cycle. Fed's Chairman Jerome Powell declared that interest rates were "just below their neutral level", signalling that the tightening cycle might be weaker than expected in 2019. The comment lifted global markets: w-o-w, prices rose across asset classes and geographies; stocks benefitted the most, particularly in the US (MSCI ACWI, 3.3%; S&P 500, 4.8%; Eurostoxx 50, 1.1%; MSCI EMs, 2.6%) and volatility fell below its long-term average (VIX, -3.4 to 18.1; 52w avg.: 15.2; 10y avg.: 18.6). Bond prices also rose, led by US (US Reuters index, 0.4%) and EMs (BAML EMs index, 0.4%). Yields fell across DMs (US 10y yield, -3bps to 3.01%) and the USD strengthened against a basket of currencies (DXY, +0.4%) and all DM currencies (EUR/USD, -0,2% to 1.132).

Francisco Quintana *contributed to this Viewsletter.*

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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*
NAFTA	*North-American Free Trade Agr.*
NATO	*North Atlantic Treaty Organizat.*
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*

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