

MAKING SENSE OF *THIS* WORLD

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By Brunello Rosa



Trump's Latest Twist On China Trade Deal Signals That Cold War II Is In Full Swing

The decision by US President Donald Trump to present China with the threat of imposing a 25% tariff on all Chinese imported goods as of Friday 10th of May marks yet another twist in this [seemingly endless saga of US-China trade relations](#). The decision led to [immediate heavy losses in global equity markets](#) (in Asia, Europe and the US) and shows that Trump is willing to sacrifice positive momentum in financial markets in order to pursue his “art of the deal.” Analysts believe this is just another tactical move to force the Chinese to sign a deal on less favourable terms, and that an eventual agreement will be reached in the next few weeks. Still, the move is risky for a number of reasons.

First, this episode could end up like the recent [failure at the summit with North Korea in Vietnam](#). After proclaiming with great fanfare that a deal with North Korea was at hand, Trump ended up leaving the negotiating table, accusing Kim of unreasonable requests. It is not clear when the two sides will meet again. In the meantime, [Russia's Putin has entered the scene](#) and complicated an already difficult negotiation process. So, breaking off discussions with China now could imply that a long pause will take place before China and the US continue negotiating.

Second, by May 18th the US will have to decide whether or not start imposing tariffs on auto sector trade with [European countries, most notably Germany](#). It is possible that the Chinese were delaying any agreement to see whether or not Trump would have the nerve to start a trade war on two fronts at the same time. But the effects of today's decisions on financial markets show that the first victim of any delay in reaching a deal is China itself (and other Asian markets by extension) – and Trump knows it. If Trump were to open the European trade front while the Chinese front is still open, it could result in a [severe hit to confidence in financial markets and economies in general](#). Trump has certainly shown that he is willing to sacrifice a few percentage points of equity valuations to pursue his negotiating strategies.


Even if China and the US were to return to the negotiating table and reach a deal quickly, today's episode shows that the relationship between the two sides remains fundamentally fraught. The [strategic rivalry between China and the US on a number of dimensions](#) (military, security, economic, investment, technology) is in full swing and will not be assuaged by any short-term trade deal. We have discussed how the trade conflict is only the most visible component of a much wider geo-strategic rivalry that amounts to a new Cold War, which we can call Cold War II.


It is quite likely that, as during the Cold War between the US and the Soviet Union, there will be a series of “truces” that will allow the two contending nations to gather their energy for subsequent returns to outright competition, instead of the two being able to reach any sort of comprehensive compromise that would more permanently end such competition. With a Cold War II, we risk returning to a two-bloc system in which de-globalization would occur, implying a massive reversal of the previous global integration in trade, investment, supply chains, technology and data transfers. This potential fragmentation of the world economy would have significant economic, financial and political implications. Like its predecessor, Cold War II is likely to be won by the richer, faster-growing, and larger economy. Only this time the winning country might not be the US.

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Looking Ahead

The Week Ahead: The US-China Trade Deal Becomes Uncertain Again

In the US, President Trump announced that the US could start imposing a 25% tariff on all Chinese imported good. The current 10% tariffs on USD 200bn of Chinese goods would rise to 25%, and USD 325bn of additional Chinese goods that were currently “untaxed” would soon be subject to a 25% tariff. Apparently, the decision was made as the trade deal with China was falling short of several of the US goals - including a strong reduction of China’ government industrial subsidies. China’s trade balance is likely to decline sharply (c: 2.3%; p: 14.2%) as manufacturing continues to suffer (manuf. PMI Apr., a: 50.2; c: 51; p: 50.8), but – supported by the government stimulus - remains in expansion mode (i.e.: > 50).

In the US, CPI data is expected to come in above the 2% target (CPI Apr., c: 2.1% y-o-y; p: 1.9%). Monetary policy remains on hold.

In Turkey, the High Electoral Board will announce its final verdict on Istanbul’s municipality elections. Inflation to remain subdued.

In Australia, the RBA is expected to leave rates unchanged at its May policy meeting (c: 1.5%).

The Quarter Ahead: Risks And Uncertainty Will Weigh On EZ And US Growth, In The UK PM May Could Step Down

In the US, rising productivity could allow higher growth without accelerating inflation. Manufacturing will suffer: *i)* the uncertainty on the US-Mexico border closing; and *ii)* high prices of materials, due to the trade war with China - as shown by the recent ISM decline (ISM manuf. PMI Apr., a: 52.8; c: 55.0; p: 55.3).

In the EZ, downside risks (i.e.: Brexit, US–China trade war, political and budget tensions in Italy and France, and a downturn in German manufacturing) will likely weigh on growth, in spite of the implicit fiscal stimulus adopted in Germany, France and Italy.

In the UK, PM May could step down after the defeat in the May local elections, triggering: *i)* a Conservative Party leadership contest; *ii)* a national election; or *iii)* a second Brexit referendum. Voters will want the Brexit issue resolved for “the country to move on”; e.g.: the deadlock over Brexit is blamed for the Labour and Tories losses in local elections, as voters turned to smaller parties. Due to political uncertainty the BoE will keep interest rates on hold and a cautious stance.

In DMs, monetary policy will remain supportive. In the US, the market-probability of a Fed rate-cut in 2019 dropped to 47% (p: 74%).

Last Week’s Review

Real Economy: DM Growth Recovery, But Low Inflation Keeps DM Monetary Policy On Hold

In the US, stronger-than-expected growth (GDP Q1-2019, a: 3.2%, the best Q1 since 2015; c: 2.5%; p: 2.2%) lifted April labor data: the unemployment rate fell to its lowest level in almost 50 years (unemployment rate Apr., a: 3.6%; c: 3.8%; p: 3.8%) due to: *i)* a sharp increase in nonfarm payrolls (a: 263k; c: 185k; p: 189k); and *ii)* a lower labor force participation rate.

In the EZ, GDP grew above expectations (Q1-2019 GDP, a: 1.2%; c: 1.1%; p: 1.1%), and unemployment fell (March, a: 7.7%, the lowest in more than a decade; p: 7.8%). Manufacturing PMI recovered to 47.9 (p: 47.5) but remains in contraction mode (i.e.: < 50). Inflation remains subdued. Inflation accelerated more than expected y-o-y (April, a: 1.7%; c: 1.6%; p: 1.4%), still below the 2% target.

Monetary policy still on hold in DM. The Fed maintained its pledge to be “patient”, and left rates unchanged (a: 2.5%) due to a lack of inflation pressure.

In Turkey, inflation remains in the double-digit territory – on account of increased food and energy prices (CPI Mar., a: 19.50%; c: 19.57; p: 19.71%).

Financial Markets: US Stocks Supported By Strong Growth And Labor Data, DM Bonds Down

Market drivers: As the week went by, strong data on the US economy more than offset earlier losses due to the Fed’s push back on rate-cut expectations.

Stocks: w-o-w, global stocks rose (MSCI ACWI, 0.2%), led by the US (S&P500, +0.2%). Volatility rose but remains below historical averages (VIX S&P 500, +0.2 points to 12.9, 52w avg.: 16.0; 10y avg.: 17.5).

Bonds: Dovish CBs and lower concerns over global growth led investors into high-quality US corporate debt. W-o-w, globally, indices were flat (BAML Global bond index, -0.1%), while EM bonds performed positively (EM BAML, USD, +0.7%). In the US, 10y USTs yields rose 3bps to 2.53%.

FX: the USD fell against a basket of currencies (DXY, -0.5%), the EUR (EUR/USD, +0.5% at 1.120) and the GBP (GBP/USD, +2.0% at 1.317). EM currencies remained unchanged (MSCI EMs, 0.0% at 1638).

Commodities: Oil prices fell to the lowest in a month (Brent, -1.8% to 70.85 USD/b) after US inventories hit their highest since 2017 and production increased.



@RosaRoubini



Rosa & Roubini



Rosa&Roubini Associates

For more information, please call us on +44 (0)207 1010 718 or send us an email to info@rosa-roubini-associates.com

www.rosa-roubini-associates.com

118 Pall Mall, London SW1Y 5ED

Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	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		



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