



R&R Weekly Column
By Brunello Rosa



The Trade Truce At The G20 Meeting In Osaka Buys Time, But Does Not Resolve The Dispute

The truce agreed to by US President Donald Trump and Chinese President Xi Jinping at the G20 meeting in Osaka is a welcome development, but it does not resolve any of the underlying issues that exist between the two sides. According [to press reports](#), the US will now refrain from imposing additional tariffs on Chinese exports to the US, and will allow US companies to sell their products to the retail section of Huawei's business. The Chinese will buy more US agricultural goods. The two sides also agreed to resume the talks that were abruptly interrupted on May 5th, talks aimed at possibly reaching an agreement in coming months. As President Trump tweeted, however, he is "not in a hurry," since the quality of the deal is more important than the speed at which a deal can be reached. In advance of this truce, market participants had already largely been expecting this sort of outcome, in which no deal was reached, yet neither did a complete collapse of the negotiations occur, rather a generic commitment to resume talks was made, with the goal still being an eventual compromise that both sides would consider more advantageous than the status quo. [We also expressed this view](#), but warned that the most likely way forward is not that eventually a long-term agreement will easily be reached, but instead a controlled escalation take place, which in turn will lead to another temporary truce, as part of a [larger geo-strategic confrontation between the United States and China that will last for decades](#).

In fact, Trump [will not want to reach a deal until he has secured at least two, if not several, precautionary rate cuts](#) by the Federal Reserve, ahead of the November 2020 Presidential election. He also still has to evaluate what type of rhetoric towards China the American voters will want to hear ahead of the election. It may be that, tired of the economic effects of these prolonged trade tensions, the American voters that Trump is trying to mobilise will be attracted by moderate language on China, suggesting the possibility of a compromise between the two countries being reached soon. Conversely, an angry working class that is deeply disappointed by the continuous disappearance of jobs and factories will want to hear incendiary rhetoric against China yet again, portraying China as the cause of all America's economic troubles. Trump will want to keep all options open until well into 2020, to consider how events unfold in coming months.

But keeping all options open will also come at a huge economic cost. The option value of waiting for a resolution to US-China negotiations is leading many big businesses to a sort of "investment strike", which is already weighing on economic performances in the largest, most advanced economies, such as the US, Germany and Japan. The ongoing balkanization of global supply chains will have an impact on companies' cost structure irrespective of whether a trade deal will eventually be reached or not. As such, the real risk is that the damage that will be inflicted upon the US and world economy by this Cold War 2 and its various components (the trade war, technological competition, disruption of supply chains) is larger than is currently being estimated, and that a few cuts by proactive central banks [will therefore not be able to prevent a global recession from occurring in 2020-21](#).


Thus, even if after the G20 meeting a few people around the world breathe a sigh of relief, the reality is that the underlying problems that exist between the two countries remain mostly unresolved. As fiscal policy remains largely constrained, once again central banks will have to be the first line of defence against the ongoing synchronised global economic slowdown.

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Looking Ahead

The Week Ahead: Weakness Expected In The Manufacturing Sector, Worldwide

Globally, manufacturing sentiment will remain weak (EZ Markit Manuf., c: 47.7; p: 47.8; Japan Nikkei Manuf., c: 49.5; p: 49.5; China NBS Manuf., c: 49.5; 49.4).

In the US, while labor market indicators are likely to improve in June (Nonfarm Payrolls, c: 165k; p: 75k; average Hourly Earnings, c: 3.3% y-o-y; p: 3.1), PMI indicators are expected to soften (ISM Manuf., c: 51.5; p: 52.1).

In Australia, the RBA is expected to lower its policy rate by 25bps (c: 1.00%; p: 1.25).

The Quarter Ahead: Renewed Hopes On Trade, But Global Growth To Remain Weak

In the US, price pressures will remain contained and inflation below target. Soft inflation readings and continued uncertainty over global trade lifted market expectations of 'one rate cut in July' to 72% (p: 68%).

The **global economy** will suffer from: 1) secular deceleration; 2) a broader China-US power struggle; and 3) brewing US-Iran tensions.

The US agreed to put new tariffs on Chinese goods "on hold for the time being", delaying a 10% tariff on USD 300bn of Chinese imports (note: since May 10, tariffs on USD 200bn of Chinese goods have been raised from 10 to 25%). Trade negotiations need to address unresolved issues, including key US demands, such as: *i*) reforms of intellectual property rights; *ii*) the removal of industrial subsidies; and *iii*) policy-enforcement procedures. For a deal to be struck, **China** insists that Huawei must be fully removed from the "black list."

After twenty years of negotiations, the **EU and Mercosur** agreed on the world's largest free-trade agreement: over the next 10-15 years, tariffs will be eliminated on about 90% of the two-way trade flows.

Opec is expected to maintain production subdued, as Russia and Saudi Arabia hinted at extending – by six to nine months – their large (1.2mn bpd) oil output-cutting deal.

Last Week's Review

Real Economy: US-China Truce And EU-Mercosur Deal To Help Trade, DM Inflation Remains Low

A second **US-China** trade truce. At the G-20 Summit, President Trump and President Xi agreed to: *i*) a second trade truce; and *ii*) restart negotiations.

In the US, an unexpected decline in aircraft sales led 'durable goods orders' to fall in May (a: -1.3%; c: -0.1; p: -2.8); yet, orders for business equipment rebounded, signaling that – despite trade-related uncertainties – corporate investments remain resilient (Nondefense capital goods orders ex. aircrafts, a: 0.4%; c: 0.1; p: -1.0).

In the US, the Fed's preferred inflation gauge held steady in May (PCE, a: 1.5% y-o-y; p: 1.6, core PCE, a: 1.6% y-o-y; c: 1.5; p: 1.6).

In the EZ and Japan, inflation remains below target (2%) (EZ CPI Jun., a: 1.2% y-o-y; c: 1.2 p: 1.2; Tokyo CPI Jun., a: 1.1% y-o-y; c: 1.3; p: 1.1). In Japan, the industrial sector kept shrinking (IP May, a: -1.8% y-o-y; c: -2.6; p: -1.1).

In Turkey, the CHP candidate Mr. Imamoglu won the 'Istanbul mayor election-re-run' against the AKP candidate Mr. Yildirim – by a greater margin than on March 31 (54 versus 45%). President Erdogan accepted the outcome but hinted that the new mayor could face allegations of insulting a provincial governor.

In Iran, after Tehran breached the uranium stockpile limits set in the 2015 nuclear deal, the government rejected talks with the US.

Financial Markets: Market Performance Driven By Expected Policy Support

Market drivers: despite growth headwinds, market sentiment and asset markets enjoyed: *i*) policy support; *ii*) the resumption of trade talks; and *iii*) low inflation readings, that support CBs easing stance. As a result, risk aversion may have bottomed.

Stocks: w-o-w, global stocks remained flat (MSCI ACWI, +0.0%). US equities fell (S&P 500, -0.3%) and the EZ rose (Eurostoxx, +0.2%).

Bonds: globally, indices rose w-o-w (BAML Global bond index, +0.3%). Goldman Sachs and JPMorgan lowered their 10y-UST yield forecasts to 1.75% year-end (p: 2.80%), given: *i*) a potentially prolonged trade-war; and *ii*) a dovish shift by key CBs.

FX: the USD weakened against a basket of currencies (DXY, -0.1%) and EM currencies strengthened (MSCI EMs, 0.4% at 1,650).

Commodities: Oil prices rose w-o-w (Brent, +2.1% to 66.6 USD/b).

Farah Aladsani contributed to this Viewsletter.



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



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