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MAKING SENSE OF *THIS* WORLD — *7 October 2019*

R&R Weekly Column
By Brunello Rosa

WTO Opens Up A European Front In The Trade Wars

Following a number of warning signals, a European front in the global trade wars has now been opened by the World Trade Organisation (WTO). In a recent ruling on a 15-year old dispute, the WTO ruled that the US is authorised to apply tariffs worth USD 7.5 billion annually on the UK, France, Germany, and Spain (the "Airbus nations"), as well as on the wider EU, as a compensation for the subsidies that the EU has allegedly given to Airbus, providing the company with an unfair advantage against its US rival Boeing. Similarly, in a separate ruling that is expected in the months ahead, the EU is likely to be authorised to impose tariffs (likely billions of dollars worth) on EU imports of US goods, due to the subsidies that the US government has provided to Boeing. This could mark the beginning of a tit-for-tat escalation between the EU and US, which could prove damaging for both sides.

Ironically, it is the WTO, an international body devoted to the resolution of trade disputes, that is risking opening this new front in the ongoing international trade wars. As discussed in our previous analysis, US President Trump has opened a number of fronts for his country's trade wars: he began by withdrawing the US from the TPP, then continued with a worldwide tariff increase on steel and aluminum (even imposing such tariffs on its close allies Canada, Europe and Japan, albeit with selective exemptions), then moved to the re-write of NAFTA with Canada and Mexico, and finally finished *in style* with China, subjecting it to several rounds of tariff increases as well as technological disputes. When it seemed that on the Chinese front a deal could finally be reached, Trump was ready to wage war to Europe and the European car industry. The procrastination of the negotiations with the Chinese therefore meant that this European leg of the dispute has repeatedly been postponed. Now, however, the European front is officially open.

The list of goods impacted as a result is very large: French wine, Italian cheese and olives, whisky, and cashmere sweaters, among other items. This cannot be good for Europe: its economy is already in stagnation, with some of its largest economies (such as Germany and Italy) flirting with a recession. In particular, while France and Germany have at least benefited from the positive impact of the aerospace industry to their economies, Italy, which does not belong to the Airbus consortium, would be hit by new tariffs without ever having directly or greatly benefited from the subsidies the company is alleged to have received.

Neither will the US economy remain immune from the expected counter-ruling by the WTO, nor from any retaliatory tariffs that the EU might decide to implement. The American economy is decelerating as the effects of tax cuts are fading out, and the Fed is not following Trump's game of forcing the central bank to provide monetary stimulus as an (imperfect) offset of the tariffs on various countries that the US government has imposed.

This new European chapter of the American trade war is unlikely to have a happy ending, especially as the most likely outcome for the US-China front of the trade war is not a fully-fledged deal or a total breakdown in negotiations, but rather a continuation of the "controlled escalation" that has been taking place. Unfortunately, the world economy will have to deal with the effects of these disputes for years to come, forcing policy makers to provide fiscal and monetary stimulus, and keeping markets unnecessarily volatile.

Our Recent Publications

- ITALY UPDATE: Upcoming Budget To Test The Solidity Of The M5S-PD Majority, *by Brunello Rosa, 4 October 2019*
- Focusing On Capital Preservation, Limiting The Risk-Taking To Fixed-Income, *by Alessandro Magnoli Bocchi, Fawaz Sulaiman Al Mughrabi and Farah Aladsani, 3 October 2019*
- Flash Review: RBA Cuts Rates And Signals Further Easing Ahead, *by Brunello Rosa, 1 October 2019*
- **GEOPOLITICAL CORNER:** High Noon: The Brexit Crisis Reaches A Climax, *by John C. Hulsman, 24 September 2019*

Looking Ahead

The Week Ahead: German Manufacturing Picks Up And Inflation Remains Below Target In US And Germany

In the US, inflation is likely to remain unchanged (CPI Sep., c: 1.7%; p: 1.7%), below the Fed's 2% target. US-China trade negotiators will meet in Washington for the 13th round of high-level negotiations.

In the EZ, German factory orders (Aug., c: -4.6% y-o-y; p: -5.6%) and IP (Aug., c: -2.7% y-o-y; p: -4.2%) are expected to improve, while remaining in contractionary territory. German inflation is expected to slightly rise (CPI Sep., c: 1.7% y-o-y; p: 1.4%).

In China, the services sector is expected to strengthen (Caixin Services PMI Sep., c: 52.9; p: 52.1).

The Quarter Ahead: Global Growth To Slow, Trade Tensions And Brexit Risks To Remain Elevated, Potential Impeachment Of Trump

The global economy is likely to weaken further, hampered by: *i)* the prolonged contraction in manufacturing, due to the unpredictability of trade disputes; *ii)* reduced consumer spending and, as a result, deferred orders; *iii)* capital flow volatility; *iv)* rising geopolitical risks.

In the US, business activity is likely to suffer a weak manufacturing sector. The Trump administration will implement tariffs on USD 7.5bn of imports from the EU following a WTO decision authorizing tariffs "due to EU subsidies of Airbus". House committees conducting the investigation for President's Trump impeachment will schedule hearings and subpoena documents, but the Trump administration is unlikely to cooperate. On October 15, the House, currently in recess, will be back in session and the Democratic presidential candidates will hold a debate. The market probability of a Fed cut in December stands at 89% (p: 69%).

In the UK, talks will resume after the EU put Brexit negotiations on hold over the Irish border, as "the UK proposed alternative to the Irish backstop creates a customs border and hence cannot not be the basis for a legally-binding treaty". PM Boris Johnson emphasized "the only options are a 'new deal' or 'no deal'".

In the EU, the ECB launched a new lending benchmark called €STR – intended to replace Eonia – a daily reference rate that reflects "unsecured" overnight lending between EU banks – which prices about EUR 24tn (USD 26.3tn) of derivatives deals. The ECB set the €STR rate at -0.549%.

Last Week's Review

Real Economy: Global Economic Outlook Keeps Deteriorating, Market Sentiment Remains Fragile

In the US, *i)* the manufacturing sector suffered a stronger-than-expected contraction (ISM manuf. PMI Sep., a: 47.8; c: 50.1; p: 49.1); and *ii)* the services sector grew at its slowest pace in three years (ISM non-manuf. Sep., a: 52.6; c: 55.0; p: 56.4). Labour market data were mixed: *i)* payrolls grew below-consensus, at a decelerating pace (Nonfarm Payrolls Sep., a: 136K; c: 145K; p: 168K); *ii)* the unemployment rate fell to 3.5% (p: 3.7%); while *iii)* earnings declined (Avg. hourly earnings, a: 2.9% y-o-y; c: 3.2; p: 3.2), hampering the outlook for US consumption. House Speaker Pelosi (D.) formally launched an impeachment inquiry aimed at President Trump's July 25 phone call with Ukrainian President Zelensky.

In the EZ, inflation was weaker-than-expected (CPI Sep., a: 0.9% y-o-y; c: 1.0%; p: 1.0%) – remaining below the ECB's 2% target. The EZ composite PMI – an aggregate measure of manufacturing and services – fell to the lowest level in six years (Markit PMI Composite Sep., a: 50.1; c: 50.4; p: 50.4).

In Japan, IP contracted more-than-expected (IP Aug., a: -4.7% y-o-y; c: -1.8%; p: 0.7%).

In Turkey, inflation decelerated below-consensus into single-digits (CPI Sep., a: 9.3% y-o-y; c: 15.5%; p: 15.0%), despite a stronger-than-expected monetary easing. CBs continue to ease.

In Australia, the RBA cut as expected its key policy rate by 25bps to 0.75% (p: 1.00%), and signaled more easing ahead.

In India, RBI cut its interest rate by 25bps (a: 5.15%; c: 5.15; p: 5.40).

Financial Markets: Jitteriness And Risk-Off Sentiment Hampered Stocks And Supported Bonds

Market drivers: Rising recession odds, US-EU trade tensions after the WTO ruling and a string of disappointing US data increased market jitteriness.

Stocks: w-o-w, global equity indices fell (MSCI ACWI, -0.9% to 515) driven by both DMs (S&P500, -0.3% to 2,952) and EMs (MSCI EMs, -0.5% to 997). Volatility fell (VIX S&P 500, -0.2 points to 17.0, 52w avg.: 17.3; 10y avg.: 17.0).

Bonds: w-o-w, global indices rose (BAML Global bond index, +0.4%).

FX: w-o-w, the USD weakened against a basket of currencies (DXY, -0.3% to 98.808), the EUR (EUR/USD, +0.3 to 1.098) and the GBP (GBP/USD, +0.4% to 1.233); EM FX rose (MSCI EMs, +0.3% at 1,615), while the Turkish lira remained stable (USD/TRY, -0.4% to 5.695).

Commodities: Oil prices fell below USD 60 (Brent, -5.7% to 58.4 USD/b) as Saudi Arabia restored production. Gold prices rose.

Farah Aladsani *contributed to this Viewsletter.*

The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*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*