Weekly Market Summary

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Are President Trump & Co. Deliberately Targeting the Global Economic Recovery??

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Back in early June this year, I released an economic piece entitled "*With Friends Like Donald Trump, Matteo Salvini & Luigi Di Maio, Who Really Needs Enemies?*" At that time, financial panic & chaos had taken hold of markets following the rough birth of Europe's first populist government in Italy (a mix of anti-establishment and right-wing ministers who had promised an "*Italy first*" agenda), the ousting of Spain's Prime Minister Mariano Rajoy by the country's parliament (following the loss of a vote of no-confidence amid a corruption scandal engulfing his Popular party), and the announcement by US authorities that exemptions to tariffs on aluminium and steel imports from the EU, Canada and Mexico were being removed.

The latter - frenetic and rushed US actions on global trade - have since continued unabated, convincing both investors and policymakers that a full-blown trade war is under way with no easy, nor immediate, ways of defusing the conflict. Yesterday's dialling up of the tariff rhetoric by the Trump administration (the US president ordering his trade office to consider imposing a 25% duty on $200 billion worth of Chinese goods, up from an initial 10%) - with a statement by Commerce Secretary Wilbur Ross confirming that there will be more pain ahead and that Trump will personally "*hold China responsible for its unfair trade practices*" - is surely a sign that current trade disputes will most likely witness further escalation, at least in the near-term, especially that the Asian nation has repeatedly stated that it will never surrender to US trade threats! Not to mention the recent threats of "crushing" sanctions against Russia, recently made by US Congress or the latest sanctions against Turkey (a NATO ally). The US is obviously not trying to make friends in the world right now; Quite the opposite; they are isolating themselves, both at the political and economic level!

However, it should be clear that no country wins a trade war, whatever Donald Trump or his "*smart*" trade advisors think! The bizarre comments by his Commerce Secretary, Wilbur Ross, that the rise in US steel prices following the imposition of tariffs reflected "*profiteering*" by speculators merely underlined the economic illiteracy involved. If you restrict the supply of something, its price tends to go up. That is how tariffs are supposed to work! There is no excuse for ignorance about the potential impact of what Mr Trump has done. History shows that previous trade wars too have led to financial difficulties (for instance, when the US hit trading partners with its infamous Smoot-Hawley tariff in 1930, it led to an immediate escalation into a global tit-for-tat protectionism - making the Great Depression much worse), and later required many years of patient global work - during the creation of the post-war trading order - to undo their negative impact.

Fast forward to today, and there should have been little doubt that the likes of China and the EU - or even Canada, despite its dependence on trade across the American border - would reciprocate Mr Trump's tariffs. That makes those tariffs even more reckless. If anything, the pain that countries will cause by retaliating is even more immediate than in the 1930s. Compared with earlier decades, the global integration of supply chains means that many imports are destined for use in domestic production. Cutting one's own car manufacturers off from specialist imported components is a spectacularly "*stupid*" move. But more damaging than the immediate financial threat is likely to be the longer-term impact on innovation and productivity. Modern supply chains are not just disaggregated production lines. They are networks for learning and technology in which knowledge is created and disseminated across the globe. The US is right that China, with its forced technology transfer, attempts to capture and exploit too much of this knowledge purely for its own benefit. But the answer to that is to make the system run more openly and fairly, not to destroy it. Mr Trump's tariffs are leading the global economy into a highly dangerous place. More enlightened governments must do their best not to multiply his ill-informed errors.

At the start of 2018, the world economy was undergoing a synchronised expansion, with growth accelerating both in advanced economies and emerging markets. Moreover, despite stronger growth, inflation was tame - if not falling - even in economies such as the United States, where goods and labour markets were tightening. Stronger growth with inflation still below target was still allowing unconventional monetary policies to either remain in full force, as in the Eurozone and Japan, or to be rolled back very gradually, as in the US. The combination of strong growth, low inflation and easy money was also keeping market volatility extremely low. And with yields on G7 government bonds staying depressed (10-year German bund yields still hovering close to 40 bps, at a time Germany's annual growth and inflation run slightly north of 2.0% .. just SURREAL !!), investors' animal spirits were running high, boosting the price of many risky assets. Investors were also celebrating President Trump's tax cuts and deregulatory policies. Many commentators even argued that the decade of the "*new mediocre"* and "*secular stagnation*" was giving way to a new "*goldilocks*" phase of steady, stronger growth.

Eight months later, the picture is starting to look quite different. Though the world economy is still experiencing a warm expansion, growth is no longer synchronised (latest IMF warning). Economic growth in the Eurozone, the United Kingdom, Japan and a number of fragile emerging markets is starting to slow. Additionally, the combination of a stronger dollar, higher US short-term interest rates,and less liquidity does not bode well for emerging markets. And whilst the US and Chinese economies are still expanding, the former is being driven by unsustainable fiscal stimulus. Worse still, the significant share of global growth driven by "Chimerica" (China and America) is being threatened by this latest escalating trade war. The danger is that a negative feedback loop between economies and markets will sooner or later take hold. The slowdown in some economies could lead to even tighter financial conditions in equity, bond and credit markets, which could further limit growth. And unlike the short risk-off periods in 2015 and 2016, which lasted only two months, investors this year have been in risk-off mode since February, while markets are still moving sideways or downward. But this time the US Federal Reserve and other central banks are starting or continuing to tighten monetary policies (latest being the Bank of England's Monetary Policy Committee who decided unanimously yesterday to raise the UK benchmark rate by 25 bps to 0.75%, following a solid rebound in Q2 UK economic activity). With inflation rising, central bankers cannot come to the markets' rescue this time (unless they opt to revert back to monetary easing).

Moreover, while the Trump administration's growth-boosting policies are already behind us, the effects of policies that could hinder growth have yet to be fully felt. Trump's favoured fiscal and trade policies will crowd out private investment, reduce foreign direct investment in the US and produce larger external deficits. His draconian approach to immigration will diminish the supply of labour needed to support an ageing society. His environmental policies will make it harder for the US to compete in the green economy of the future. And his "bullying" of the private sector will make firms hesitant to hire or invest in the US. Over time, growth-enhancing US policies will be swamped by growth-reducing measures. Even if the US economy exceeds potential growth over the next year, the effects of fiscal stimulus will fade by the second half of 2019 and the Fed will overshoot its long-term equilibrium policy rate as it tries to control inflation; thus, achieving a soft landing will become harder. By then, and with protectionism rising, frothy global markets will probably have become even bumpier, owing to the serious risk of a growth stall – or even a downturn – in 2020.

In a 2015 speech announcing his candidacy, Trump noted that the country "*needs a leader that wrote The Art of the Deal (Trump's book).*" "*I'm a negotiator. I've done very well over the years through negotiation,*" he said in a Republican debate in 2016. "*That's what I do, is deals… I know deals, I think, better than anybody knows deals"* Trump has recently repeated. But the past 18 months of Trump's presidency have shown that whatever skills Trump "*thinks*" he acquired over the course of his business career have not necessarily translated to his work in the White House. The failed repeal-and-replace health care negotiations, bungled efforts to get funding from Mexico for his promised border wall, the pulling out of the Trans-Pacific Partnership and the Iran nuclear deal -Trump has proven to be more adept at breaking deals than making deals. And the truth is that Trump was, and still is, an aggressive, impulsive, zero-sum, win-at-all-costs, transactional, unpredictable, often under-informed and ill-prepared, gut-following, ego-driven, want-it-and-want-it-now negotiator!

This afternoon brings the release of the all-important US payroll release*. Bloomberg consensus is for July payrolls to have risen by a strong 193,000 (following a sizable 213,000 jump in NFP for the month of June). A print in excess of 175,000 would surely seal a 25 bps rate hike for the US o/n Fed funds rate at the upcoming September 26th FOMC meeting (future interest rate markets already assigning a 100% probability for such outcome, with prevailing uncertainty just linked to probabilities of a 4th rate hike this year, most likely happening at the December 19th FOMC meeting). It will also be worth keeping a close eye on the other important elements of the report, namely the unemployment rate (expected to drop to 3.9%, from 4.0% last month) average hourly earnings (likely to rise by a strong +0.3% mom & +2.7% yoy, in line with the June print), the participation rate (last at a still depressed 62.9%) and average weekly hours (expected unchanged at 34.5 hours).

**After a solid second quarter for growth and jobs, payrolls weren't able to continue that momentum into Q3. Nevertheless, while a 157K gain in non-farm payrolls was well below the 193K expected for July, an upward revision of almost 60k to the prior two months leaves the level of employment roughly where the consensus had forecast. Adding to the somewhat mixed bag of data, wages were up 0.3% in July, but a downward revision to the prior month meant that the annual pace is still tracking an uninspiring 2.7%. Today's numbers are unlikely to do much to alter expectations for a rate hike at the Fed's upcoming September 26th FOMC meeting or the pace of hikes thereafter.*

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