

Thoughts from the Americas

Having recently spent two weeks visiting clients in the Americas we outline the main discussion points and client feedback



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Trade wars & protectionism

President Trump is trying to cut the US trade deficit, particularly with China, but his success may be limited given huge tax cuts and rising wages are giving US consumers more money to spend. Much of the increase in cashflow is being used to buy imported consumer goods, so getting a smaller deficit is going to be challenging. The fact so many countries have since been excluded from the US tariffs shows a willingness to do deals to avoid trade wars while there was growing optimism in Mexico that NAFTA will survive with Mexico willing to offer concessions to Trump. China reportedly offering to talk also gives some hope that the situation will calm. The fact that the Republicans lost the Pennsylvania House seat, despite it being a steel area, suggests a level of ineffectiveness of the protectionist policy with the electorate as we look towards the mid-terms in November. Clients broadly felt the protectionist rhetoric was more bark than bite and that things will calm down.

Rising US government borrowing

Fiscal sustainability is a worry. The fiscal deficit potentially hitting 5% of GDP despite the economy growing 3% YoY is causing nervousness. Should growth disappoint (trade war, geopolitical risks, etc) that 5% of GDP fiscal deficit could quickly become 7% or 8%. At a time when the Fed is reducing its balance sheet and concern that China could threaten to reduce Treasury purchases if we do enter an all out trade war there is a recognition that this situation could add to upward pressure on Treasury yields.

Rising inflation risks and strong growth

This too could add to upside risk for bond yields and market rate hike expectations. Corporates broadly said that pay is rising in their company. Several said that you can't just offer a couple of percent. They have to be big increases, especially for companies based outside the major cities where attracting staff is more challenging. There are widespread worries about staff quitting as they are not sure where they will be able to get replacement hires. Our suggestion that inflation could hit 3% this summer (cell phone data plan charges, medical care costs, dollar weakness, rising commodity prices) raised a few eyebrows but no real shock.

Federal Reserve policy

The path for Federal Reserve interest rate hikes may be more aggressive than the market is pricing. Our 4 hikes for 2018 with the risk of 3 next year got no real pushback given our arguments relating to growth and inflation and the changing make-up of the FOMC voters.

Upside risk for US Treasury yields

With the Fed hiking rates, concerns over the US' fiscal position and our assumption that trade fears will gradually recede, our prediction of a higher, flatter yield curve (10Y yield in 3.25-3.50% range in 2H18) didn't face much opposition. Corporates customers are all expanding strongly, and there is no sense of a slowdown on its way amongst the ones we visited (a broad range of industries ranging from tech to distribution to cyclicals and services).

Euro's upside risks

We were talking a very positive EUR/USD story. The combination of "good" dollar weakness (global growth warranting stronger currencies) turning to bad dollar weakness (Trump's protectionism, Steve Mnuchin's suggesting a weaker dollar can be a good thing, rising deficits) coupled with a positive euro story - rebounding portfolios into the euro area, FDI flows relating to Brexit (people switching from investing in the UK to the Eurozone) and the 3%+ Eurozone current account balance. Our suggestion that we could see 1.40 at some point in 2019 caused a few awkward squirms, but there was an acceptance that it wasn't a completely mad call - we were there only 4 years ago. Latam financial institutions were increasingly switching from US to European assets. They were negative on the USD and were fully backing the stronger EUR call and stronger JPY view.

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