

War is stupid

The world stands on the brink of a trade war as Donald Trump announces severe tariffs on steel and aluminium - forget the yield curve - this is how recessions start.



War

The biggest threat to global growth is a trade war

At the beginning of each year, economists are often asked to list the biggest threats to their forecasts. This year was no different to most, and though my prognosis was generally favourable, my biggest risk was trade - namely, that US President Trump would unleash a trade war. Other analysts have been scrutinising speeches from the Federal Reserve about rate policy, still others, analysing the slope of the yield curve to gauge recession risk. In my opinion, these are all second order to a global ramping up of tariffs on trade.

Trade is just about the only thing economists are agreed on - more is better. You might ask, better for whom? That would be a fair criticism of recent trade deals, gains from which seem to have accrued to a narrow and already privileged group. But even if such criticisms have merit, it doesn't mean that less trade is good - for anyone. If it were, then we imagine the Dow Jones would be up 400 points today, not down 400 points on the back of Trump's announcement of "severe tariffs" on steel and aluminium. Even the USD seems to be in agreement, giving back some of the gains against the EUR of the last few days, though that may reflect the sharp drop in bond yields and slight flattening of the curve.

If Trump does indeed announce tariffs of 25% on imported steel and 10% on imported aluminium, then retaliation seems inevitable. And though we may worry about China's reaction (so far they have been very patient), Canada and Europe seem particularly vexed - not unreasonably given that national security will probably be used as the excuse for tariffs. Korea and Japan are also big steel exporters to the US, and Australia a big exporter of the raw materials that third parties (mainly China) use to make steel. If these US "allies" take the lead with retaliatory tariffs, it will open the door for China to respond too.

Korean production - difficult to disentangle

Korean production for January came in stronger than the consensus view, recording a 4.6%YoY gain (consensus 1.7%, ING f 4.4%). But we aren't sure whether to be happy or concerned. The data are in all likelihood affected heavily by the Chinese New Year distortions- as all data in this region are at this time of the year. The stronger year-on-year increase seems to have been boosted by downward revisions to historical data, whilst the January month on month gain missed slightly on the downside and was subsumed by a bigger downward revision to the prior month's gain, leaving production in the December-to-January period essentially unchanged.

We certainly need to see more data to work out exactly what the production momentum is for Korea. Yesterday's trade data were encouraging, so for now, we prefer to err on the optimistic side, though not so much that we can envisage any BoK action until much later this year.

Italian elections -just when you thought European politics looked safe

Europe managed to dodge a number of political bullets last year - the Dutch elections passed uneventfully, France did not vote for extremism, and Germany's election, though inconclusive, at least did not usher in a far-right party. With the exception of Germany's CDU/SPD negotiations, which are still an interesting backstory, the main event risk for Europe this year is the Italian elections this weekend. Having sounded highly Eurosceptic at times, the popular five-star movement has been sounding a little more mainstream recently. But polls suggest that we may come in on Monday morning to another German-style inconclusive poll. Protracted negotiations will then follow and quite possibly, new elections later on. This probably isn't a substantial negative to the EUR. Time and again, European countries have proved that they operate quite well without a government (Netherlands, Belgium...).

May scrambles for unity on Brexit - tough ask

With a wide spectrum of views to appease, today's speech by UK PM Theresa May will attempt to please everyone, and in the process, will probably please no-one. The current state of affairs is that the EU has put forward a framework which crosses many of the UK's red lines for Brexit, whilst May has put forward a plan which can fairly be described as "cherry picking", and therefore unacceptable to the EU.

This doesn't mean that the UK is hurtling towards crashing out of the EU without a deal, This is a negotiation, and it would be odd if the opening offers were acceptable to either party. But the gulf seems as wide as ever, and the clock is ticking. Not surprisingly, GBP looks a little vulnerable right now.

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