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UNITED KINGDOM

Economic update: Trade, Tech & Trump

There is a sense that global activity softened a little in 1Q18 with sentiment knocked back by President Trump's renewed protectionist push. The latest tech-led equity market wobble hasn't helped either, but the underlying global economic story remains good. While an economically damaging trade war cannot be ruled out, we are hoping calmer heads will prevail and look forward positively to 2Q18



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Executive summary

The healthy market glow from President Trump's tax cuts has swiftly dimmed in the wake of his renewed focus on protectionism. China is clearly in the spotlight with Europe's reprieve from steel and aluminium tariffs linked to support for pushing China to adopt "fairer" trade practices. The problem is that the huge tax cuts Trump enacted puts more money in the pockets of consumers, much of which will be spent on imported consumer goods. As such we consider it unlikely there will be any meaningful improvement in the overall trade deficit at the end of all of this.

The equity market correction is another issue to watch. It has resulted in part from protectionist fears, but also growing concern over what intensifying regulatory scrutiny for the tech sector might mean. On the positive front, there are signs that Trump is willing to do deals and flexibility from all parties will hopefully avoid an all-out trade war. Given the strong domestic growth story, the competitive exchange rate and a strengthening global economy we are sticking with our 3% US growth forecast for 2018

with three further Fed rate hikes this year.

Even though sentiment in the Eurozone has been sliding, the growth outlook continues to be positive. While the mood is somewhat less “Europhoric” thanks to concerns about the impact of trade uncertainty and some complacency around reform, we still expect growth to come in at 2.4% this year. But despite this, inflation is still not moving towards the target. This is causing ECB governing council members to strike a more dovish tone. In our view, the first deposit rate hike is unlikely to come before June 2019 at the earliest.

With one year to go until the UK leaves the EU, talks are entering the most difficult phase yet. But the agreement of a post-Brexit transition period will be welcome news for businesses. Alongside rising wage growth, this makes a May rate hike more likely.

China has responded robustly to US trade measures by announcing its tariffs on US goods. The signal is clear: China will not be pushed into concessions, and is willing to accept some economic pain in what Beijing may ultimately see as a political dispute. Further retaliatory measures are possible if the US escalates tensions further, but both sides seem willing to negotiate. The question now is whether an agreement that works for both sides can be found.

The White House’s protectionist policies are driving the USD lower against safe haven currencies such as the JPY. We suspect things will get worse before they get better and see outside risk of USD/JPY falling as low as 100. The Eurozone’s huge 3.5% current account surplus also puts pressure on the EUR to appreciate. We still target 1.30/USD.

Despite the big wobbles seen in risk assets, US market rates have managed to maintain reasonable poise. In fact, we continue to expect the 10-year yield to break above 3% over coming months as robust fundamentals, QE unwinds, and supply measures continue to act as upside forces.

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