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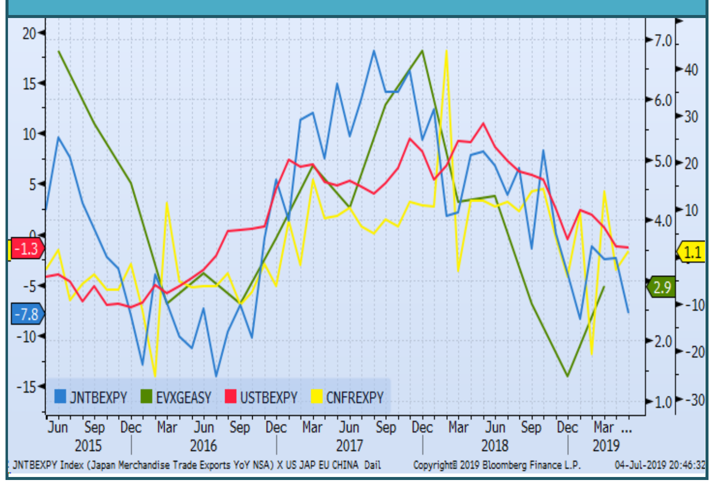
ECONOTE No. 84: Economic shelfies of G3 and of some others 31/6/2019

Summary	Investment Conclusions
The "global economy" is now a fairly meaningless expression given the complete disengagement of GDP growth and domestic policy cycles among the biggest economies in the world such as the US, EU, Japan and China. The US-China trade war preoccupies the markets, but this did not stop the S&P 500 hit new highs. The ECB and BoJ are on full ease for years now with the Fed lingering at the edge of cutting rates after hiking since Dec. 2015.The UK is in full political disintegration mode, while the EU change of political guard speaks of continuity, at least in the ECB. The Chinese economy could be stabilizing with the Hong Kong politics peering through the monolithic cracks of China's political system. And the weather in Europe reminded that global heating means just that, at the time that there are distressing signs that US, Japan, Australia and China are dropping ecoball.	I have always eschewed expressions such as "world equities markets" or "world interest rates" as these have stopped existing as collective nouns for years now. But currently, interest rates are an exception with Asian rates falling, G2 rates stuck to zero or negative and the Fed near cutting. No wonder that equity markets are doing well although pushing to overbought levels. Much to my reluctance, buying G3 equities (but not just yet China) is now an option. As the US-China trade war is, to my opinion, not a serious macro event, this realization will, eventually, benefit the AUD versus the USD. And in a defiant note (sticking- out- neck time) I maintain my view that the UK will not exit the EU, **Brexit will not happen** and, hence, a six months bullish GBP position is warranted.

The tangled macros and financial trends

As the Fact Box chart shows, the **US** is doing well, growth-wise, while the **EU** and **Japan** are bottoming as is **China**.In comparative terms, the EU and Japan are growing within a 1.0% yoy range , the US over 3.0% and China at over 6.0%, glaring differences that can only be explained by structural issues as to why the G2 can not replicate US's growth pace, but with China having the huge statistical advantage of a very low base.The EU growth pace inevitably reflects that of Germany's but also moslty France's and Itlay's structural issues of rigid labour markets, labour productivity and competitiveness within a fixed exchange rate regime.Japan is, and will be plagued, by deflation, ageing labour market and a monetary policy which is totally and ineffectively continuing to pursue a crude version of the quantity theory of money whereby increases in money stock cause the prices of goods and services to rise.In Japan it did cause the prices of assets to rise, hence, persistent negative bond yields, but not of the prices of milk and of shoes !The equally loose ECB monetary policy, is very likely to be continued by the new incumbant Christine Lagarde .The Fed, unsure over its PCE inflation target of 2.0%, but persistently less than that and now at 1.6 % yoy, will be tempted to cut rates.The fly in the ointment in all this is the impact of the **US-China trade war** on the US and China growth rates and of any collateral damage on other economies.As Fig. 1 shows exports growth of China has dipped but not in a consistent trend unlike that of the US and of Japan while EU exports growth appears to be bottoming.Estimates of the longer term negative impact of the trade war on the GDP of the US and China shows ranges of -0.25% to -1.2% of GDP, a small impact indeed. Evidence also points out that US importers have passed on fully to the US consumers the tariffs on Chinese exports making complete nonsense of the trumphant claims that the US is "collecting billions of USD from China" fiscally correct but damaging to GDP growth as it is a restrctive fiscal policy. What has been consistently disregarded is that net exports growth has a very small impact on the GDP growth of US and China.The economies of China and of the US are not exports driven, which is not to say that **sectoral** impact of tariffs (or of trade restrictions in general, see Huawei) are not importnant.And this may partially explain why **S&P500, Nikkei, and SXSE** (Fig.2) are all overbought and above their moving average helped by the macros, and could stay there helped by zero G2 rates and falling Fed rates.

Fig.1: Exports growth, US (red), EU (green), Japan (blue), China (yel)

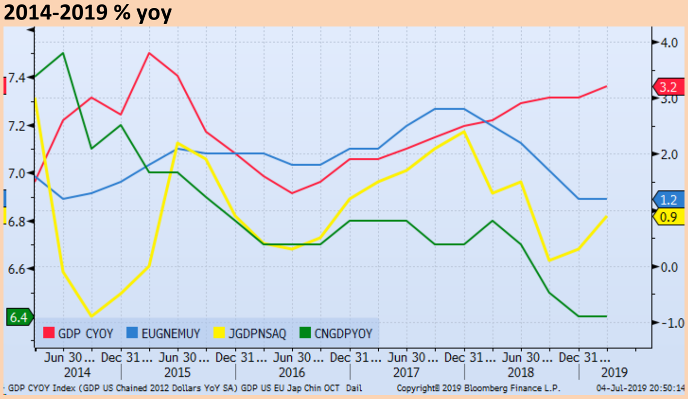


Source: Bloomberg

And now for something completely different….

The **Brexit** issue is supposedly coming to a climax in October 31 when the UK leaves with a deal, crashes out without one, or revokes article 50 and stays in th EU.I stick to my long held view that the UK will be forced to stay in the EU for the following reasons: (1) A deal can not and will not be negotiated between the end of July, when we will know the new PM of UK, and end of October not only because there is no time but because the EU has repeatedly said that the May deal is the only deal on the table (thrice rejected) and will not be changed (2) Crashing out without a deal will be very likely stopped by Parliament and, bluster aside, Boris Johnson, assuming he is the PM, will not go down in history as the PM who crashed UK and then took the blame for the disruption and economic losses this entailed. (3) This leaves revoking article 50 which triggered the Brexit process.It is totally unlikely that B.Johson, if elected PM, will revoke, but the Parliament can but also is unlikely to do so.Coming to the edge without a deal could mean elections, which the Tories will lose, or the Parliament goes for a referendum, which need several months of preparation and choice of wording.Elections or referendum may produce a pro-Remain administration or decision, but

Fact Box: GDP growth, US (red), EU (blue), Japan (Yel), China (green) 2014-2019 % yoy

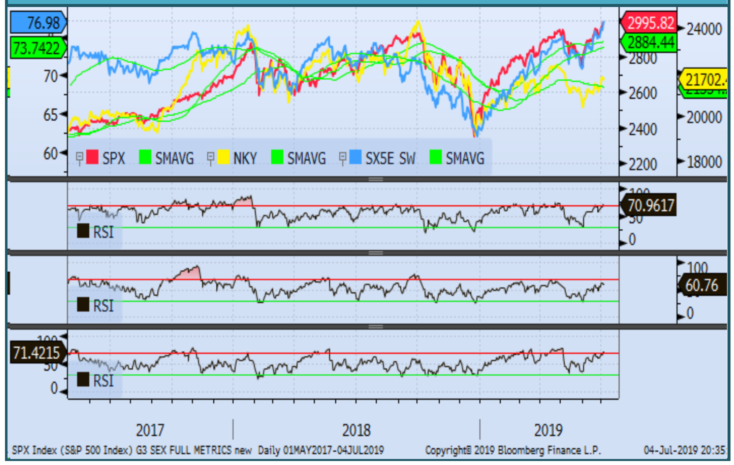


Source: Bloomberg

either of two may force the UK, much to the horror of Macron, to ask for another extension this time of 2 years to sort out the collective mental break down of a once proud, staid and relatively placid country reduced to a gibbering directionless blob. As Hamlet said “I used to be indecisive, but I am not so sure now”. A long extension, a very likely outcome, will be the death of Brexit. I stick to this view not because it suits my firm Remain stance but because of the likelihood that it will happen.

Which brings us to the hot item of **climate change policies**. By now it is well known that during 2018 CO2 emissions accelerated and during 2019 major polluters, such as China and the US, took very retrograde steps. The US just liberated the coal sector, mining and coal-fired power stations, under Trump’s policy of supporting coal and disbelief on the causes of climate change. The 2016 Paris accord appears to be dead as far as the US is concerned after giving notice to withdraw. China, however, which stuck by the Paris agreement and has been

Fig.2: **Stock metrics, US (red), EU (blue), Japan (Yel) 2017-10**



Source: Bloomberg. RSI=Relative Strength Index in order of S&P, Nikkei, SX5E

Are there any conclusions ?

active in its domestic emission and pollution policies, has now been shown to continue with an extensive and active construction program of coal-fired power stations.So has India, where state banks have been active in the financing of these stations.Full page colour ads in the FT accused Japanese banks as being very active in the financing of coal-fired power stations in various countries,Vietnam in particular.Last but not least, the newly elected government in Australia gave the final go-ahead to the enormous Adani coal mine, while S.Africa, beset by crippling power shortages, is finishing the biggest-ever coal-fired power station in the world.Yes, hot, indeed…

The conclusions are that in a confusing world, carefull attention to facts is more important than ever whether it allows a balanced picture of the damage so far of the US-China trade war, or the adherance to emissions policies away from platitudinous press releases.Along the same lines, one can ask whether major economies are or are not under monetary stimulous, and if they are, why is inflation so persistently low ? Meanwhile G3 equities stay supported, not only because of low interest rates, but also because I believe that the negative impact of the US-China trade war has been exagerated.The supply lines disruptions caused by the trade war as well as the sector specific impact have been writ large as pure macro effects, which does not reflect reality.

Andrew Freris (writing completed 30/6 and revised 5/7)