Weekly Update

C0 | EXTERNAL PUBLICATION


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Global trade – Steel yourself

The announcement by Donald Trump of 25% and 10% tariffs on steel and aluminium imports respectively has raised fears of a trade war. This is quite understandable given it is widely thought that the 1930 Smoot-Hawley Tariff Act, which raised duties on over 20,000 imported goods, contributed significantly to the Great Depression.

There are of course significant differences today. First, steel and aluminium imports are small – they represent only 1.6% of US imports – as are those of solar panels and washing machines from China, on which tariffs were raised in January. Second, steel has often been singled out for protection by US presidents – most recently by GW Bush in 2002-2003 – with no discernible long-term impact on domestic jobs or production (see charts). Third, the World Trade Organization was set up (under US leadership) to set rules governing trade disputes between members and to keep tariff barriers on a level playing-field. Finally, the countries which will be targeted have evolved in recent days – initially, the White House said no exceptions, then moved to exempt Canada and Mexico, then Australia – raising hopes that the impact might be diluted.

However, some areas of concern remain. First, the president has claimed that the tariffs are justified on national security grounds, although his own Secretary of Defence has noted that the US military only uses 3% of domestic steel and aluminium output. This could put the US in breach of WTO rules, potentially damaging its credibility if Trump ignores its injunctions.

Second, the president is unlikely to switch tack, unlike GW Bush who cancelled his tariffs after 18 months – he has been a consistent proponent of protectionism for US "rust-belt" industries since the 1980s. With the recent departures of more moderate voices from the administration – Secretary of State Tillerson and chief economic advisor Cohn, for example – policy is now more likely to reflect Donald Trump's core beliefs.

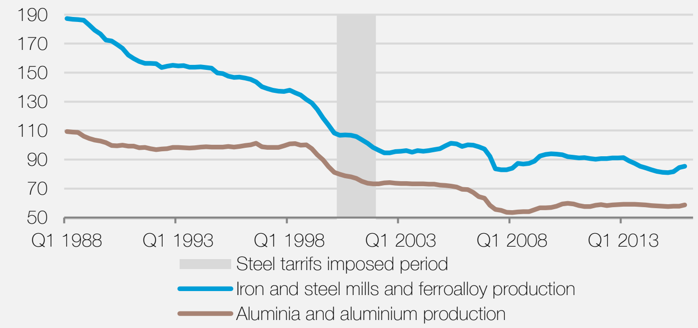
Third, the US trade deficit is indicative of low savings and high consumption, making the US key to global demand. Faster growth breeds higher consumption meaning more imports. Imposing tariffs would also raise costs for consumers of steel and aluminium – the potential negative impact for their 6.5 million employees would far outweigh the positives for the 144'000 employed in the metals' production.

Finally, the Department of Commerce report which recommended raising tariffs is set to be followed by another on China's alleged theft of US intellectual property. While the tariffs on metals are of no importance to China, which does not figure in the top ten exporters to the US, an attack on such "unfair trade practices" is potentially much more damaging. With the European Union already threatening to impose tariffs on over 200 imports from the US if there is no exception on its metals exports to the States, a trade war would inch a step closer.

Bottom line. While the near-term impact of protectionist rhetoric is unlikely to derail markets, trade war worries will not disappear any time soon. Any escalation in tit-for-tat tariffs could hit investor confidence.

In 2002-2003, imposing tariffs had no lasting impact on US jobs

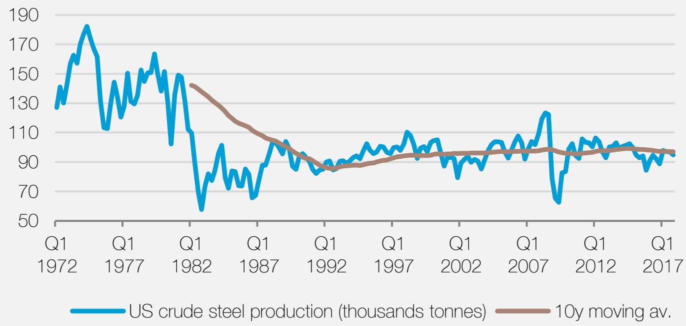
Steel and aluminium employment



Sources: SGPB, Bloomberg, Q1 2018

US crude steel production has been stable for decades

US crude steel production, quarterly data (100 = year 2012)



Sources: Datastream, World Steel Association, Q4 2017

This week and next

EUROZONE

- After a strong Q4, industrial production fell 1% MoM in January vs an expected -0.5%, taking YOY growth to 2.7%, the lowest since April 2017.
- Growth in eurozone employment remained rather steady, printing at 1.6% in Q4 versus 1.7% in Q3.

Next week's key events		*Per.*	*Prev.*	*Cons.*
20 Mar	Consumer confidence	Mar	0.1	0.1
22 Mar	Manufacturing confidence	Mar	58.6	58.2

UNITED KINGDOM

- In January, manufacturing production increased for the tenth consecutive month, rising 0.1% MoM. Production growth has been boosted by exports given stronger global trade.

Next week's key events		*Per.*	*Prev.*	*Cons.*
20 Mar	Consumer prices, YoY	Feb	3.0%	2.8%
21 Mar	ILO unemployment rate	Jan	4.4%	4.4%

UNITED STATES

- Non-farm payrolls surprised on the upside in February, with 313k – a record since mid-2016 – instead of 205k.
- The unemployment rate stayed at 4.1% in February.
- The February CPI was in line with expectations at 2.2% YoY. We expect inflation to be driven higher by strong growth.
- Retail sales in February declined by -0.1% for the third consecutive month.

Next week's key events		*Per.*	*Prev.*	*Cons.*
22 Mar	Initial Jobless Claims	17 Mar	226k	--
22 Mar	Leading Indicator	Feb	1.0%	0.3%

ASIA & EMERGING COUNTRIES

- The YoY increase in Japanese industrial production in January fell to its slowest rate since October 2016 at 2.5%.
- In China, inflation took off in February, reaching 2.9% YoY (40bp more than expected) the fastest pace since late 2013.

Next week's key events		*Per.*	*Prev.*	*Cons.*
22 Mar	Japan: manufacturing confidence	Mar	54.1	--
23 Mar	Japan: consumer prices, YoY	Feb	1.4%	1.5%

Sources: Datastream, Bloomberg, 19 March 2018, Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, ECB = European Central Bank

Our 6-month targets

CURRENCIES & COMMODITIES

	Thursday close	6mth target
EUR/USD	1.23	1.25
GBP/USD	1.39	1.28
USD/RUB	57.4	60
AUD/USD	0.78	0.72
EUR/CHF	1.17	1.18
USD/CNY	6.32	7.1
USD/CAD	1.31	1.37
USD/JPY	106	118
Brent	$65.1	$55
Gold	$1317	$1225

No change to our 6-month targets this week.

Forecast figures are not a reliable indicator of future performance

Question time

Past performance should not been seen as a guarantee of future returns.

EQUITIES
What's your view on Indian equities?

The Indian economy has experienced a slowdown in recent years, with real gross domestic product (GDP) growth down from a peak at 9.1% YoY in Q1 2016 to 5.7% in Q2 2017. Such weakness can be explained by a series of structural reforms to modernize India and fight the shadow economy:

- the demonetization shock in November 2016;
- the introduction of a harmonised tax rate on goods and services (GST) in July 2017; and
- public banks' recent efforts to clean up their balance sheets (large volumes of non-performing loans).

The economic outlook for 2018 looks brighter than last year. The disruption caused by demonetization and the GST is fading and activity is recovering gradually thanks to stronger consumer demand. Real GDP expanded +7.2% YoY in Q4 2017 after 6.5% in Q3. The government has also taken growth-supportive measures (civil servant pay rises, privatizations, increased public spending) ahead of major state elections in 2018 and the general election in 2019.

Against this background, corporate profits should grow faster this year. According to IBES consensus, earnings-per-share (EPS) will grow in the high teens in coming months, a key support for the Indian equity market. However, the market, as measured by the MSCI India, is expensive with a 12-month forward profit/earnings ratio of 17.5x (a 14% premium to the 10-year average) compared to 12.3x for the MSCI Emerging Markets.

In addition, the central bank has recently turned more hawkish on inflation risks due to higher oil prices and the government fiscal boost – financial conditions could tighten as interest rates are hiked. Furthermore, investor sentiment is likely to be impacted by the recent major fraud in the second largest state bank, which raises concerns about financial stability. Finally, investor appetite for Indian equities may be eroded by the mooted introduction of a tax on long-term capital gains on equities.

In the medium to long term, Indian equities should continue to benefit from government efforts to push India's real GDP growth potential above 8%. Efforts to recapitalise state banks and resolve bad loans under the new bankruptcy law will help private credit growth revive gradually and strengthen the public banking sector. The Modi government will likely continue reforming (e.g. real estate, power sector, railways and transportation).

All in all, we believe that the Indian market will likely lag other Asian equity markets in coming months but that it remains attractive in the longer run.

Market performance

Past performance should not been seen as a guarantee of future returns.

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-37 bp	-1 bp	➡	0 bp	-2 bp	-1 bp
3mth Euribor (EUR)	-33 bp	0 bp	➡	0 bp	0 bp	0 bp
3mth Libor (USD)	218 bp	11 bp	⬆	56 bp	48 bp	103 bp
3mth Libor (GBP)	61 bp	1 bp	➡	9 bp	8 bp	26 bp
10-year US Treasury bond	283 bp	-4 bp	⬇	47 bp	41 bp	32 bp
10-year German bond	57 bp	-6 bp	⬇	27 bp	15 bp	16 bp
10-year French bond	71 bp	-5 bp	⬇	21 bp	4 bp	-33 bp
10-year UK bond	146 bp	-4 bp	⬇	28 bp	24 bp	32 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0.0%	➡	-0.9 %	-0.3 %	2.2 %
BAML EURO Corp HY	0.0%	➡	-0.1 %	-0.2 %	5.2 %
BAML GBP Corp IG	0.2%	⬆	-1.6 %	-1.5 %	2.2 %
BAML US IG	0.0%	➡	-2.6 %	-2.5 %	3.2 %
BAML US HY	-0.2%	⬇	-0.4 %	-0.7 %	5.2 %
JPM Global EM Sov. Plus	0.2%	⬆	-1.2 %	-1.7 %	7.3 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1.23	-0.1 %	➡	4.7 %	2.5 %	14.6%
EUR/CHF	1.17	0.0 %	➡	0.6 %	0.0 %	9.0%
GBP/USD	1.39	0.9 %	⬆	4.6 %	3.2 %	13.4%
USD/JPY	106	0.1 %	⬆	-5.5 %	-5.6 %	-6.2%
USD/BRL	3.29	0.6 %	⬆	-0.3 %	-0.8 %	5.9%
USD/CNY	6.32	-0.3 %	⬇	-4.3 %	-2.8 %	-8.6%
USD/RUB	57.4	0.6 %	⬆	-2.4 %	-0.4 %	-1.7%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0.1 %	⬆	-1.4 %	-1.3 %	-0.1 %
United Kingdom (3-7yr)	0.1 %	➡	-1.0 %	-1.0 %	-1.4 %
Germany (3-7yr)	0.2 %	⬆	-1.0 %	-0.4 %	-1.0 %
Japan (3-7yr)	0.0 %	➡	0.0 %	0.0 %	-0.1 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	522	0.6 %	⬆	3.6 %	2.3 %	19.5 %
Eurostoxx 50	3 414	0.0 %	➡	-3.8 %	-2.3 %	3.5 %
DAX	12 346	-0.1 %	➡	-5.8 %	-4.4 %	2.8 %
CAC 40	5 267	0.3 %	⬆	-1.4 %	-0.8 %	9.0 %
S&P 500	2 747	0.4 %	⬆	3.2 %	3.2 %	17.5 %
FTSE 100	7 140	-0.9 %	⬇	-3.7 %	-6.3 %	0.8 %
SMI	8 879	0.4 %	⬆	-4.3 %	-4.1 %	6.2 %
Topix	1 744	2.0 %	⬆	-2.6 %	-4.0 %	13.3 %
IBOV Brazil	84 928	-0.1 %	➡	17.0 %	11.2 %	28.2 %
MICEX Russia *	2 272	-0.8 %	⬇	6.0 %	7.7 %	14.1 %
MSCI EM	1 216	1.8 %	⬆	9.3 %	5.3 %	32.3 %
SENSEX 30 India	33 686	1.0 %	⬆	0.8 %	-0.3 %	16.0 %
Hang Seng (H-K)	31 541	3.0 %	⬆	9.7 %	5.8 %	37.5 %
Shanghaï Composite	3 291	0.1 %	➡	0.8 %	-0.5 %	1.5 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$65	1.6 %	⬆	2.6 %	-2.3 %	25.9 %
Gold	$1 317	-0.4 %	⬇	4.9 %	1.0 %	9.7 %
Silver	$16.4	-0.4 %	⬇	2.5 %	-3.5 %	-2.7 %

Source: Datastream, on 15 March 2018. 1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7 year returns. Figures are rounded.

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