Major Country Developments
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By Byron Shoulton

Overview

The U.S. economy grew at a slower pace than forecast in the first quarter of 2018, confirming a muted start to the year and raising questions over whether the deceleration will carry into the current quarter as trade tensions rise. The economy expanded at an annualized rate of 2% in the first three months of 2018, according to the final reading from the Commerce Department. That compares with analysts' forecast for growth of 2.2%. The revised figure marks a much slower rate of growth than in the final three months of 2017, when the U.S. economy grew at a 2.9% annual pace. It is also the slowest pace in a year. Growth was held back by a slowdown in consumer spending, which grew only 0.9% after clocking 4% in the fourth quarter of 2017.

President Trump is moving forward with more tariffs on imports and restrictions on China's access to sensitive U.S. technology. The two pronged approach is aimed at blocking Chinese imports of advanced U.S. technology, while preventing Chinese companies from investing in U.S. technology companies. Planned investment restrictions are to go into effect shortly. The Administration's decision to move forward with the tariffs and other sanctions against **China, the EU, Canada, Mexico** and other countries, threatens a backlash against U.S. exports. Some worry that the flurry of protectionist policies now being unleashed will help slow the global economy and broadly weaken demand for materials.

The U.S. Administration is blaming speculators for a recent 40% increase in domestic steel prices, arguing that the price increases are far more than is justified by the 25% tariff that President Trump imposed on steel imports earlier this year. U.S. benchmark steel price increases are way above those seen in Europe or Canada over the same period. An investigation has been ordered by the Commerce Department into the recent steel price increases in the U.S. The administration is claiming that intermediaries are stockpiling steel, withholding supplies from the U.S. market and hence driving prices higher. Industry groups are warning that similar price increases are likely on U.S. imported autos and auto parts, should tariffs be imposed as threatened. Rising concerns about auto tariffs reflect the anticipated disruption to the U.S. economy and global trade- if they were to go into effect. It is expected that auto tariffs would be much more disruptive than the metal tariffs introduced so far. The U.S. imported more than $190 billion in cars and light trucks in 2017. It imported less than $30 billion worth of steel.

The Administration have also blamed speculators for recent swings in soybean prices, affecting America's biggest export crop. Soybean prices have tumbled as a result of fears that China will retaliate against U.S. threats of tariffs on up to $250 billion of Chinese exports.

U.S. pork producers have also been caught in the crossfire of the Administration's trade policies with both China and Mexico imposing tariffs on U.S. pork exports. Many producers were already feeling the fallout from the U.S. pulling out of the Trans-Pacific Partnership. **Japan, Canada, Chile and Peru** – four of the six largest pork buyers in the TPP- imported less U.S. pork in the first-half of 2018, according to the U.S. Meat Export Federation. **Australia** bought more U.S. pork, while Vietnam - a smaller market than the others, doubled its pork imports from the U.S. in the same period.

U.S. manufacturer Harley-Davidson announced plans

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to shift more production overseas to avoid European Union tariffs on its motorcycles. Harley prizes its made-in-the-USA reputation as central to its appeal. But the Milwaukee company has opened factories in **Brazil, India and Australia** to tap international markets and hold down prices as sales falter in the U.S. Harley's manufacturing footprint outside the U.S. is set to expand. The company said the 31% tariff the EU enacted on its motorcycles—retaliation for U.S. steel and aluminum tariffs—would raise the cost of each bike it ships there from the U.S. by about $2,200. Rather than raise prices, Harley said it would shift production of the motorcycles it sells in the EU outside the U.S. over the next 18 months. President Trump responded by proposing heavy tax hikes on Harley-Davidson if it goes through with its plans to relocate production outside the U.S.

Canada is preparing to retaliate against U.S. trade sanctions, listing several U.S. made goods that will be subject to tariffs when entering Canada.

The latest moves may provide the U.S. with some leverage in negotiations, however they help complicate the business plans of some U.S. businesses, now forced to interpret what the likely impact of aggressive U.S. tariffs (and the responding counter tariffs) will have on their businesses, on trade flows, competiveness, and relations with major trading partners and allies going forward. Consumers will be hit with higher prices from tariffs, resulting in weakened consumer spending which would slow economic growth.

Meanwhile, U.S. sales of new homes in June hit the second-highest level since October 2007, a welcome sign for a market held back by tight supplies and rising prices. But one month of decent numbers masks a deeper problem: there aren't enough homes being built. Recent data show new home construction is well below historic averages. New-home starts recently touched a recovery-era high, which is good news, but new highs need to be set and exceeded consistently over the next few years – in order to get to the level of building needed to support growing demand that would result in strong sales growth.

Separately, global crude prices may be finding a 'sweet spot' for U.S. shale producers. Oil-producing regions of the U.S. are surging now that the U.S. is pumping record volumes of crude (10.9 million barrels a day during the second week of June). That is helping the U.S. economy to grow, while redefining the sweet spot at which oil prices are positive for U.S. consumers and producers alike. The cost of a barrel of crude has risen roughly 60% in the past year. That's a burden on consumers, who have to pay more at the pump, and feeds through the broader economy as businesses raise prices to cover higher manufacturing and transportation costs. Yet the economy is still relatively strong. Bottom line: more-expensive crude is far less of an economic drag than it once was. Still, oil prices rose in June after OPEC and its allies agreed to begin increasing production, albeit less than was anticipated.

China

Chinese President Xi Jinping is responding to U.S. proposed trade and investment restrictions with equal vigor, making an aggressive trade fight much more likely. Mr. Xi told heads of American and European multinationals that Beijing plans to strike back against U.S. trade restrictions. While China's tariff options are limited, Beijing can hold up mergers & acquisition deals involving U.S. companies, delay licenses, ramp up inspections; and it could encourage China's one billion-odd consumers to shun American products. Beijing's aggressive defense is dashing hopes of an early settlement to the trade dispute -

while the White House insists it's about to roll out new tariffs on $34 billion of Chinese goods. In response, China plans to impose levies on U.S. soybeans, energy and other products of the same value. China also indicated that it will increase domestic production of certain crops (e.g. soy) to break its reliance on imports going forward.

After China's central bank in late June reduced the amount of cash it requires banks to hold in reserve, the Chinese currency fell to its weakest level against the dollar so far this year. The move frees up $100 billion for Chinese banks to boost lending while the weakened currency will make Chinese exports cheaper in global markets. This will further inflame trade tensions. The yuan's fall has gathered pace since the U.S. and China stepped up mutual tariff threats in June. Market participants expect the yuan to keep falling, but if it were to tumble too much, that would likely spur capital outflows from China. This is not a trend that Chinese officials want to see develop – as it would be a repeat of the pressure on the currency which led to a surprise yuan devaluation in August 2015. Many observers are vying for a negotiated settlement rather than an all-out trade war between the U.S., China and other trading partners. However, if more tariffs are implemented there is a better than fair chance that the Administration's tariff policies will result in a gradual slowdown of the global economy. Negotiations will take place even in the midst of the current tussle over tariffs, and will likely last over several years. Without major concessions, there is a growing consensus that the global economy could slowly wind into recession should a full-blown trade war ensue.

A recent Bank of America Merrill Lynch survey indicates that foreign investors are likely to buy fewer U.S. government bonds if there were to be a full-blown trade war. That's because central banks won't need to invest as much in the U.S. given that their countries won't make as many dollars from international trade. Other analysts say the fall in investment would be a sign of retaliation against U.S. protectionism. China, for example, as the U.S. biggest creditor, bought an accumulation of U.S. bonds as international trade grew in the 1990's onwards. The dollar is the most commonly used currency in global trade, so dollars that China accumulated were invested by reserve managers. Hence, lower global trade volumes should result in a slowdown of global reserve accumulation, which would result in a weakened need to spend dollars on U.S. assets.

Eurozone

Eurozone businesses remained upbeat in June, even while new tariffs were imposed on trade between the EU and the U.S., amid fears that more will likely follow.

The European Commission says that measures of confidence among manufacturers and service providers were unchanged from May, notwithstanding a drop in consumer and business sentiment – to 112.3 from 112.5 in May. The resilience of business confidence in the face of rising trade tensions will come as a relief to the European Central Bank, which has expressed concerns that the threat of greater protectionism could make businesses more cautious in both their investment and hiring plans. According to the European Central Bank, the implementation of higher trade tariffs and the possibility of wider protectionist measures represent a key risk to global growth momentum. The steadiness of sentiment also suggests that a period of slowing growth may be coming to an end, following surveys of activity released last week that recorded a first rise in business activity in June after four months of softening. The ECB earlier this month cut its growth forecast for 2018 in response to a weak first quarter, but policymakers nevertheless said they expect to end a program of bond purchases known as quantitative easing in December. This is based on their view that growth would continue to be solid and broad-based.

There are other signs that the trade conflict has yet to dampen confidence. Figures released by the ECB show businesses increased their borrowing by $30

billion in May, representing an increase of 2.7% from a year earlier. The EU retaliated to U.S. imposed tariffs on steel and aluminum imports from the EU by placing its own tariffs on $3.25 billion of imports from the U.S., including bourbon and Harley Davidson motorcycles. The U.S. subsequently repeated the threat to place tariffs on European cars. European policymakers don't expect those measures to have a significant impact on Eurozone economic growth. They cite the lack of friction between the EU and emerging markets or with other of the EU's trading partners. As long as frictions are absent across those lines, the chances are high that the global recovery can continue, they argue. The expansion may be a bit slower than 2017 but the outlook remains upbeat.

Turkey

President Recep Erdogan was reelected in June with 53% of the vote. The Turkish President's decision to call elections 18 months before he needed to was not without hazard. But a delay would have been riskier still. Turkey is in deepening economic trouble, and the longer the president waited, the more vulnerable his plans to monopolize power.

For now Erdogan's gamble has paid off. Having won a majority in the June 24, 2018 elections, he now assumes the all-powerful executive presidency that was publicly, if controversially, endorsed by referendum in 2017. Very few observers regarded the recent polling as being fair. President Erdogan was campaigning from a position of maximum power, with control of the media, the courts, and with the powers of a state of emergency in place since a 2016 coup attempt.

The main concern is that Turkey may be entering an uncertain period of one man rule. Mr. Erdogan will have much to contend with. The new Turkish constitution strips government of a prime minister, weakens parliament and gives the presidency executive powers. Even strongmen need scapegoats. Going forward Mr. Erdogan will shoulder the blame alone when things go wrong; and there is much on the horizon that could turn badly. The economy is vulnerable and faces some immediate tests. Some regard the banking sector as fragile, having borrowed heavily in dollars before the lira began its steady slide. A fine by the U.S. Treasury on the part of state-owned bank Halkbank over Iran sanctions-busting is pending. This could turn into billions of dollars and compound collapsing relations with Turkey's western allies. The more these relations worsen, the more Mr. Erdogan has become reliant on former adversaries, namely Russia and Iran. Yet Turkey depends on Europe for the vast majority of trade and investment. Then there is Ankara's military adventurism in Iraq and Syria, where the threat of a flare-up on the border is considerable.

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Following the election results, rating agency Moody's commented that Turkey's vulnerability had been exacerbated by expansionary fiscal and monetary policies over the last two years, adding that the ability to reverse that trend rests completely in president Erdogan's hands.

Latin America

Colombia elected a new youthful president, Ivan Duque, who promised a new generation of leadership for a country that has been dominated by a long-established elite and is still emerging from half a century of civil conflict.

Argentina's economy grew slightly faster than expected in the first quarter of 2018 (3.6%), ahead of the country's decision to seek financial assistance from the IMF. Argentina's Treasury and finance minister have assured markets that the government will meet tough new targets for lowering the 2019 fiscal deficit, as it defends the decision to seek the $50 billion IMF assistance.

Policymakers at Brazil's central bank stood their ground and left benchmark interest rates unchanged following a brutal sell-off of the currency (the real) in June, which spurred debate over whether Brazil would need to increase interest rates. Multinationals operating in Brazil are counting the cost of a nationwide truckers' strike which brought the country to a near standstill, disrupting supplies and hitting Latin America's largest economy. Several multinationals have reported declining revenues as a result of the strike, which ended only after the government offered drivers subsidized diesel fuel. With elections due in October 2018, the episode has raised questions over perceptions of political risk amid fears that Latin America's largest economy does not have the political will for tough fiscal reforms – which is essential to restoring sustained growth. The offering of a subsidy to striking truckers was the opposite of the type of changes that economic experts believe is needed in Brazil. Nonetheless, the impact of the strike on daily life caused political reality to kick in.

Fuel prices in Brazil have been hit by a combination of surging global oil prices and the depreciation of the country's currency, the real, against the dollar. Diesel pump prices began rising daily, leading truck drivers to revolt. The public overwhelmingly supported the strikers against the government of President Temer (one of the country's most unpopular presidents in history, according to polls). With growing calls from congress to interfere in state-controlled energy giant Petrobras's pricing policy, the company's chief executive resigned. The result has been an increase in Brazil's risk premium. Petrobras stock lost about 36% of its value and the real hit two-year lows against the dollar.

Brazil's economy is still struggling to recover from its worst recession in history in 2015-16. Growth in 2017 registered a tepid 1%. The next government will need to rein in Brazil's over-generous pension system that is swelling the budget and hampering growth. At this point, there appears to be no clear frontrunners in the October elections. Populists from the left and right are leading in the polls, while centrist reform-minded candidates are barely being recognized.

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FCIA's Deals Of the Month

Multibuyer Non-Cancelable Limits Policy: A Key Account Non-Cancelable Limits Export Policy with a $30,000,000 Limit of Liability used to support a bank facility.

Multibuyer Non-Cancelable Limits Policy: A Non-Cancelable Limits Export Policy supporting $10,000,000 of software to Europe.

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If you are a company selling products or services on credit terms, or a financial institution financing those sales, you are providing trade credit. When you provide trade credit, non-payment by your buyer or borrower is always a possibility. FCIA's Trade Credit Insurance products protect you against loss resulting from that non-payment.

* ***Non-Cancelable Limits:*** *Subject to policy terms and conditions, after issuing the policy, the insurer may not unilaterally reduce any country or buyer limits.*

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