

Economy

Focus US

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Protectionism: a political tool more than a trade tool

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Donald Trump's diatribe against Mexico is just a foretaste of what is to come. The whole planet is more worried about the future of relations between the US and China. The US trade deficit with this country is due in large part to the fact that China is at the end of the value chain. This overestimates the value of US imports from China. For its part, China has its own brand of economic patriotism. It has long pursued a mercantilist foreign-exchange policy, but this is no longer the case today. All in all, the stage is set for a political confrontation between the US and China, and trade is only an excuse here.

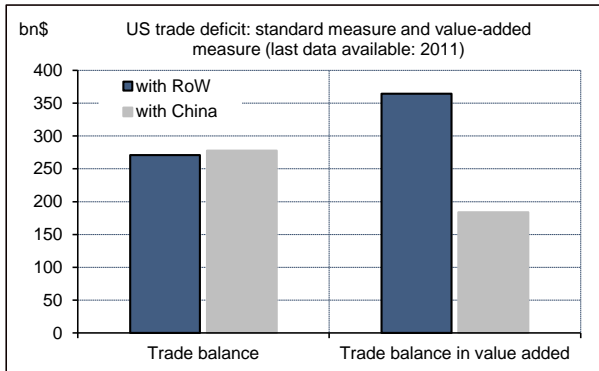
The week's focus

America First was the central theme of Donald Trump's inauguration speech, continuing his hostile stance on free trade announced during the campaign. For Trump and his advisors, international trade is a zero-sum game. From the US standpoint, a deficit is a sign of weakness and a surplus the sign of unfair competition. It is never acknowledged that there are mutual benefits to trade. In this way of seeing things, China's case is clearly intolerable. The bilateral deficit in 2016 was \$ 350bn, out of a total US deficit of \$ 500bn. China is the assembly point for many products exported to the US. The value of its exports largely overestimates its contribution in terms of value-added. Stripping out this effect, its surplus would be around a third lower (left-hand chart). It is worth noting that a similar effect is visible on US-Mexican trade.

The other grievance commonly heard in the US about China concerns the exchange rate. It is widely acknowledged that China long intervened to keep its currency weak in a bid to gain market shares. Recently, however, intervention by Chinese monetary authorities has mainly consisted in slowing the yuan's depreciation. Since 2014, capital outflows have gathered pace in China, pushing the yuan downwards and the trade surplus upwards, all else being equal. Over the same period, the PBoC has dipped into its foreign-exchange reserves to boost the currency and to avert a sharp depreciation. Its reserves fell by \$ 513bn in 2015 and by \$ 320bn in 2016. This mainly took the form of sales of US Treasuries (right-hand chart). This behaviour by Chinese authorities is not, of course, impartial. It mainly aims to preserve the yuan's image as a relatively stable currency and to reassure people about the state of the Chinese economy.

In response to Trump's protectionist rhetoric, the Chinese President struck the opposite tone at the last Davos summit. Each has tools to destabilise the other (import tariffs against currency manipulation). Two losers in sight?

US trade deficit: vs. China and vs. the rest of world



Sources: Thomson Reuters, OECD, Oddo Securities

China: holdings of US Treasuries



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Economy

- Business confidence continued to improve in the manufacturing sector in **January**. The Markit PMI-manufacturing index gained 0.8pts to 55.1. Regional indices improved overall. The oil sector also continued its recovery. The number of rigs in operation increased last week to 551 (+29 units), the highest level since 2015, although this is still well short of the records set in 2014 (around 1,600 units). Lastly, sentiment continues to improve in the services sector. The PMI index rose by 1.2pts to 55.1. Here too, there was an improvement in regional indices in the districts of New York, Philadelphia and Richmond.
- The latest figures in the residential housing sector were mixed, but keep in mind that they are volatile from one month to the next. Existing home sales fell by 2.8% in **December**. While sales were roughly flat on an annual basis (+0.7%), supply pressures continue to grow. The number of homes for sale was down sharply from a year earlier (-6.3%). On a 12-month average, inventory levels cover 4.3 months of sales, close to the level seen in 2005. There are good reasons to stimulate production. New home sales plunged by 10.4%, taking them back to their year-earlier level.
- According to an advance report, the trade deficit in **December** stood at \$ 65bn. This fairly stable level should not overshadow the acceleration in trade, up 3% in December for exports and up 1.8% for imports. In addition, inventories grew by 1% at wholesalers and were stable at retailers. All these figures paint a positive picture of the state of both domestic and external demand.

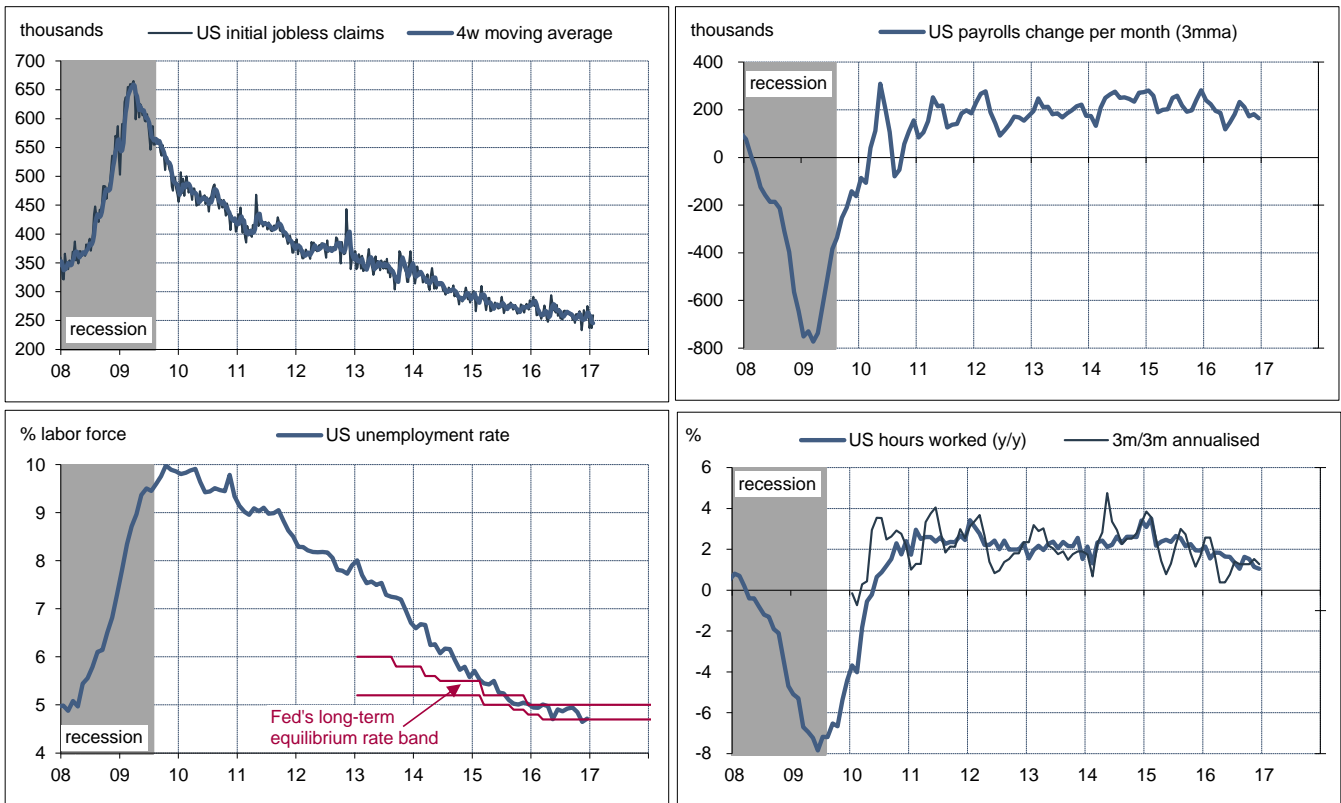
Monetary and fiscal policy

- After his inauguration on **20 January**, the new President spent the week staging the signing of his first executive orders. In the economic area, the most symbolic measure was the withdrawal from the *Trans-Pacific Partnership*, a free trade agreement that had not come into force yet anyway. It aimed to strength US trading ties with countries in Asia (Japan), the Pacific (Australian and New Zealand) and South America (Chile and Peru). One of the goals of this agreement was also to contain China's influence in this region. It is therefore quite possible that Chinese leaders will be very pleased with this decision.
- It was known that Mexico would be a top target for Trump from the moment he came to power, as so it has proved. Tired of his threats, the Mexican President announced on Twitter that he was suspending a scheduled visit to the White House. We can sympathise. Mexico is the United States' third-largest trading partner after China and Canada.
- Other economic decisions relating, for example, to the federal budget, the renegotiation of NAFTA or accusations of Chinese currency manipulation will have to wait until members of the Trump cabinet are confirmed by the Senate. Of the 15 members who have been named, only two have actually taken up their positions: Defence Secretary James Mattis and the Secretary of Homeland Security John Kelly. As such, there is still no Treasury Secretary in place.

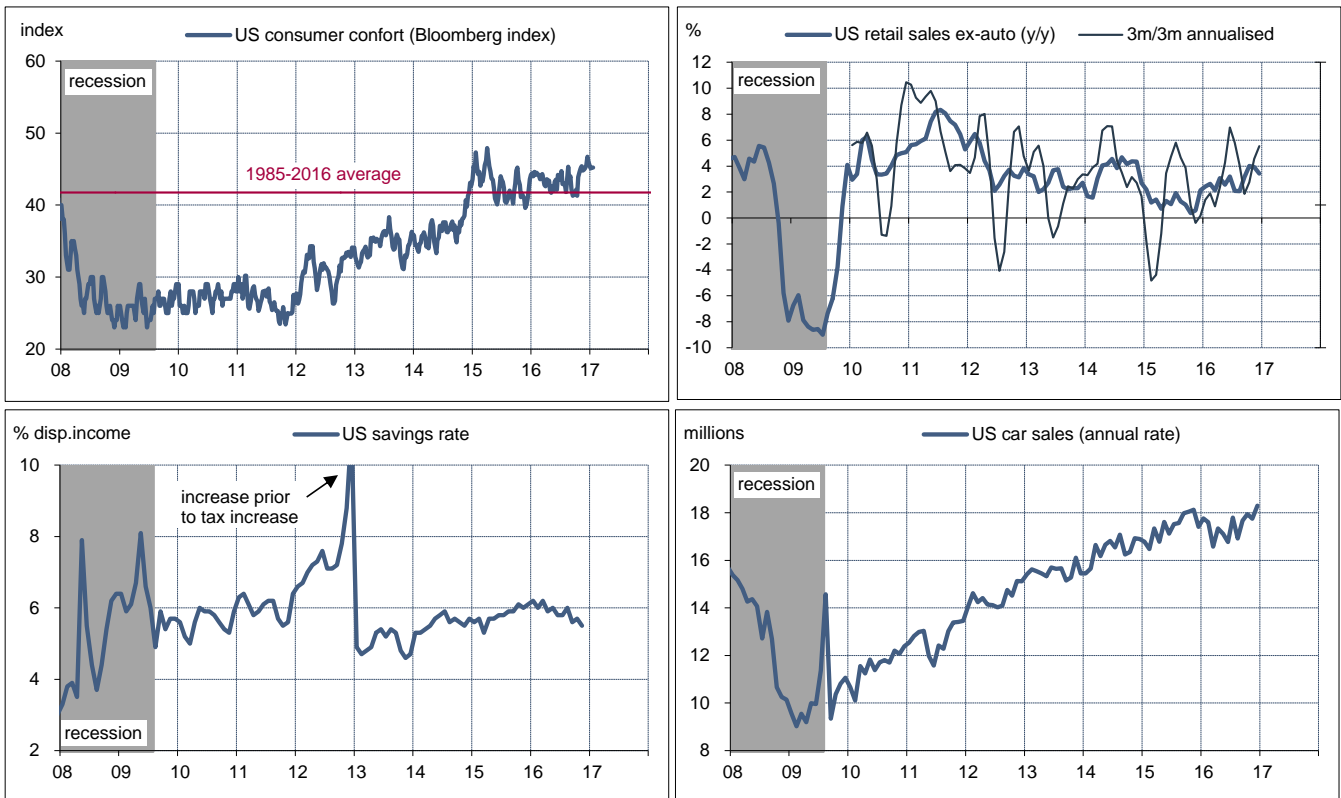
The week ahead

- The next FOMC meeting is scheduled on **1 February**. No monetary policy changes are expected. The futures market puts the probability of a hike in the federal funds rate at just 15%. This rises to 38% by the March meeting, to 53% by May and to 74% by June. The press statement will probably note simply that figures published since the last meeting were solid overall. The unemployment rate is below 5% and CPI inflation is around 2% (an annualised 1.4% for the PCE index and 2.1% for the CPI). In view of the uncertainties surrounding promised changes to fiscal and trade policy, the Fed has no reason to deviate from its current plan to raise rates two or three times this year.
- Many macro figures are due out next week, as always at the start of the month. Attention will focus as usual on consumer confidence (31 January), the ISM-manufacturing index (1 February) and the job market report (3 February). Given the preliminary data available (see *above*), business confidence should improve. The decline in initial jobless claims to 234,000 over the reference week in January suggests that the unemployment rate could fall further, but the consensus forecasts a stable rate of 4.7%.

Appendix 1 - Labour market

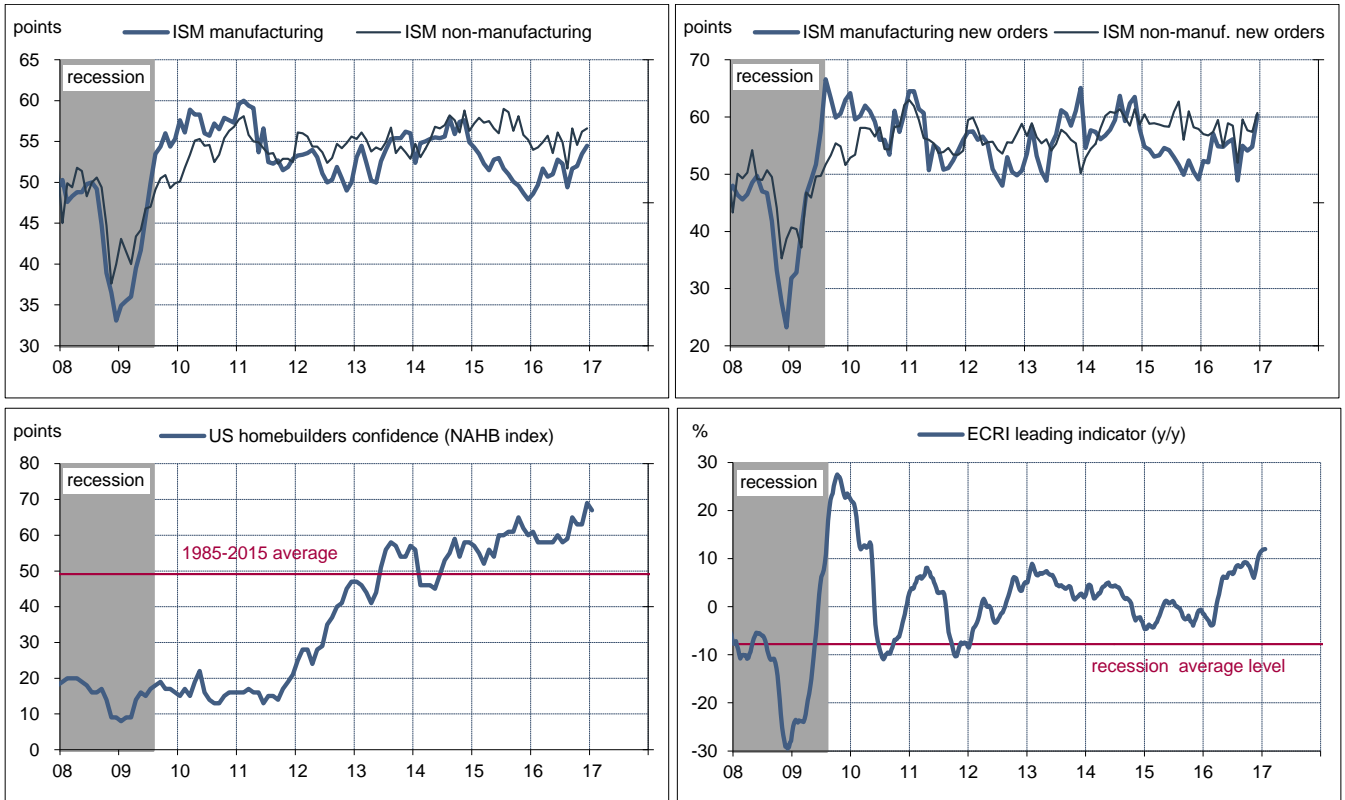


Appendix 2 - Consumer

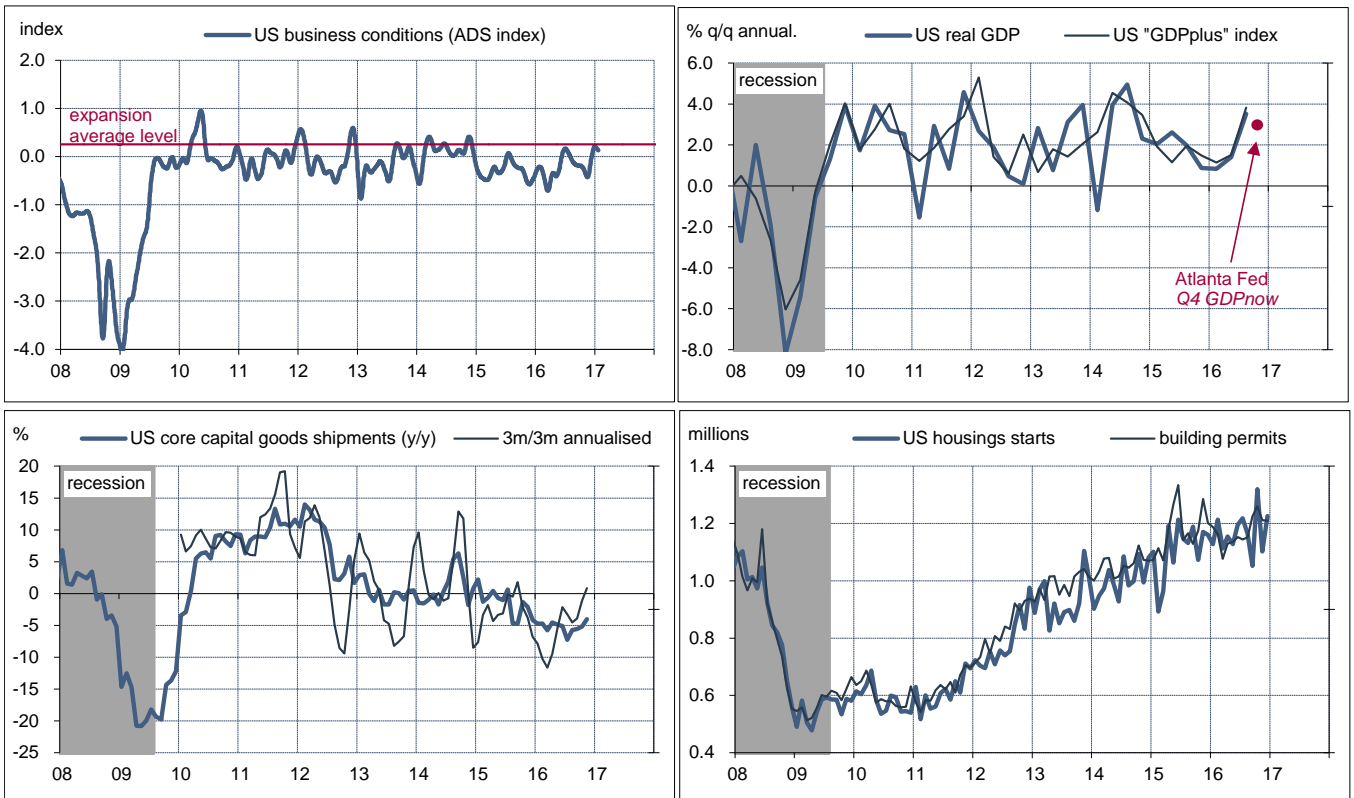


Sources : Thomson Reuters, Bloomberg, Oddo Securities

Appendix 3 - Business climate

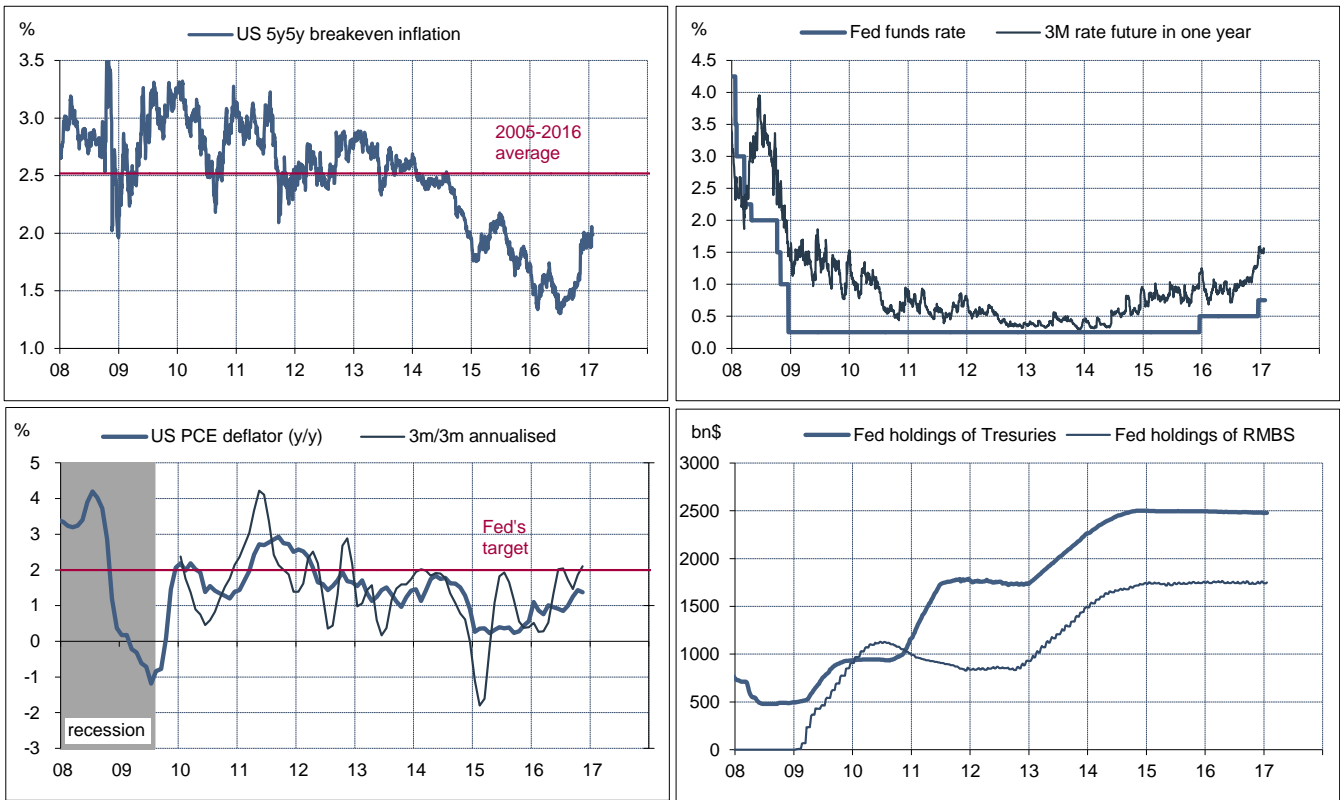


Appendix 4 - Conditions of economic activity

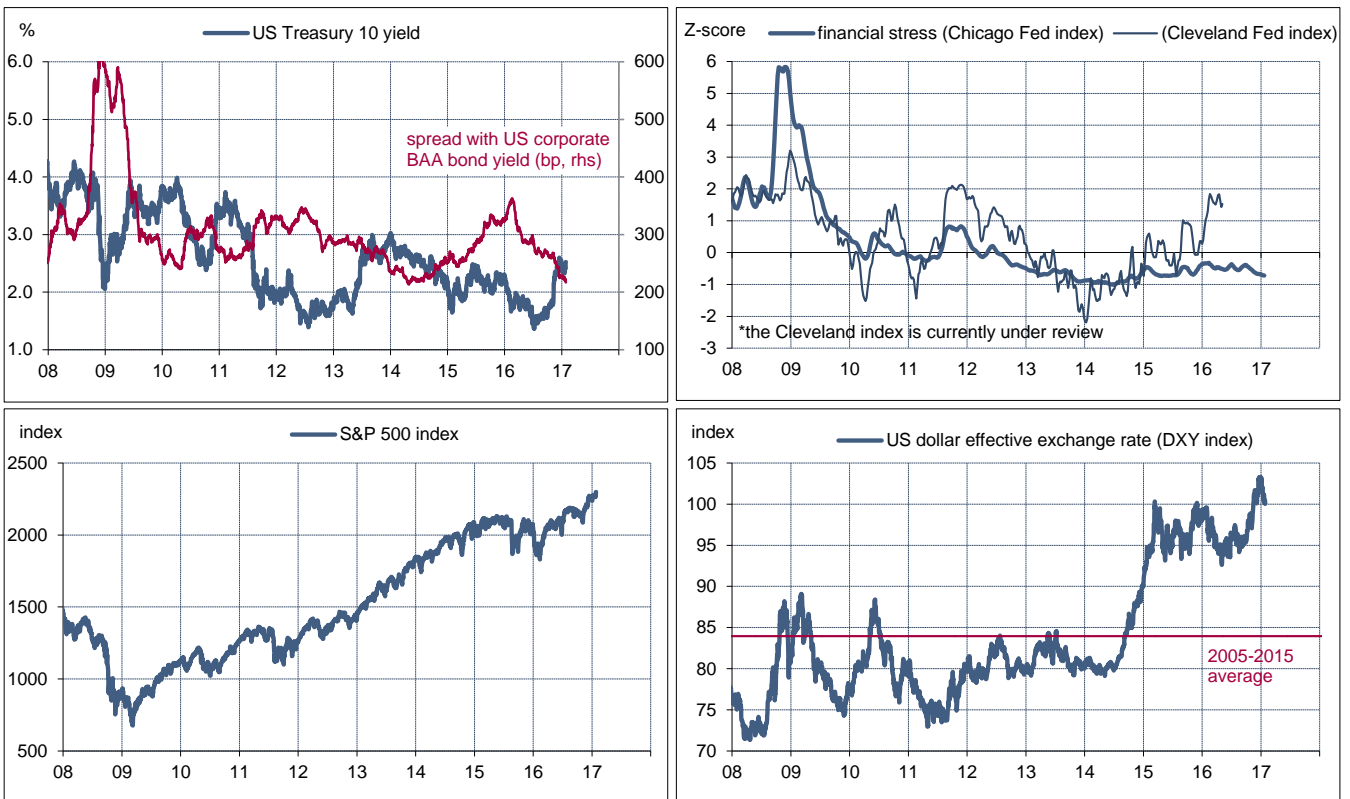


Sources : Thomson Reuters, Bloomberg, Oddo Securities

Appendix 5 - Inflation and monetary policy



Appendix 6 - Financial markets



Sources : Thomson Reuters, Bloomberg, Oddo Securities

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