

MARKET UPDATE: EU OFFICIALS BACK PRIME MINISTER AS TRADE TENSIONS BETWEEN US AND CHINA SIMMER

17th September 2018

LAST WEEK – KEY TAKEAWAYS

UK politics: Encouraging remarks from the EU bolster Prime Minister

- Sterling strengthened on Monday as the EU's chief Negotiator Michel Barnier claimed a Brexit deal could be agreed by November;
- In a further boost for Prime Minister Theresa May, outgoing European Commission President Jean-Claude Juncker hailed her Chequers proposal as a starting point for a post-Brexit free trade area;
- Eurosceptic Conservative MPs met on Tuesday to discuss replacing the Prime Minister, although leading Brexiteers including David Davis and Jacob Rees-Mogg expressed their support for Mrs May, claiming they believe she is doing a good job and they only disagree with her Brexit policy;
- Eurosceptic Tories abandoned plans to publish their blueprint for the UK's relationship with the EU after Brexit due to differences over key issues, but they did outline a proposal for managing the Northern Irish border;
- Bank of England (BoE) Governor Mark Carney warned government ministers a 'no deal' Brexit might lead to turbulence in the UK economy, including a material drop in house prices, but he suggested growth could outperform current forecasts if a deal is agreed based on the Chequers proposal;
- **Omnis view: We continue to believe a soft Brexit is the most likely outcome, at least temporarily. This would be a more positive scenario than the market currently expects, offering the potential for UK equities to rebound. We recently reduced our underweight to UK equities in discretionary portfolios to reflect this potential.**

UK economy: Bank of England leaves rates unchanged, commits to gradual tightening

- The BoE's Monetary Policy Committee voted unanimously to keep interest rates at 0.75% following its meeting on Thursday and committed to gradually increasing rates subject to a 'smooth adjustment' to Brexit;
- There was good news for the UK economy as wage growth picked up in the three months to July, increasing 2.9% on an annualised basis¹;
- The unemployment rate remained at a record low of 4% over the same period, according to the Office for National Statistics²;
- **Omnis view: Despite better than expected economic data, we would question whether higher interest rates are needed. We believe further hikes are unlikely before the UK formally leaves the EU in March. Nonetheless, tighter monetary policy would support the pound.**

Global trade: Trade tensions between US and China continue to simmer

- US Treasury Secretary Steve Mnuchin sought to arrange a meeting with senior Chinese officials in an effort to defuse trade tensions before President Trump imposes the next round of tariffs on \$200 billion of Chinese goods;
- However, President Trump adopted a contradictory tone, expressing indifference to any meeting with China tweeting that the US is under 'no pressure to make a deal';
- Research by the US chambers of commerce in Beijing and Shanghai showed over 60% of US companies operating in China have been affected by trade tariffs, and a third are considering moving their manufacturing out of the country³;
- China asked the World Trade Organisation for permission to impose sanctions on the US of \$7 billion per year in response to a dispute about anti-dumping duties stretching back to 2013;
- Meanwhile, the US hopes to agree at least a partial trade deal with the EU by November, and Mexico's Finance Minister said his country is willing to sign a bilateral trade pact with the US if Canada cannot negotiate terms for its continued participation in the North American Free Trade Agreement;
- **Omnis view: Trade tensions between the US and China are having an increasing impact on the global economy. Supply chains are being disrupted, companies are postponing or cancelling investment decisions, while inflationary**

¹<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/september2018#average-weekly-earnings>

² <https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment/timeseries/mgsx/lms>

³ <https://www.amcham-shanghai.org/sites/default/files/2018-09/2018%20U.S.-China%20tariff%20report.pdf>

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pressures could build, forcing central banks to tighten monetary policy. However, President Trump's entrenched position on trade, combined with his confrontational negotiating strategy, means a rational outcome may take some time to materialise unless his policies are curtailed by poor mid-term election results for the Republicans.

EU: Concerns ease over Italian budget as European Central Bank keeps interest rates on hold

- Italian Foreign Affairs Minister Enzo Moavero eased concerns about the country's upcoming budget, signalling the coalition government intends to comply with EU rules on spending;
- The European Central Bank decided to leave interest rates unchanged at its meeting on Thursday and until the summer of 2019 at the earliest, and it confirmed it will reduce its programme of quantitative easing to €15 billion from October before bringing it to a halt at the end of the year;
- There was no clear winner in the Swedish elections, as the centre-left and centre-right parties ended up with a similar number of seats and no majority, meaning the populist Sweden Democrats could influence the formation of the next government;
- **Omnis view: Despite Mr Moavero's reassurance, we have reduced our overweight position in EU equities due to the uncertainty about the Italian budget and the potential impact on the European debt markets. Nonetheless, we believe the economic outlook in the EU is improving, so we may reverse this move once the coalition government announces its budget in October.**

Emerging markets: Currencies creating headaches for policymakers

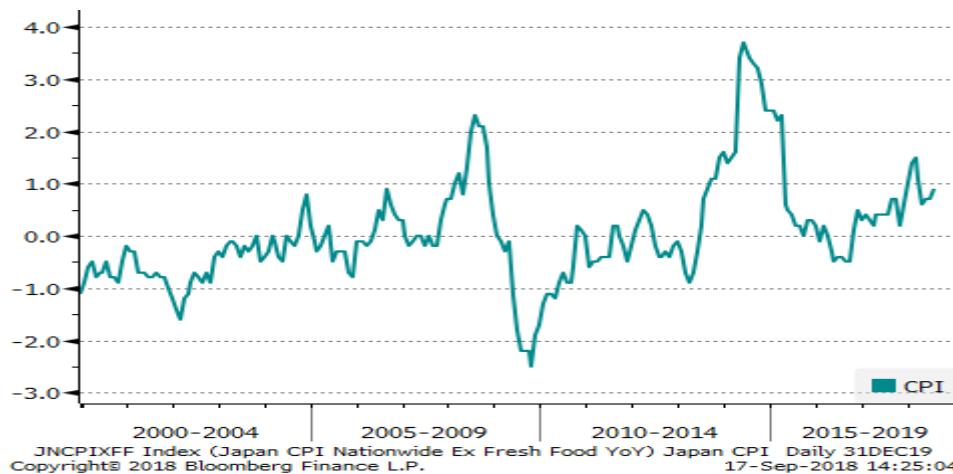
- Turkey's central bank defied President Recep Erdoğan and raised interest rates to 24% to combat spiralling inflation and to strengthen the Turkish lira which has weakened considerably against the US dollar this year;
- As expected, Argentina's central bank decided to leave interest rates unchanged at 60% and announced it intends to maintain the same rate until December at the earliest;
- Elsewhere in emerging markets (EMs), the Russian rouble weakened to its lowest level since 2016 amid concerns about the independence of the country's central bank, while election uncertainty put pressure on the Brazilian real;
- **Omnis view: Continued turbulence may hinder sentiment in EMs, although there was a positive development in Turkey as the central bank forged ahead with raising interest rates. We still believe the risk of contagion is limited, and EMs remain attractively valued, but we reduced our position in portfolios due to the strength of the US dollar and the unpredictability of the Trump administration.**

LOOKING AHEAD - TALKING POINTS

Economic data: Inflation data in the UK and interest rates in Japan

- UK inflation is expected to tick up when the Office for National Statistics publishes August's annualised figure on Wednesday;
- The Bank of Japan announces its latest interest rate decision on Wednesday, while Japanese balance of trade data is released on Wednesday followed by inflation data on Friday;
- **Omnis view: Inflation is expected to increase in the UK, with the services sector and wage growth driving the UK economy. However, we do not expect UK rate increases in the near future. Similarly, we do not expect the BoJ to change rates this week.**

Japanese Consumer Price Inflation (% , Year-on-Year)



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EU leaders meet on Wednesday

- EU leaders meet in Austria on Wednesday for a two-day summit, where they will discuss their plans for agreeing a Brexit deal with the UK by November;
- The Prime Minister will also update her EU counterparts about her Brexit plans at the meeting;
- **Omnis view: While we do not expect any firm conclusions from the summit, any greater clarity or softening of rhetoric will be welcomed.**

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