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Global Macro 360

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Weekly Note: New Year, New Prospects for Global Trade

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The key question in the 2018 economic outlook is how to think about fiscal policy. One perspective is that the tax cut will boost growth by an estimated 0.3pp in both 2018 and 2019. Moreover, it is believed that increased federal spending might contribute a similar amount, for a total fiscal contribution of just over 0.5pp. This is not a huge amount by historical standards. Another perspective is that the policy shift is more significant than suggested by these numbers because it comes at a time when the deficit is already large relative to the low (and falling) unemployment rate. From this perspective, the fiscal expansion—of which the tax cut is one important part—looks like a very important reason to expect stronger near-term growth and, ultimately, tighter monetary policy.

TABLE 1 THIS WEEK IN MARKETS

Name	YTD %	MTD %	WTD %
DOW JONES	2.28%	2.28%	2.28%
S&P 500	2.77%	2.77%	2.77%
RUSSELL 2000	1.71%	1.71%	1.71%
NASDAQ COMPOSITE	3.68%	3.68%	3.68%
Euro Stoxx 50	3.21%	3.21%	3.21%
FTSE 100	0.11%	0.11%	0.11%
DAX 30	3.48%	3.48%	3.48%
NIKKEI 225	4.92%	4.92%	4.25%
HANG SENG	3.42%	3.42%	1.39%
S&P/ASX 200	1.26%	1.26%	1.32%
EUR-USD X-RATE	-0.30%	-0.30%	-0.75%
EUR-GBP X-RATE	0.69%	0.69%	0.60%
Gold Spot $/Oz	1.14%	1.14%	0.00%
Crude Oil	2.91%	2.91%	3.00%

To this end, the most important takeaway from the December FOMC meeting was the upward move in the 2020 median dot to 3.1%, more than one hike above the (unchanged) 2.75% median longer-term dot. In our experience, many market participants use the longer-term dot (i.e. the Fed's estimate of the neutral rate) as shorthand for the expected terminal funds rate. However, most Fed officials view these two concepts as distinct, and they now expect the terminal rate to overshoot the neutral rate significantly. Our own view remains that the funds rate will rise faster and higher than suggested by the dots, partly because we have a lower unemployment forecast than the committee. But even the Fed's view suggests that market pricing for the funds rate path remains too low.

The US Dollar had a weak finish to 2017 and a poor start to this year. It's arguably the greenback's performance since last August that has been the most striking. Since that time, the Federal Reserve raised the funds rate again and began the process of shrinking its balance sheet. On top of this, the prospects for tax reform went from dim to done deal and the US economy chugged along at an annualized growth rate of 3-4%. Yet despite the robust macro news, the trade-weighted Dollar essentially moved sideways. We expect 2018 to look much the same: solid US growth, continued rate hikes from the Fed, but a Dollar moving in unpredictable ways.

US protectionism was the dog that did not bark in 2017 yet remains a risk still in 2018. Despite the concerns after Brexit and the Trump election in 2016, 2017 was actually a good year for global trade. The US did announce a withdrawal from the Trans-Pacific Partnership and a renegotiation of NAFTA, but existing trade relationships were not really disrupted, and trade integration has continued to deepen in other parts of the world. So we remain guarded optimists on the prospects for global trade, but as was the case at the start of 2017, 2018 starts again with the threat of US protectionism. In particular, the Trump Administration looks likely to announce several trade restrictions in the coming weeks. The two most important are the decision in the Section 301 investigation regarding China's intellectual property practices, which looks likely to result in the imposition of new tariffs and potentially other restrictions, and a potential announcement of intent to withdraw from NAFTA if late January negotiations fail to yield progress. Such action may be a headwind to CNY which has been strengthening of late alongside other Asian currencies. There is however a more material risk to the Mexican Peso given the upcoming presidential elections, and the institutional anchoring that NAFTA provides to that country.