Macro Readings

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The Week that was …

- U.S. reached a trade deal with the U.K. and agreed to trade talks with China
  - U.S. agreed to lower tariffs on select imports from the U.K. in exchange for fewer nontariff barriers against U.S. exports. This outcome is far from the sub-3% tariff rate that the U.S. previously enjoyed.
  - US and China agreed to slash their massive recent tariffs, restarting stalled trade
- The Federal Reserve left the fed funds rate unchanged this week, as expected, and flagged risks of higher inflation and unemployment.
  - In this season of uncertainty, it was encouraging to hear Powell characterize the economy as “resilient and in good shape.”
  - He was transparent about looming economic threats but acknowledged that the magnitude of risks depends on where tariffs ultimately land pending the outcome of trade negotiations.
- Key economic readings related to the services sector, which represents more than 70% of the economy, were mixed but remain in expansion territory.

Soft data vs Hard Data

- Soft economic data refers to surveys, sentiment indicators, and expectations, such as consumer confidence, business outlook surveys, and Purchasing Managers' Indexes (PMIs). Less reliable but usually much more timely.
- Hard economic data refers to measurable and objective metrics like GDP, employment readings, retail sales, and industrial production. Hard data is much more reliable but arrives after the fact.
- Right now, there are mixed signals. The soft data mostly screams “beware”. The hard data is mostly benign.
- Whether survey-based indicators have lost their touch is still up for debate—and probably a question that only applies to this unique cycle. There is some debate about whether the hard data will ultimately follow the soft data, however.
- This primarily stems from what occurred in 2022, when soft data weakened precipitously in the wake of the Russian invasion of Ukraine, the regional bank crisis and elevated inflation, while the hard data largely held up.
- This period came to be known as the “vibecession.”
- Even though many Americans didn’t feel great about the health of the economy, their continued strength on the back of a healthy labor market, prior fiscal support and residual pandemic savings powered the economy forward.

Historical Precedence

- In fact, several elements of the 1973–75 recession rhyme with the current environment. quickly recap: an expansion in fiscal spending in the mid-1960s — to finance the Vietnam War and the Great Society social welfare programs — helped to push up inflation.
- This was compounded by loose monetary policy, which led foreign investors to question the sustainability of the gold standard. A run on the dollar was followed by the move off the gold standard, along with wage and price controls, and eventually an oil crisis.
- Interestingly, however, while soft data (ISM New Orders) and hard data (Retail Sales, Profit Margins) began to worsen on the dashboard as the energy shock unfolded in the mid-1970s, it was the soft data deteriorating to red first, while the hard data held up in yellow territory, initially.
- There are key differences between that period and today as well, such as: the U.S. is no longer on the gold standard, today's U.S. shale industry has provided an offset (economically) to the negative impacts of higher oil prices.

Inflation : Macro Read

- Higher inflation is likely here to stay for the following reasons.
- We've entered an era of deglobalization. The COVID crisis cemented an already underway trend away from globalization (which supports low inflation) toward deglobalization (which supports high inflation). Since the pandemic, there has been very little consolidation of public finances, and fiscal policy is structurally becoming more supportive of higher inflation. .
- Globalization and fiscal austerity helped harmonize economic cycles and suppress inflation across the world. Now these factors have begun to fade. Cycles are likely to become more disjointed, and countries will react differently to market events, with varying fiscal and monetary responses.
- More frequent and volatile economic cycles –When the world faces the next market shock central banks are unlikely to have the same freedom to cut interest rates as they used to. In the past, central banks could slash interest rates during downturns and printed money to buy bonds. Now, with stickier inflation, they won't be able to loosen policy so quickly.
- The Trump administration inherently accelerates deglobalization trends by making international trade more difficult and expensive. Changes to trade will prompt diverse policy responses from one place to the next.

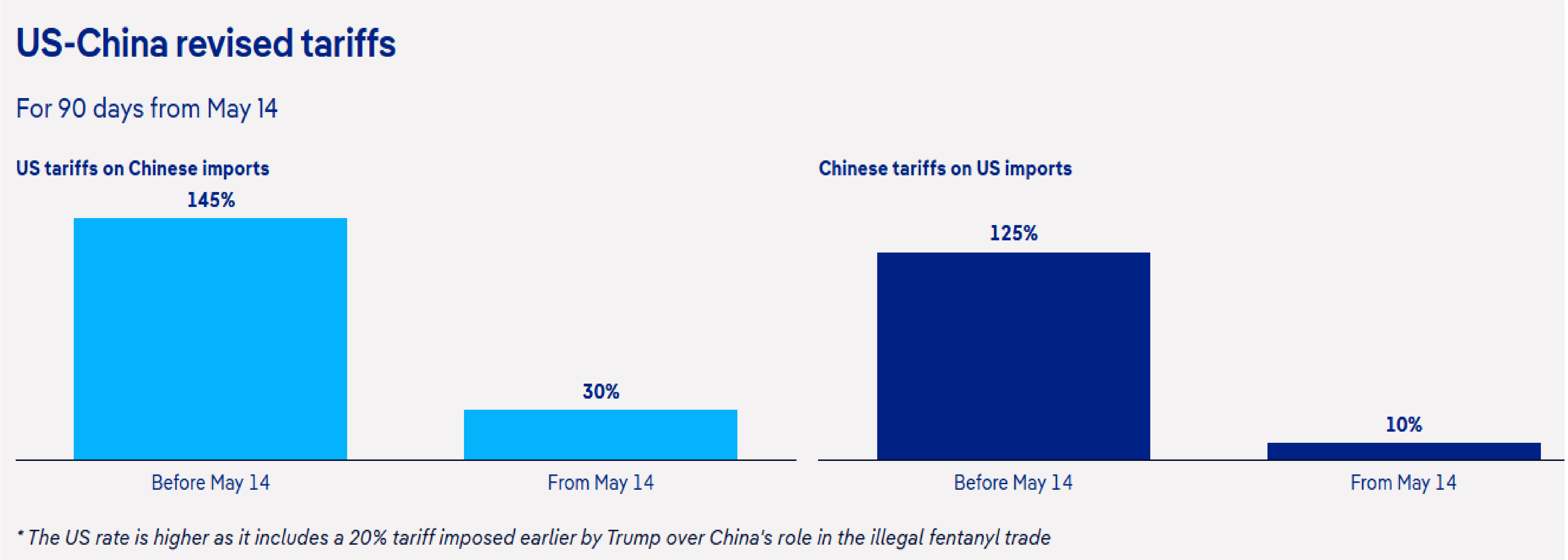
From Sell US to Buy US …

- However , it has been proved that Initial Jobless Claims are the single most important economic indicator to watch — canary in the coalmine — in determining the path of the economy.
- So far, claims have held up extremely well in the weeks following Liberation Day, and we believe the late-April jump is a seasonal adjustment issue related to the timing of spring break in New York that has cropped up over the past few years but will likely reverse in early May.
- However, slipping profit margins means there is less of a buffer should the labor market weaken or demand slow in the coming months. This leads us to believe that the risk-reward tradeoff facing both the economy and financial markets would have skewed to the downside ,in case the present tariff turmoil had continued without any resolution
- As of now , with De escalation deal with China and a renewed focus from the administration on its supply-side agenda (deregulation, tax cuts/fiscal support) the dynamics had shifted the skew to be more favorable. However, prompt action is likely needed in order to counteract the negative (and building) effects of continuing uncertainty on policy front and the margin pressure.
- From Sell US to Buy US …

- US and China agreed to drastically roll back tariffs on each other's goods for an initial 90-day period, in a surprise breakthrough that has de-escalated a punishing Trade war and buoyed global markets.

- The 90-day tariff cuts offer a critical window for negotiators under pressure to forge a lasting resolution to the trade war.

- The White House announced a mechanism for ongoing talks, led by China's Vice Premier He Lifeng and US representatives Bessent and Greer. Discussions would take place in the US, China, or a neutral third country.

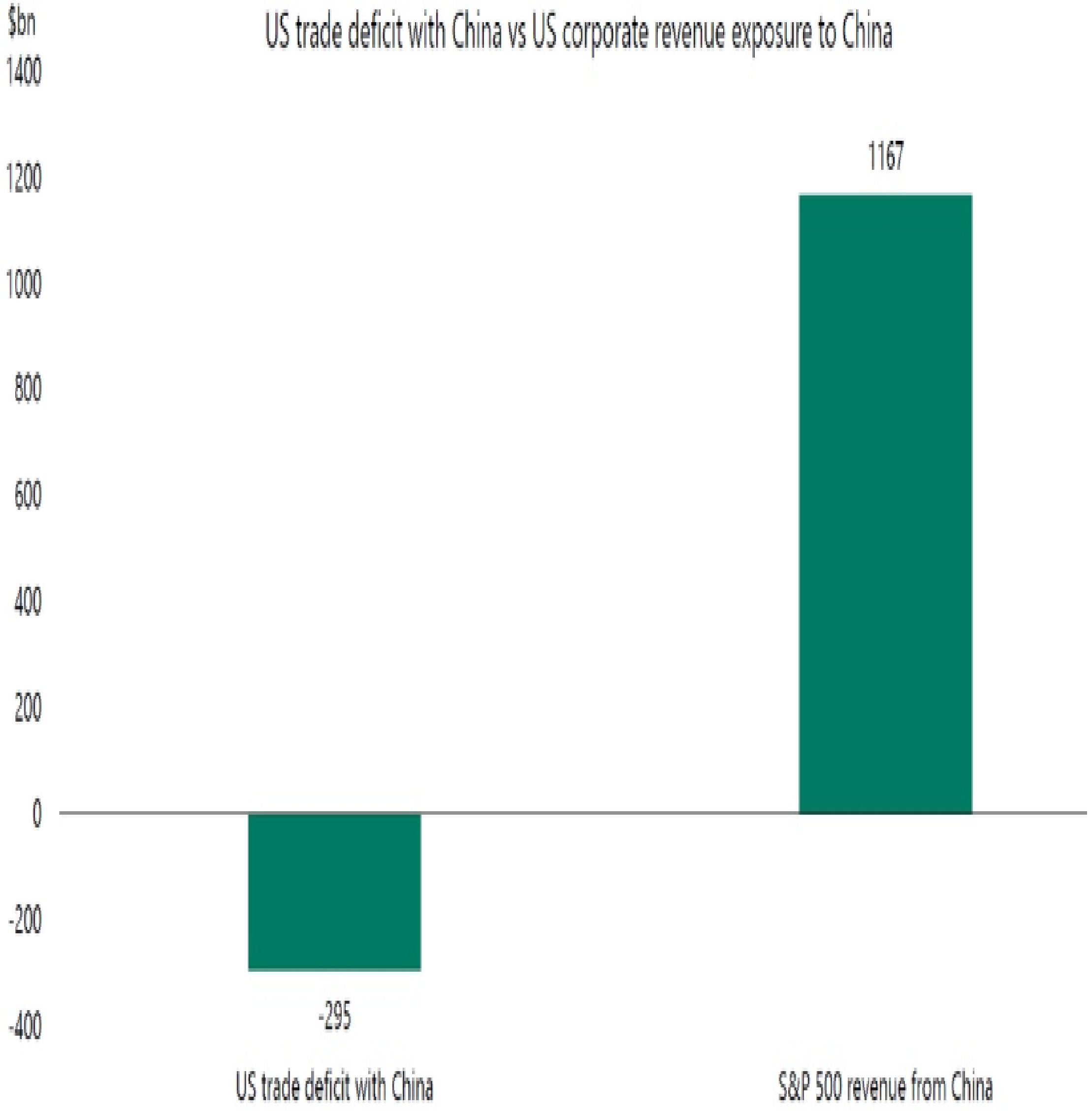


US- China De-escalation

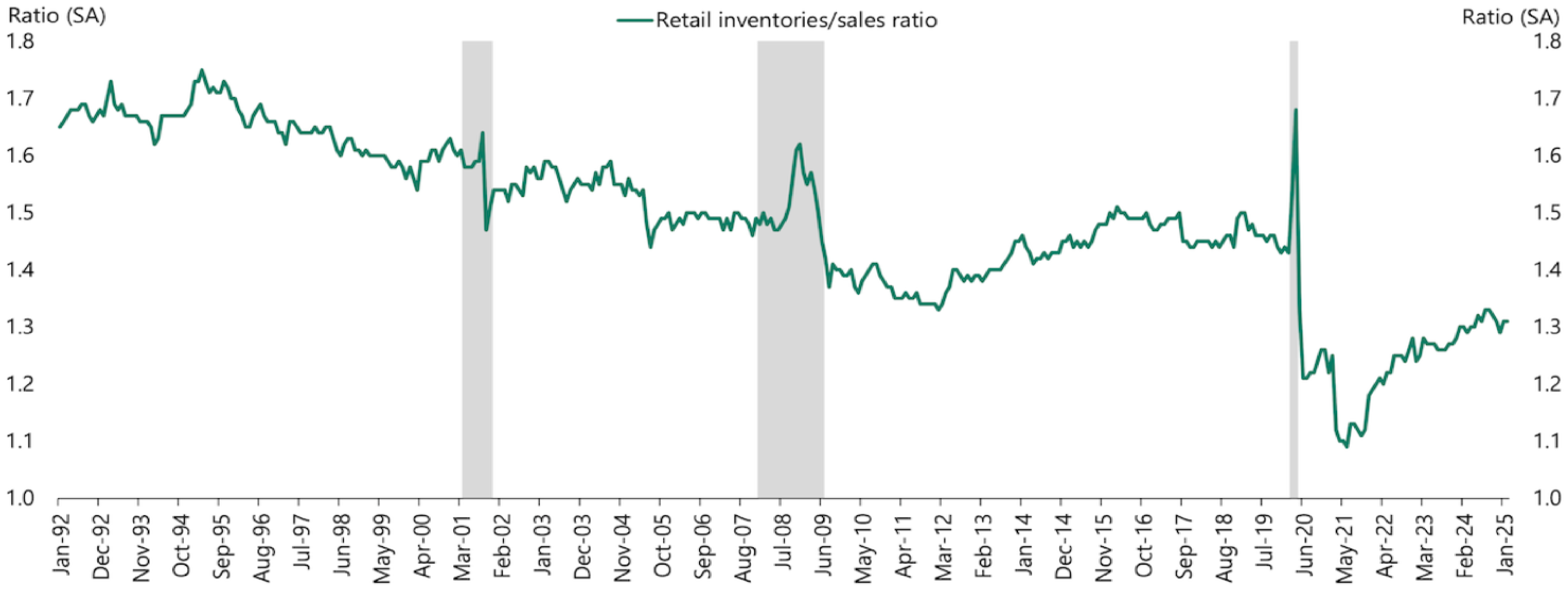
- First and foremost, tariff rates have been significantly reduced, which means trade can resume and Chinese companies exporting goods for Halloween, Christmas, Black Friday etc. can ship their goods at tariff rates that are manageable. China could soon see tariff rates reduced by a further 20% if they strike a deal on Fentanyl, which seems likely based on positive comments from Bessent on China's efforts to meet the US on this point.
- Second, negotiations according to the Chinese delegation happened in a good atmosphere with mutual respect, sincerity and understanding for the other side. These are key points for China and often underestimated. And in China it vindicates that the initial strong retaliation has paid off with the US showing more respect now instead of bullying. People matter in diplomacy and Bessent and Greer seem to be the right people at the table. You can disagree and have demands but if you show respect and understanding, it is much easier to get results when dealing with China.
- It is worth keeping in mind that achieving significant reductions in US trade deficit with China, which remains a high priority for the US side according to Greer, appears unlikely without a significant reduction in US demand. Heading toward a baseline scenario where US tariff rates on China are ultimately around 40%. A headwind but manageable for both sides.

Need for De-escalation

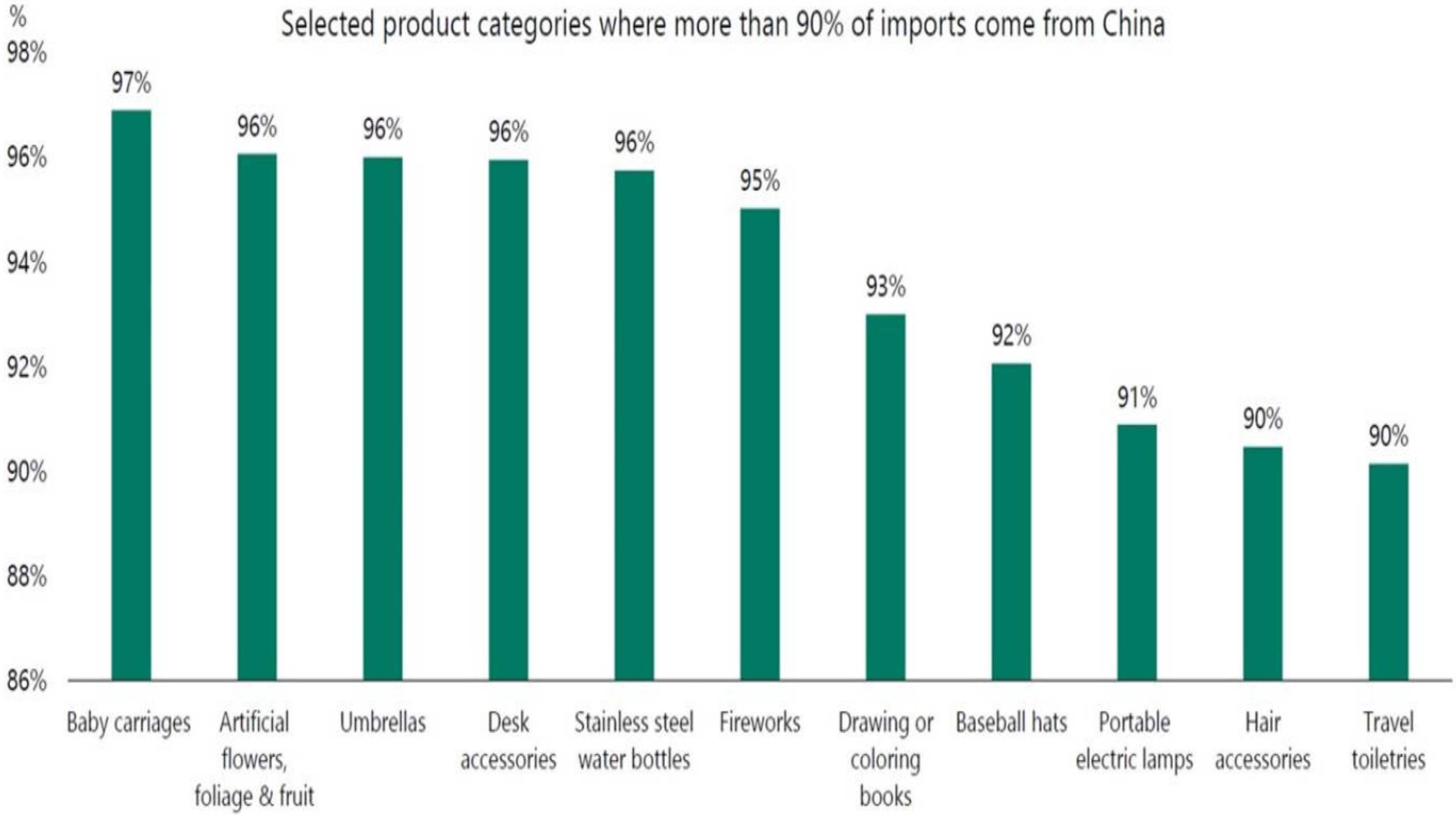
- Although the trade war is all about goods., there are other channels which gets impacted -US is connected with China via sales of American products in China to Chinese consumers.
- China makes up about 7% of total annual revenue in S&P 500 companies.
- For example, McDonald's has 6,820 restaurants in China, Walmart operates 364 stores in China, and Apple sold 43 million iPhones in China in 2024
- Comparing the magnitude of the trade deficit with the revenue generated by S&P 500 companies in China shows that US companies made $1.2 trillion in revenue selling to Chinese consumers—about four times more than the size of the trade deficit in goods between China and the US.
- The bottom line is that if the US has to decouple completely from China, it would result in a significant decline in earnings for S&P 500 companies no longer selling products to Chinese consumers.



Retail inventories at lower levels than in 2019



- The inventory-to-sales ratio for retailers was 1.5 before the pandemic, and now it is 1.3.
- In other words, retailers will more quickly have empty shelves when goods no longer come in from China.


%
Selected product categories where more than 90% of imports come from China
98%
96%
94%
92%
90%
88%
86%
97%
96%
96%
96%
96%
95%
93%
92%
91%
90%
90%
Baby carriages
Artificial flowers, foliage & fruit
Umbrellas
Desk accessories
Stainless steel water bottles
Fireworks
Drawing or coloring books
Baseball hats
Portable electric lamps
Hair accessories
Travel toiletries

Europe : Re-positioning

- The deep entanglement between the two sides of the Atlantic (worth $9.5 trillion and 16 million jobs) means that the dramatic changes in policy have an existential impact on the continent - No matter what shape Trump’s tariffs ultimately take, they fracture the relationship between Europe and its largest trading partner.
- To call this a big deal is an understatement.
- The US represents as much as 3% of GDP for Europe. Plus, the US has been a growing market for European exports, which have risen by 40% since 2019 (by contrast, exports to China have remained flat).
- What’s more, Trump has diluted if not withdrawn US security guarantees, which puts pressure on Europe to do two things: integrate more and ramp up defense and infrastructure investment. A major step forward on these fronts is the recently announced German fiscal package, which, at US$1.3 trillion, is the largest we’ve seen since German reunification.
- The biggest risk is that Trumpism, in the guise of an America-first foreign policy, is likely to outlast Trump’s second term.
- It’s increasingly clear that EU leaders and their partners have a unique opportunity – and an obligation – to carve out a more secure and independent space in a hostile global environment.

Europe : Preparations are Continuing

- The European Commission, the executive arm of the European Union, on Thursday morning announced two new steps that it could take to hit back at America if trade negotiations fail.
- Officials laid out 95 billion euros, or $107 billion, worth of goods that they could target with higher tariffs in retaliation to the duties that US has announced or imposed. They also said that the bloc would start a World Trade Organization dispute against US on across-the-board tariffs, as well on duties levied on cars and car parts.
- While Thursday’s list touches only goods, European officials have been clear that if the trade fight deepens, they could hit the American services sector. That is a serious vulnerability for U.S., since European consumers are major users of American technologies, including cloud computing, search engines and social media.
- The goal is both to pressure US to reach a deal and to ensure that the European Union is prepared if negotiations fail and higher tariffs become a lasting feature of the trade relationship.
- Thursday’s announcement is a sign that those preparations are continuing.

US-UK Trade deal

- The U.S. and the U.K. announced a new trade deal on Thursday last week. Both countries indicated they will continue to negotiate to potentially expand the agreement. Under the terms of the deal:
  - The 10% universal tariff on most imports from the U.K. will remain in effect
  - The first 100,000 vehicles from the U.K. will be subject to the 10% tariff rate, beyond which a 25% tariff rate will apply
  - U.K. tariffs will be reduced or eliminated on certain U.S. exports, including agricultural products such as ethanol and beef
  - U.S. tariffs on imports of U.K. steel and aluminum will be eliminated
- The economic benefit of this deal is likely limited,, as the U.K. represented about 4% of U.S. exports and roughly 2% of U.S. imports in 2024, resulting in a U.S. trade surplus.
- Importantly, the agreement demonstrates that trade talks are progressing, and it could serve as a framework for further negotiations with other trading partners. However, negotiations with countries with which the U.S. has trade deficits could be more challenging.

China : Monetary Stimulus

- People's Bank of China (PBoC) was one of many central banks to make a monetary policy announcement last week.
- In one of the more aggressive rounds of monetary easing seen since last September, the PBoC announced a 50 bps cut in the Reserve Requirement Ratio, which lowers it to 9.00% for major banks.
- The central bank also announced a 10 bps cut in the seven-day reverse repo rate, to 1.40%. Chinese authorities also announced several stimulus measures aimed at supporting the housing sector, small businesses and the stock market.
- The measures also came amid news of U.S.-China trade talks aimed at deescalating tensions, talks that are starting this weekend.
- While the policy actions announced last week provided a fillip to sentiment and will support liquidity, fiscal policy changes were notably absent, and unless there is also broad and large-scale fiscal stimulus, it's unlikely that these decisions will significantly impact the economy and shield it from the effects of current tariffs

Monetary Policy decisions around the world

- Among the emerging market central banks to ease this week were Poland's central bank, which cut rates 50 bps to 5.25%, and the Czech central bank, which cut rates 25 bps to 3.50%.
- In contrast to many other emerging economy institutions, the Brazilian Central Bank (BCB) moved in the opposite direction and tightened policy.
- In a widely anticipated move, BCB policymakers unanimously raised rates to 14.75% from 14.25%. In their monetary policy statement, policymakers stated that the “current scenario continues to be marked by de-anchored inflation expectations, and high inflation projections.“
- Turning to advanced economies, BoE delivered a widely anticipated 25 bps rate cut, bringing the policy rate down to 4.25%. The decision, however, was split in that five policymakers voted for the 25 bps rate reduction, two policymakers voted for a larger 50 bps cut and two voted for no change. In comments accompanying the decision
- Sweden’s Riksbank and Norway’s Norges bank both decided to leave rates unchanged at 2.25% and 4.50%, respectively. They both stated considerable global uncertainty being higher than usual as a major reason for holding rates steady

China : Tale of Two Economies

- For several years, discussion around China has centered on its transition from the old economy – based on manufacturing, construction, and infrastructure – to the new economy, led by services and consumption-related businesses. The single most important factor explaining the abrupt end to China's investment-oriented growth model is the correction in the property sector

- There is a growing feeling that the country is moving closer to a transition point where the new economy more than offsets the decline of the old.

- With China's investment and production in high-tech industries growing and Beijing prioritizing techno-industrial policy, it should come as no surprise that China leads global exports of many high-tech goods .

- This includes the so-called "new trio" (electric vehicles, lithium-ion batteries, and solar panels) as well as critical minerals, to which China has suggested it will apply export controls, probably partly to discourage Washington from increasing its tariffs and export controls aimed at China.

Taiwan : Local Connotations

- The Taiwanese dollar's unprecedented 6% surge over just two days – its largest in decades – reflects intensified hedging by domestic insurers and corporates amid unhedged foreign asset exposure. The Taiwanese central bank owns USD580bn of foreign exchange reserves (71% of GDP) reflecting a history of active intervention to weaken the currency. However, its decision to refrain from intervening during the latest market volatility suggests a probable shift in policy stance

- The recent turmoil in the Taiwanese currency market is interpreted as a sign that USD-linked Asian economies start shifting from defensive managed floating to aggressive currency moves in a context of US trade negotiations.   Though rumours of intentional currency manipulation amid trade talks with the US were denied, this appreciation highlights Taiwan’s economic vulnerability.

- This episode has localized connotations whereas the markets ried drawing generalized conclusions : Taiwan is the world’s fifth-largest foreign creditor with a massive net international investment position (NIIP) of USD1.7trn, of which USD300bn is in overseas life insurance investments. This casts a shadow over other Asian economies with large trade surpluses, with spillovers already visible from Malaysia to South Korea. However, contagion of a similar scale is unlikely, as Taiwan’s exceptionally large NIIP makes its situation distinct among regional peers.