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FINANCIAL SOLUTIONS

Double Down Trump

By Ahmet Jakupi

Weaker than expected inflation in America drove equities and saw 10 year bond yields drop to 2.96%. Cheaper cars, telecom services and home utility prices saw moderate inflation in April at 2.1% below economist expectations of 2.2%. The other factor lightly discussed in the mainstream economic news is wage growth. Even though unemployment has dropped to 3.9% and current job growth remains strong, wage growth is nowhere near the time periods of the late 60's and early 1980's. Corporations are driven to improve efficiency as they look to reduce costs. Labour costs are a major component. Wage growth rose by 4.45% in March compared to average wage growth of 6.21% from 1960 till 2018. Wage inflation reached an all time high in January of 1979 of 13.77% and a record low of -5.77% in March of 2009. For inflation to be lasting and meaningful for the Federal Reserve to act with successive interest rate increases, inflation must break above 2.2% and continue to tread higher.

President Trump doubles down on Iran as Commerce Secretary Wilbur Ross, presses Chinese leadership to accept more American goods. This would drive the trade deficit with China down by $200 billion over the next two years. Ross believes selling more American goods to China is a direct way to drive the economy. Trade wars and economic strong arming never ends well. Is America now becoming the economic police for the global economy? President Trump sure believes so.

In Europe, America's withdrawal from the Iran deal has EU firms reeling. The JCPOA (joint comprehensive plan of action) as the Iran deal is known as, allowed international firms to do business in Iran without fearing the extraterritoriality of American law allowing Washington to punish cooperation conducting business in Iran. Global banks in the past which have ignored American sanctions have seen fines as high as $9 billion dollars for evading sanctions. European leaders are doing everything possible to limit the down side of EU firms. Washington has given firms operating in Iran between 90 and 180 days to phase out of existing agreements with Iran and are banned from signing any new contracts. Other problems loom over the EU as a Brexit deal is not materializing. More concerning is the tariff war with America. Germany has the most to lose as it exports $133 billion of goods to America. An aggressive position with America will only see a second round of tariffs by America focus on the German car industry. What we are more likely to see is that the EU will follow a South Korean style of approach and accept a cap on exports. The same is expected to transpire in Canada and Mexico.

The Bank of England will hold interest rates steady as first quarter growth was lack luster. A rise in interest rates would only serve to further slow growth as higher borrowing costs would further erode GDP.

The EU economy grew by 2.4% in the first quarter year over year in 2018 following 2.7% increase in the previous period. The EU is the world's second largest economy as measured by purchasing price parity. Growth in domestic production has averaged 1.76% from 1996 till 2018 reaching an all time high of 4.6% in the second quarter of 2000 and a low of -5.40% in the first quarter of 2009.

Oil prices will be hitting new highs regardless of growing supply due to the cancelation of the Iran deal. At these prices we will see investment capital flood in as anxious investors look to participate in black gold's rise. Iranian leadership is scrambling to secure buyers of their oil. China has confirmed it will continue to buy oil and in a surprising move so has Chile. Brent crude oil prices and West Texas (WTI) took different paths as the difference in price between two was more than $7 a barrel. Why the spread in price?

America's energy producers are ramping up production fast, now that the transportation infrastructure for oil can deliver creating gluts of oil. Globally, the threat from OPEC to continue to cut supply along with Iran and Venezuela's decline production all drive Brent prices upward. Price disparity is 10 at 10% difference.

In China, for the first time since 1999 the pace of retail sales declined for the fourth month suggesting a softening economy. Additionally investment into homes also declined. Industrial output was the only bright spot which jumped due to more than expected automobile sales and a surge in steel productions. Given a looming trade war industrial output could come under threat. China may have entered into a long anticipated slowdown as protectionism of trade grows. As a remedy the Peoples Bank of China will loosen monetary policy to keep growth from slowing too sharply as it continues a crackdown on systemic and financial risks brewing with the Chinese economy. The world's second largest economy is entering a period of slowing investment and softening demand.

Here in Canada let's start with the elephant in the room. About 3.4 million home owners are subprime borrowers and rising rates could spell disaster for them. Subprime borrowers in Canada have less than favourable credit scores which allows lenders to charge a higher interest rate. Rising interest rates leave little wiggle room. Subprime borrowers represent about 11.9% of all debt holders. In April, our economy failed to create new jobs as the labour market has hit capacity. Since the start of this year our labour force has shrunk by 25,500 (retiring workers) and employment is down by 41,4000 jobs. Wage inflation hit a new high in April at 3.3% comparable to 2012.

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