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Intrigue and Trade

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An economic forecast rests on a foundation of assumptions about politics. They are assumptions, not expectations, because politics is not an area where economists have a discernible edge. Recent trade news, the US federal budget, national security, and election results make clear that the political ground has been shifting under our forecast. We are likely to have company in this confusion, if changes in equity prices are a reliable signal of macroeconomic mayhem to come (a big if). A short list is sufficient to establish that the world is a risky place.

- President Trump boosted tariffs from 10 to 25 percent on \$200 billion of Chinese imports on May 10, and threatened duties on another \$300 billion.
- On May 13, China retaliated with a plan to hike tariffs on \$60 billion of imports from the US beginning June 1.
- The Commerce Department put the Chinese technology company Huawei on a blacklist that requires a license in order to trade.
- North Korea is testing short-range missiles in apparent violation of a United Nations resolution (which is apparently more bothersome to Japan's Prime Minister Abe than to President Trump).
- Some 1,500 US troops are headed to the Gulf region, where the carrier Abraham Lincoln has already arrived.

Some of these pose sharp-edged threats and others are about the longer-run economic, political, and strategic climate.

This note focuses on trade policy, the item in the political category most conjunct to our economic forecast.¹ We will voice our fears about the forecast (that almost everything takes longer and is less satisfactory than anticipated), identify the key driver of the risk to that outlook (that security concerns may place quantity, not price, constraints on trade), and look to where the fallout might be significant if it blows up (both at home and abroad).

Looking Backward and Forward

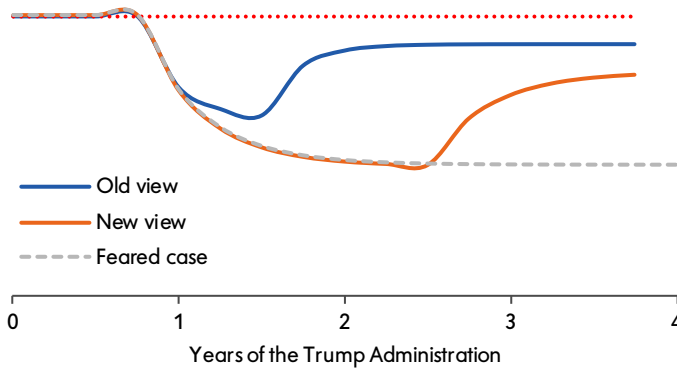
Our forecast rested on three pages from the Trump team's playbook:

1. Tariffs are a lever to negotiate more advantageous trading relationships
2. The US economy has more cyclical momentum than most of our trading partners
3. Trade is generally more important to our partners than to the US

This led us to the conclusion that political constraints (delivering deals before the midterm and presidential elections and before trade uncertainty sapped the economy and cratered asset values) would prompt deals to be cut. That said, we believed trade talks would get worse before they got better, and better would not necessarily be as good for international trade as the status quo before the dispute.

The picture below might help, which shows the hypothetical drag on US aggregate demand from uncertainty about trade. The blue line gives our view from one year ago (as here) and running (as here). One trading partner at a time, the White House would threaten, or even impose, tariffs to gain leverage in negotiation, with the harshest rhetorical salvos fired early. Economic and market backlash, and the looming midterm Congressional election, would prompt a presidential pivot to closure to declare victory.

Hypothetical Drag on US Economic Activity from the Trade Dispute



Source: Mellon assumptions.

This logic worked for the South Korea-US and Canada-Mexico-US deals, but the China-US relationship poses a more perplexing challenge to both sides. Simply put, the worst part is lasting longer and seems more unsatisfactory. We may be tracking the orange line.

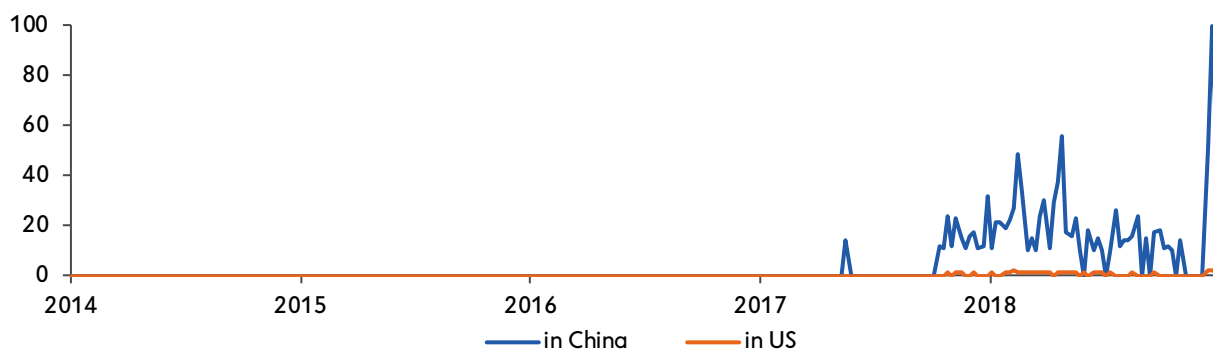
Surprisingly, Donald Trump apparently felt no need to serve as custodian of Republican party interests in the midterm election. The timing of a trade deal matters more for his 2020 election, extending the process another year. For another, neither Presidents Trump nor Xi Jinping felt pushed to the table by economic or market adversity. The US racked up significant equity

price gains and showed strong cyclical momentum, with readings of 263,000 jobs created on net in April and 3¼ percent growth of real GDP in the first quarter, emboldening President Trump. In China, asset values rose through early April and fiscal stimulus left its imprint on the expansion of activity. Meanwhile, President Xi felt a lot of love about the belt-and-road initiative from Europe (Italy and Switzerland) and at his forty-country summit.

This encouraged both leaders to be a bit more bellicose, further lengthening the process. Two concerns emerge. For one, a lengthening period of argumentation may leave long-lasting scars on economic activity. After all, investment not put in place is not in the capital stock next year. Alterations in global supply chains may box out some Chinese industry. Alienation of Chinese consumers toward US products might be hard to reverse.

In that regard, President Trump’s view that trade matters more to our partners than to the US holds especially true for Chinese news readership. A Google Trends search on the topic “trade war” in China and US sources shows a two-order-of-magnitude difference between the two countries.

New Interest in “Trade War” (Peak = 100)



Source: Google Trends, accessed May 23, 2019.

For another, high-pressure negotiations do not always end successfully. Words may be said, or deeds done, that cannot be taken back. The drag on activity could be permanent, the feared case becoming reality. This, presumably, is on the level of activity, so that growth would eventually steady but income would be lost in transition.

It is hard to detect concerns about a permanent economic loss in equity values either at home or abroad. Investors likely hold a “rational actor” view that no politician would intentionally inflict a permanent loss inimical to national interests.² Our take on recent volatility and limited correction is that expectations have been shifting back and forth between our old and new views.

The problem, of course, is that mistakes happen. A youngish Winston Churchill in 1923, surveying the world war that had just concluded, held that “One rises from the study of the causes of the Great War with a prevailing sense of the defective control of individuals upon world fortunes.” Worryingly, this attitude does not seem to be shared by Presidents Trump and Xi.

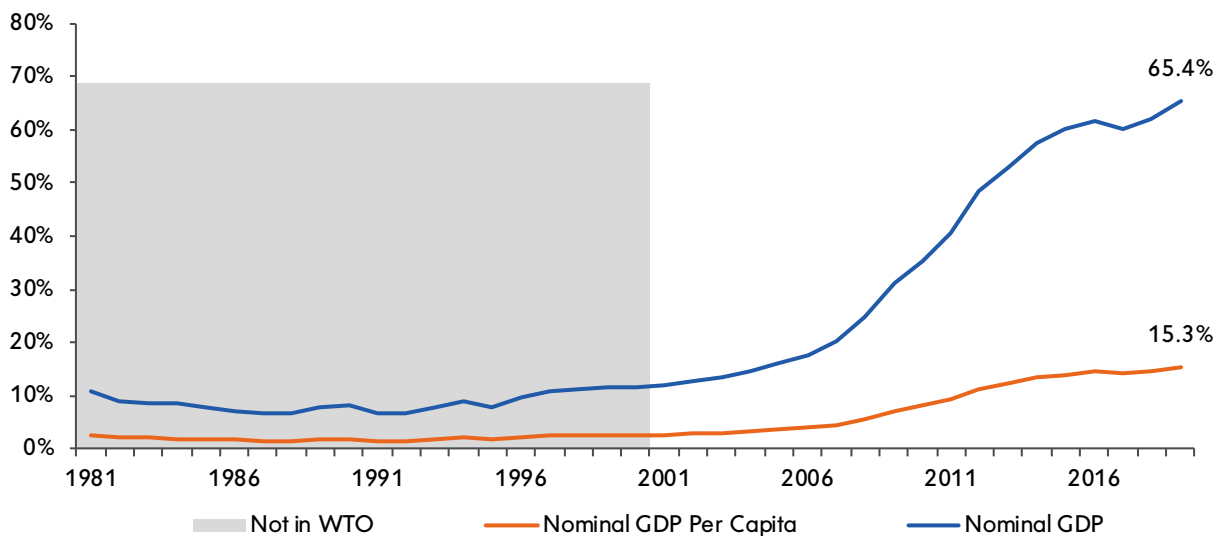
The thought, the fear, is that the problem may be intractable.

The Heart of the Matter

The relationship between the two largest economies in the world is about trade and security. The competition and conflict of interests flow from the chart below, which plots the US dollar value of Chinese nominal GDP and GDP per capita relative to that of the US. Since accession into the World Trade Organization in 2001, China gained 50 percent and closed much of the GDP gap with the US (the orange line). From the Chinese perspective, this warrants a say in global strategic debates and sway as an issuer of a reserve asset. The US reads the orange line as the increasing magnetic pull of a competing gravitational pole, one that is autocratic and quick to feel slighted.

Nominal GDP: China Relative to US

Ratio in US Dollars

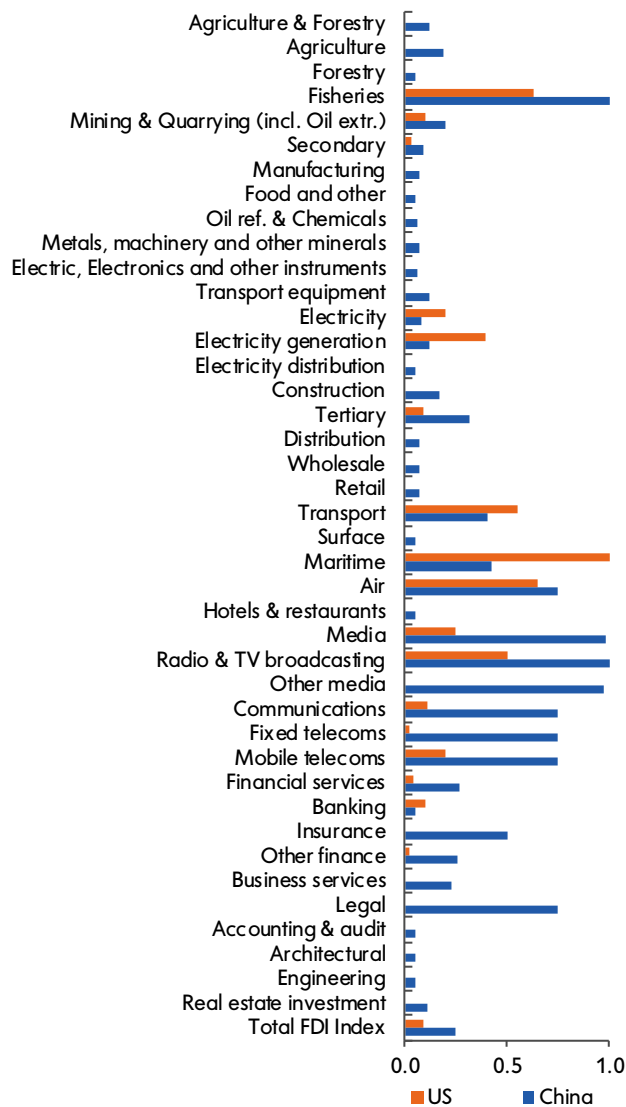


Source: IMF, World Economic Outlook (April 2019), and Mellon calculations.

When it serves their purpose, Chinese officials point to the blue line. For all the headline growth, China has just moved into middle-income territory for a developing economy. China's per-capita GDP is only 15 percent of US per-capita GDP. Such a differential, the argument runs, warrants technological transfer from the rich to the poor. To US ears, transfer sounds like the theft of intellectual property by an economy that places high barriers to foreign direct investment (FDI) around its own firms. The Organization of Economic Cooperation and Development (OECD) routinely scores restrictions on investment across major economies (with a score of one corresponding to a closed market). Comparing the US to China, there is a distinct wall around one and not the other. This is the source of ongoing dispute.

Regulatory Restrictions on FDI

OECD Index



Source: Organization for Economic Cooperation and Development, 2018, data accessed May 16, 2019.

For those in security circles, Chinese technology transfer represents theft as the biggest threat to US interests, especially in important technologies central to national defense. The poster child (or flashpoint) is Huawei, which was recently put on an export blacklist by the US Commerce Department. The retrospective reason, US officials assert, is that Huawei's technological prominence is a result of systematically stealing protected ideas and processes. The prospective reason is that letting Huawei's hardware and software dominate fifth-generation communication networks risks opening back doors to surveillance and hiding kill switches that could be triggered at a time of conflict. Especially troubling to US officials is the indistinct line between the private firm and Chinese security forces.

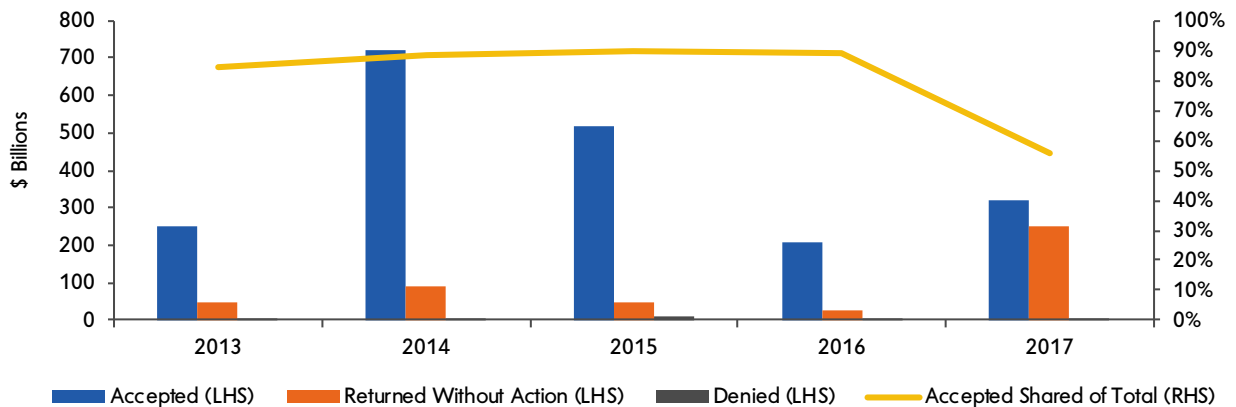
This John-le-Carré-Graham-Greene storyline no doubt darkens the prospect for successful negotiations. It also alters the mechanisms through which the US attempts to tame Chinese ambitions, with more adverse consequences for economic activity. In particular, we thought that the battle would be fought with tariffs. A tariff works through a price mechanism, with some of its effects potentially offset by changes in currency exchange values and profit margins. At the end of the day, the effect on economic activity is measured as the movement along a demand curve after attenuating effects play out.

In any event, the combative posture of the White House has emboldened security officials to tighten quantitative restrictions. These are probably more consequential for trade in that they do not have a price offset, are associated with elevated litigation risk (producing litophobia), and have an extraterritorial reach. Those features are written in the Huawei headlines, but they are also buried in US trade regulation.

A US exporter must check a potential customer against the Department of Commerce’s Consolidated Screening list, which runs to 10,659 entries. Those entities (53 of which are related to Huawei) include individuals, firms, agencies and other organizations. The plurality were put on the list by the US Treasury (8,322, mostly related to terrorist finance), but the second most important contributor was the Bureau of Industry and Security (BIS) of the US Commerce Department.

Huh? Commerce’s BIS (not the central banker version in Switzerland that looks downright transparent in comparison) keeps the Commerce Control List and considers licenses for controlled categories or suspect destinations. (The index to the Commerce Control List runs 77 pages and offers the reassurance of controls on the export of viruses and toxins, mentioned 111 and 33 times, respectively. One hopes that there are symmetric controls on imports.) Beneath the radar, the BIS has been denying or returning without action requests for licenses at an increasing pace (at least through 2017, the latest data published by the BIS). In 2017, they accepted 56 percent of all applications, off about 30 percent, primarily through procedure by sending the application back rather than rendering a decision.

BIS Licenses for Tangible Items, Software & Technology



Source: Bureau of Industry and Security

Quantitative restriction is more abrupt than relying on prices. We think this is why the global outlook is more at risk. If the US successors of le-Carré’s George Smiley tighten the screws on Chinese trade, prompting a non-price response from their competitors, there may be a more abrupt contraction in trade.

Our forecast assumes that both sides agree to put strategic competition in a box, including Huawei, set aside for a local deal on trade by year-end, convenient to President Trump’s political calendar. This assumes that the box is sufficiently small to be ignored and President Xi’s horizon is sufficiently short that he still feels it necessary to deal with the current resident of the White House. If not, the dashed line starting this discussion (page 3) feels like destiny.

What Goes Wrong if it Goes Wrong?

The narrow path to a cooperative trade outcome is, well, narrow. Quantitative restrictions in place, which may be augmented, suggest that “better” leaves much to be desired. To frame the issue, detailed data on bilateral China-US trade is presented on the next page that includes both 2018 levels and changes from 2017.

Bilateral trade is more important to China than the US by a ratio of almost five to one. This implies that the scope for China to retaliate against US punitive tariffs with their own tariffs is limited. There is not much there, there. Also, China ships capital and consumption goods to the US. As a result, the value-added share in exports from China is lower than that for the US. The value-added share matters because a tariff affects the selling price of the good at the last mile of export. If the country handing the good off to the US contributed little to the value added, the incidence of the tariff weighs more heavily on profit margins than one contributing the preponderance of value added. US trade, in contrast, is less processed, reflecting a greater value-added share.

In the table below, the change columns for US exports to China at the left and US imports at the right indicate that China can engineer a coordinated shift away from a trading partner who falls in esteem. The redirection of trade is impressive, with declines in US export values of 38 percent for soybeans, 6 percent for passenger cars, 8 percent for crude oil and pulpwood, and 7 percent for natural gas. Consolidated China looked away from the US.

The other striking feature is the extent to which the US turns to China for goods. The largest US export category to China (aircraft) would score as the eighth largest import from China. It is also the only export category above \$10 million. Fifteen import categories from China pass that bar. Also, note that negative values in the rightmost columns measuring the change in annual trade are fewer and smaller on the US side relative to the Chinese side. A controlled economy can move more forcefully than an uncontrolled one.

Industries in the left panel are at risk from reduced demand for their products. At the right are those where tariffs pass through to domestic prices. Here is where the next wave of tariffs on \$300 billion of imports from China will hit US shores with force (part of the getting worse before getting better). Prior duties were mostly placed on intermediate goods where the price consequences were diluted before the final product reached market shelves.

2018 US-China Trade by End-Use Category

US Exports to China				US Imports from China					
	2018		Change 2017 to 2018		2018		Change 2017 to 2018		
	Level	Share of US exports			Level	Share of US imports			
	\$ Millions	percent		\$ Millions	percent				
1	Civilian aircraft, engines, equipment, & parts	18,222	14.0	0.5	1	Cell phones & other household goods, n.e.c.	71,815	66.2	0.1
2	Semiconductors	7,118	14.7	2.0	2	Computers	47,323	60.9	-5.0
3	Industrial machines, other	6,825	11.3	1.8	3	Telecommunications equipment	33,948	45.8	0.7
4	Passenger cars, new and used	6,652	13.2	-6.3	4	Computer accessories	32,563	50.2	-3.0
5	Crude oil	5,392	11.4	-8.2	5	Toys, games, and sporting goods	28,225	74.1	-0.2
6	Plastic materials	3,992	10.5	-1.1	6	Apparel, textiles, nonwool or cotton	25,161	47.9	-0.2
7	Medicinal equipment	3,726	10.0	0.2	7	Furniture, household goods, etc.	22,700	56.5	0.3
8	Chemicals-other	3,211	9.6	0.1	8	Other parts and accessories of vehicles	16,377	14.5	0.8
9	Soybeans	3,154	17.3	-37.8	9	Household appliances	16,022	51.3	2.7
10	Measuring, testing, control instruments	3,131	12.0	0.3	10	Electric apparatus	15,929	27.6	0.7
11	Pharmaceutical preparations	3,022	5.5	0.3	11	Apparel, household goods - cotton	12,406	27.6	-0.8
12	Pulpwood and woodpulp	2,911	30.8	-7.5	12	Industrial machines, other	11,843	19.3	0.5
13	Other parts and accessories of vehicles	2,865	4.7	0.2	13	Televisions and video equipment	11,730	46.3	4.9
14	Logs and lumber	2,846	41.3	-3.6	14	Footwear	11,436	59.1	-2.8
15	Chemicals-organic	2,511	8.0	-0.1	15	Photo, service industry machinery	10,703	45.3	1.3
16	Electric apparatus	2,421	5.3	0.0	16	Industrial supplies, other	9,714	25.6	0.0
17	Other industrial supplies	2,174	7.7	-0.1	17	Semiconductors	8,877	16.4	-1.4
18	Laboratory testing instruments	2,042	16.5	0.6	18	Generators, accessories	8,003	30.8	1.2
19	Copper	1,793	24.5	-12.0	19	Cookware, cutlery, tools	7,926	73.7	1.8
20	Industrial engines	1,755	7.0	0.4	20	Chemicals-organic	6,753	22.1	2.0
21	Cell phones & other household goods, n.e.c.	1,463	5.4	-1.3	21	Other consumer nondurables	6,079	38.0	0.9
22	Telecommunications equipment	1,428	3.8	0.2	22	Industrial engines	5,506	20.2	-0.5
23	Petroleum products, other	1,419	2.2	-1.2	23	Finished metal shapes	5,469	25.5	-1.3
24	Computer accessories	1,328	4.0	-0.5	24	Camping apparel and gear	5,398	40.7	-1.4
25	Natural gas liquids	1,196	6.1	-6.8	25	Apparel, household goods-nontextile	5,141	52.0	-1.6
26	Fish and shellfish	1,148	19.7	-2.6	26	Medicinal equipment	5,137	12.2	-0.2
27	Nonmonetary gold	1,037	4.8	1.3	27	Stereo equipment, etc	3,938	67.0	4.0
28	Computers	941	5.7	-0.4	28	Iron and steel, advanced	3,869	32.0	3.4
29	Cotton, raw	924	14.1	-2.7	29	Nontextile floor tiles	3,582	58.7	7.2
30	Aluminum and alumina	899	10.3	-7.1	30	Materials handling equipment	3,453	17.3	-0.3

Source: <https://www.census.gov/foreign-trade/statistics/country/index.html>

The price response, in principle, depends on the adjustment of the exchange rate. Much of international trade, however, is denominated in US dollars. Moreover, for the portion in Chinese renminbi, Chinese officials are probably reluctant to let the currency slide too much against the dollar. Depreciation vis-à-vis the dollar might encourage capital outflows in China and complaints from US officials.

The relative price adjustment will divert trade, but the global pie may shrink as confidence suffers and non-price controls disrupt global supply chains. The table below attempts to shed some light on national vulnerabilities to a contraction in Chinese economic activity using bilateral trade data for the 60 largest economies of the world. Think of it as identifying which countries are important to China and where China is important. For the former, columns one and three provide the ratio of Chinese exports to those destinations relative to Chinese GDP. That is, the columns give the foreign contribution to Chinese aggregate demand. As is evident, only three foreign economies amount to much from the Chinese perspective: the US, Hong Kong, and Japan. Hong Kong is a re-export hub for the mainland. In total, only 8 of the 60 contribute more than one-half percentage point to Chinese GDP (the red shaded entities).

The picture differs starkly in columns two and four, which shows bilateral exports to China relative to the exporter's GDP. Exports to China are more than 5 percent of GDP in 18 of the 60 largest nations. A slowdown in China, as was the case in the second half of 2018, would be material for the rest of the world.

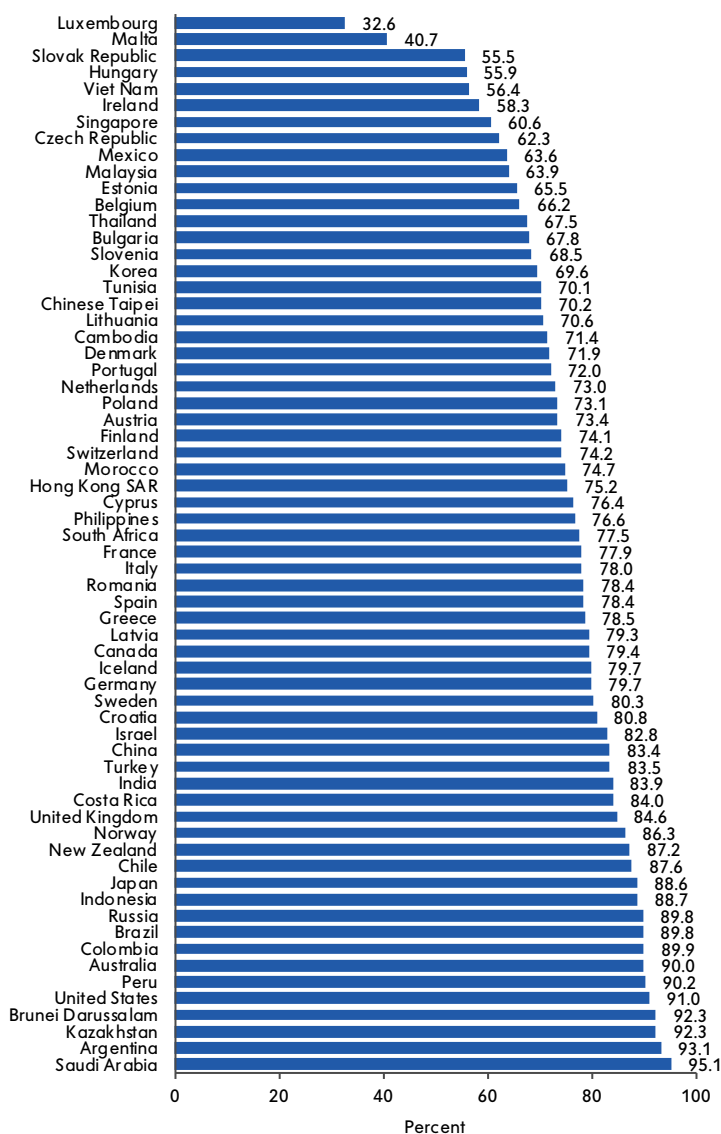
Who Loses in the Trade War?

GDP Rank		Importance in 2018		GDP Rank		Importance in 2018	
		To China 1	Of China 2			To China 3	Of China 4
1	United States	3.59	0.76	31	Israel	0.07	1.25
2	Japan	1.10	3.63	32	South Africa	0.12	7.44
3	Germany	0.58	2.66	33	Hong Kong SAR	2.27	2.35
4	United Kingdom	0.43	0.84	34	Singapore	0.37	9.31
5	France	0.23	1.16	35	Malaysia	0.34	17.92
6	India	0.57	0.69	36	Denmark	0.05	1.25
7	Italy	0.25	1.02	37	Colombia	0.07	1.76
8	Brazil	0.25	4.11	38	Philippines	0.26	6.23
9	Canada	0.27	1.66	39	Pakistan	0.13	0.70
10	Russia	0.36	3.59	40	Chile	0.12	9.08
11	Korea	0.82	12.54	41	Bangladesh	0.13	0.34
12	Spain	0.19	0.62	42	Finland	0.02	1.73
13	Australia	0.36	7.41	43	Egypt	0.09	0.73
14	Mexico	0.33	1.15	44	Czech Republic	0.09	1.82
15	Indonesia	0.32	3.34	45	Vietnam	0.63	26.59
16	Netherlands	0.55	1.35	46	Romania	0.03	0.91
17	Saudi Arabia	0.13	5.87	47	Portugal	0.03	0.94
18	Turkey	0.13	0.49	48	Iraq	0.06	9.94
19	Switzerland	0.03	5.50	49	Peru	0.06	6.78
20	Taiwan Province of China	0.36	30.05	50	Greece	0.05	0.26
21	Poland	0.16	0.62	51	New Zealand	0.04	5.45
22	Sweden	0.06	1.62	52	Qatar	0.02	4.71
23	Argentina	0.06	0.67	53	Algeria	0.06	0.63
24	Thailand	0.32	9.23	54	Kazakhstan	0.09	5.00
25	Austria	0.02	1.51	55	Hungary	0.05	2.79
26	Islamic Republic of Iran	0.10	4.86	56	Kuwait	0.02	10.88
27	Norway	0.02	0.79	57	Ukraine	0.05	2.12
28	United Arab Emirates	0.22	3.82	58	Morocco	0.03	0.61
29	Nigeria	0.10	0.47	59	Ecuador	0.03	1.85
30	Ireland	0.03	2.91	60	Angola	0.02	23.55

Source: IMF, Directions of Trade and World Economic Outlook, and Mellon calculations, as of June 2019. Notes: GDP rank is based on nominal GDP in dollars, excluding Belgium and China. Importance to China is measured as Chinese exports to the destination relative to Chinese GDP. Importance of China is Chinese imports relative to originator GDP. Red shading in column 1 and 3 denote a value greater than 0.5 percent. Green shading in columns 2 and 4 are greater than 5 percent.

For some nations, those exports to China are one link in the global supply chain. If so, exports match, to a degree, imports. Slowing demand for exports would also pull down imports, netting to a smaller effect on the trade balance. Another way to put that is to consider the value added an economy provides to the goods it exports, as in the chart below from the OCED. A little less than one-half of these economies contribute three-quarters or less to the value of what they sell. Included among them are assembly-plant economies, such as Hungary, Vietnam and Mexico, and re-export centers, such as Luxembourg, Ireland, and Singapore. In both sets, a slowing in gross exports would be associated with a smaller slowing in net exports. The former, however, with expertise in assembly, are candidates to displace production in China if trade restrictions get significant traction. Commodity exporters cluster at the bottom of the chart, since the value added of a raw material comes almost exclusively from the producer. A decline in demand for their product is a direct blow to their aggregate demand.

2017 Value Added in Gross Exports



Source: OECD, Trade in Value Added, accessed May 19, 2019.

The final table (next page) summarizes third-country vulnerability for 54 economies where data on bilateral trade and value added in gross export can be lined up. The first two columns show the importance of China and the US, respectively, in home-country GDP (the weights in the effective exchange rate indexes for each country from the Bank for International Settlements, the other BIS, which are based on bilateral trade from 2014 to 2016). The third column provides the value added in gross exports (from the OECD). The vulnerability score multiplies the value-added share by the sum of the importance of China and the US to the national economies. If the China-US dispute spirals out of hand, an economy is more likely to be a third-party casualty if it is important to bilateral trade with either country and there is no import offset (meaning the value added is high).

By those metrics, the at-risk economies are commodity producers and participants in the global supply chain. The effect of geography (an economic gravity) on trade is evident, in that those most at risk are in the Western Hemisphere (close to the US) or along the Asian Pacific Rim (close to China). Least at risk are those furthest away from both, peripheral Europe.

Third-Party Vulnerability to a US-China Trade War

		Bilateral Trade Importance of:		Value Added Share of Exports				Bilateral Trade Importance of:		Value Added Share of Exports	
		China	US		Score			China	US		Score
		1	2	3	3*(1+2)			1	2	3	3*(1+2)
1	Canada	13.4	57.7	79.4	56.4	28	Switzerland	10.8	11.6	74.2	16.6
2	Mexico	15.4	53.8	63.6	44.0	29	Norway	12.6	6.5	86.3	16.6
3	Japan	31.9	16.5	88.6	42.9	30	France	10.5	7.4	77.9	13.9
4	Chile	32.5	15.7	87.6	42.3	31	Iceland	10.6	6.4	79.7	13.6
5	Colombia	23.7	22.4	89.9	41.5	32	Italy	9.5	7.6	78.0	13.3
6	Peru	27.9	18.0	90.2	41.4	33	Netherlands	9.9	8.1	73.0	13.1
7	Australia	26.7	13.9	90.0	36.5	34	Sweden	9.4	6.7	80.3	13.0
8	Brazil	19.3	19.0	89.8	34.4	35	Denmark	10.5	6.5	71.9	12.2
9	Chinese Taipei	34.6	13.0	70.2	33.4	36	Poland	11.8	4.6	73.1	12.0
10	Korea	33.3	14.0	69.6	32.9	37	Finland	9.5	6.2	74.1	11.6
11	Saudi Arabia	20.0	13.3	95.1	31.7	38	Spain	9.3	5.1	78.4	11.3
12	India	23.1	14.0	83.9	31.1	39	Belgium	6.2	9.3	66.2	10.3
13	Argentina	19.4	13.9	93.1	31.1	40	Austria	7.2	5.7	73.4	9.5
14	Israel	12.9	24.4	82.8	30.9	41	Greece	9.1	2.9	78.5	9.4
15	New Zealand	22.7	12.1	87.2	30.4	42	Romania	7.5	3.8	78.4	8.9
16	Indonesia	23.3	9.2	88.7	28.8	43	Czech Republic	9.3	4.6	62.3	8.7
17	Hong Kong SAR	26.0	8.4	75.2	25.9	44	Estonia	8.8	3.5	65.5	8.1
18	South Africa	22.0	11.4	77.5	25.9	45	Hungary	8.5	5.5	55.9	7.8
19	Russia	21.6	7.1	89.8	25.8	46	Croatia	6.0	3.7	80.8	7.8
20	Philippines	20.9	12.1	76.6	25.3	47	Bulgaria	7.8	3.5	67.8	7.7
21	Malaysia	23.7	13.0	63.9	23.5	48	Cyprus	5.9	2.5	76.4	6.4
22	Thailand	23.6	10.7	67.5	23.2	49	Slovenia	6.2	2.6	68.5	6.0
23	United Kingdom	13.2	11.8	84.6	21.1	50	Lithuania	4.9	2.8	70.6	5.5
24	Singapore	22.5	11.3	60.6	20.5	51	Portugal	4.3	3.2	72.0	5.4
25	Turkey	14.6	6.4	83.5	17.5	52	Malta	6.3	6.4	40.7	5.2
26	Germany	12.4	8.7	79.7	16.9	53	Latvia	4.4	2.1	79.3	5.2
27	Ireland	7.8	21.1	58.3	16.8	54	Luxembourg	3.9	6.4	32.6	3.3

Source: Bilateral trade over 2014 to 2016, and value added from 2017. OECD, Trade in Value Added, BIS, broad effective exchange rate weights, and Mellon calculations, June 2019.

The End of the Affair

We need a working assumption for the political economy to form an economic forecast, but we do not have to feel good about it. We believe the trade discussion gets worse before it gets better, and better is not as good as it was. This is probably priced into financial markets, but perhaps, the market is too confidently assuming that all negotiating parties are adept. In our view, the most significant risk to the outlook is that the rational actor theory does not hold.

If it does hold, then trade will likely be a modest drag on China and the US that policymakers can mostly offset. The Federal Reserve (Fed) already did so by convincing investors it is not going to crush the economy this year. On partial resolution of the trade dispute, both economies get a boost, which is why we think that the Fed will not cut rates this year. Indeed, if US unemployment extends its downward drift to south of 3½ percent and inflation picks up beyond a tariff-related one-off boost, the next move will be to raise the fed funds rate, although not likely anytime soon.



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Vincent is Mellon's Chief Economist and Macro Strategist. In this role, he is responsible for developing views on the global economy and making relative value recommendations across global bond markets, currencies and sectors.

Previously, Vincent served as the Chief US Economist and a managing director at Morgan Stanley. For the prior four years, he was a resident scholar at the American Enterprise Institute (AEI). Vincent also worked in several roles at the Federal Reserve over 24 years, including Director of the Division of Monetary Affairs and Secretary and Economist of the Federal Open Market Committee (FOMC). His responsibilities at the Federal Reserve included directing research and analysis of monetary policy strategies and the conduct of policy through open market operations, discount window lending and reserve requirements. Prior to these roles, he was the principal liaison with the domestic desk at the Federal Reserve Bank of New York and was responsible for preparing a document outlining policy alternatives for each FOMC meeting. He was Deputy Director in the Division of International Finance and Associate Economist of the FOMC and spent five years at the Federal Reserve Bank of New York in both the domestic and international research departments.

His academic publications primarily concern the conduct of policy and issues related to the monetary transmission mechanism as well as an analysis of alternative auction techniques and Treasury debt management. After an undergraduate training at Fordham University, he received graduate degrees in economics at Columbia University.

Endnotes

- ¹ The consequences for financial asset prices of the former, events with a small probability but massive consequences, is covered here.
- ² This is why, for example, US investors shrug off debt-ceiling showdowns. What incumbent would want to live with the consequences of an avoidable default?

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