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# Two Sources of Uncertainty Have Been Eliminated

**Musha Research Co., Ltd.**
President
Ryoji Musha
Direct +81-3-5408-6821
musha@musha.co.jp
http://www.musha.co.jp

901 Renai Partire Shiodome
2-18-3 Higashishinbashi,
Minato-ku, 105-0021 Tokyo

**No possibility of a US recession caused by the trade with China**

The US-China summit meeting in Buenos Aires, which attracted the attention of people worldwide, has ended. No joint statement was issued. All we can do is to guess the outcome of this meeting by looking at statements made by the two countries. The Nikkei Shimbun printed the following report concerning this meeting: "The United States has agreed not to impose additional tariffs on imports from China that were planned to begin in 2019. Discussions will continue regarding structural reforms in China about intellectual property protection and other subjects. However, the United States has established a 90-day deadline and tariffs will be raised if there is no agreement. Although an escalation of the trade war caused by a breakdown of negotiations has been avoided for the time being, there is considerable uncertainty about whether or not the two countries can reach a decisive solution."

There were big gaps between what the United States and China have said about the subjects of their talks, a deadline and other items. The United States said that structural reforms in China are a condition for a respite in the planned tariff hike. A conclusion must be reached within 90 days regarding five issues: (1) Mandatory technology transfers by US companies to China; (2) Protection of intellectual property; (3) China's non-tariff barriers; (4) China's cyber attacks; and (5) Opening up China's service and agricultural sectors. If there is no agreement after 90 days, the United States will raise tariffs by 25% as initially planned on $200 billion of imports from China. On the other hand, China's vice commerce minister Wang Shouwen said that the aim of discussions is to end the current 25% tariff on Chinese imports worth about $50 billion. No deadline is mentioned and there were no remarks about specific agenda items, such as cyber attacks and technology transfers.

Most media reports view the current situation as merely a temporary trade war truce while putting off actions needed to solve problems. As a result, there has been no change at all in causes for concern. Is this true? The two most important aspects of the current situation are (1) the lack of any signs of a change in the key elements of the US-China struggle for hegemony and (2) actions taken by the United States and China to prevent as much as possible the trade war from impacting the economy and global markets for the time being. Regarding hegemony, there has never been any point where the two countries could reach a fundamental compromise. All the two countries can do is to try to contain each other. Each country is placing priority on near-term economic stability as the most important tactic for limiting the other's power. The US-China trade war is very unlikely to trigger a US recession. Even if the failure to reach a compromise with China after 90 days results in additional US tariffs, US officials will probably thoroughly examine the potential impact of higher tariffs on the US economy before they are enacted. Consequently, uncertainty regarding the trade war has been significantly reduced.

**The US cycle of interest rate hikes is coming to an end**

Last week, Fed Chairman Jerome Powell said that short-term interest rates are near the neutral level and there will probably be only two or three more hikes. The reason for this statement is that inflation is not speeding up. Wages are continuing to climb at a rate of almost 3%. But pressure on companies to raise prices is relatively low because of increasing productivity. This has prevented the inflation from reaching its 2% target. The US economy is healthy and the country is at full employment with an unemployment rate below 4%. Why isn't there any upward pressure on inflation? Experiencing economic health, low inflation and low interest rates at the same time is too good to be true. Nevertheless, this extremely favorable situation will probably continue for the foreseeable future under the oversight of the Fed chairman. Financial markets are just now beginning to factor in the upcoming end to US monetary tightening.

Long-term interest rates have been moving up because of monetary tightening that includes short-term interest rate hikes. Now that people are beginning to expect an end to these hikes, the US long-term interest rate has pulled back from 3.2% to 2.99% at the end of last week. All indications point to an end to the upward trend for long-term interest rates as well.

In the past, monetary tightening has always been the cause of an end to a period of US economic expansion. Naturally, people are worried that the ongoing monetary tightening means an economic downturn is near. However, no one can deny that the economic conditions for full-scale monetary tightening do not exist right now. The long-term interest rate has increased but is still only about 3%, half of the nominal US economic growth rate of about 6%. Long-term interest rates are far from the level where they would start to slow down economic growth.

**A powerful relief rally may start soon**

Due to this positive outlook, it is still far too early to adopt a pessimistic view of the economy. Sharp drops in stock prices in February and October 2018 caused an increasing number of people to think that the prolonged upturn in stock prices and longest postwar period of economic expansion are both in their final stages. However, two potential causes of an end to economic growth – the US-China trade war and US monetary tightening – are no longer a reason for concern at this time. This is a very significant development.

Stock prices may recover only slowly because of the severe losses incurred by risk-takers due to the surprisingly large stock market downturns and extreme volatility. But there is also reason to expect a rapid rebound. After all, stocks sold off for technical reasons will be bought back for the same reasons. Some people think the death of the multi-year bull market is imminent because of the double-top chart pattern in 2018, with peaks in February and October. But there seems to exist no double-top, as the September high was above the January high and that the February low was below the October low. For these reasons, it is quite possible that the stock market will regain its energy early in 2019.

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