Deglobalisation?

The usual themes continued to dominate the headlines this week: Coronavirus, Brexit, economic recovery, Europe's 'Hamilton moment', US-China trade tensions and so-forth.

Of these, the increasing US-China tension has pre-occupied the thoughts of investors. The question is whether or not rising tensions will negate the potential positive effect on markets of any forthcoming bounce in industrial production.

So what happened?

On Thursday, China's National People's Congress confirmed plans to pass a bill establishing an enforcement mechanism for ensuring national security for Hong Kong. No further details were forthcoming on Thursday according to Bloomberg but, according to press reports, Beijing is effectively moving to bypass the city's legislature to implement national security laws. Residents fear the move will erode freedoms of speech, assembly and the press. In response, the Hang Seng Index plunged 5.6%, with real-estate firms the worst hit.

Democracy advocates called for protests against the legislation and President Trump said he would respond "very strongly".

Why does the US have any say?

Well each year the US Secretary of State, now Mike Pompeo, has to declare whether Hong Kong still enjoys a high degree of autonomy from Beijing in order to assess the city's special trading privileges with the US.

LATEST

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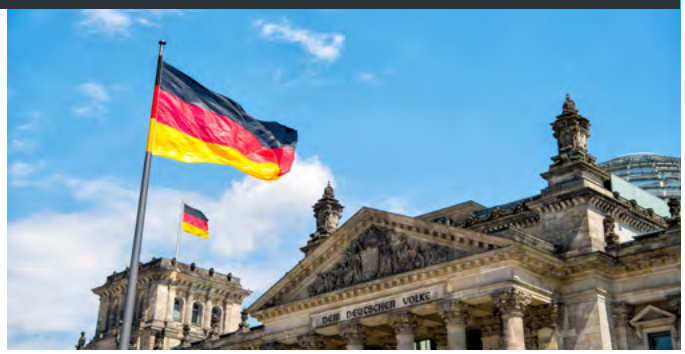
Most analysts do not think it is a coincidence that China announced this new Hong Kong law one day before it dropped its growth target. Keeping a growth target in place would have been a signal of weakness to Trump. The Chinese leadership has dared Trump to take action knowing that any real action taken by Trump would not only be bad for China, but also bad for US and global stocks in an election year when Trump does not want a weak stock market.

The US should be less worried about China given that the size of America's working-age population is set to more than double in size relative to China's over the next 80 years, but this is not Trump's view. The US under Trump is badly placed to wage a new cold war against China. Borrowing from James Ganesh, the last cold war was won by the US with cultural attraction, economic inducements, diplomatic finesse and military protection. This is hardly what is on offer today from the Trump administration.

So, investors are concerned that increasing tension between the US and China could be a bad thing for risk assets. On the other hand, based on forecasts from Jonathan Wilmot global industrial production momentum looks set to rebound from -20% per annum to +20% per annum in the space of a few months. This morning, the Euro Area flash manufacturing PMI – a measure of manufacturing strength – for May came in at 39.5 compared with an expectation of 38.

Last week Elon Musk specifically cited Tesla's experience at its factory in China as providing a template for how to resume production in the US safely and it appears that other major firms are learning how to live with the virus too.



A Hamilton moment?

Another major piece of news, which could prove to have a lasting positive effect, was the announcement that French president Macron and German Chancellor Merkel conjured up a Hamilton moment this week. You may have seen the musical Hamilton. It is based on the story of Alexander Hamilton who, in 1790, paved the path to the creation of the US's federal system. His idea was to transfer the revolutionary war debts accrued by the states to the federal government and then let President Washington levy taxes and issue treasury securities to repay those obligations.

According to Bloomberg, Merkel agreed that German taxpayers will underwrite as much as €135bn of aid to help the hardest hit countries in the Eurozone rebuild their economies post the virus. This plan still faces many hurdles since a group of four EU countries are already lobbying against it but we see this as a positive sign that France and Germany were able to come proactively to an agreement without markets having to force their hand. This should be beneficial for risk assets in Europe and we look forward to seeing if this German/French proposal becomes law in the Eurozone.

So, things are balanced precariously.