THE WALL STREET JOURNAL.
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U.S. News: Economic Output Steamed Ahead in Second Quarter

By Paul Kiernan
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Corrections & Amplifications

China is the U.S.'s largest trading partner. A July 2 U.S. News article about economic output incorrectly said it is the biggest foreign buyer of U.S. goods.

(WSJ July 20, 2018)

(END)

WASHINGTON -- The U.S. economy has just completed one of its strongest quarters of this expansion, bouncing back from a modest first quarter while the rest of the world appeared to stumble.

Several closely watched models that track economic output point to the fastest growth since the third quarter of 2014, when the economy expanded at a 5.2% annualized rate.

The Federal Reserve Bank of Atlanta's GDPNow model estimates a seasonally adjusted annual growth rate of 3.8%, while forecasting firm Macroeconomic Advisers' projection says gross domestic product looks to have expanded at a 4.8% rate. Only once in the 35 quarters since the recession ended has GDP growth exceeded the latter pace.

Spending by consumers, businesses and the government appeared solid in the second quarter. Early data suggest output was further boosted by inventory investment and a surge in exports. But economists warn that output is likely outpacing the economy's long-run capacity for growth, raising the possibility of a slowdown next year.

The expansion enters its 10th year this month, building on what is already the second-longest expansion on record. Faster growth has helped drive the unemployment rate to its lowest level in 18 years, fueled corporate-profit growth and lifted President Donald Trump's approval ratings.

Analysts have been raising their earnings estimates for publicly traded companies, many of which are due to report results in the next month.

Howard Silverblatt, a senior industry analyst at S&P Dow Jones Indices, said operating earnings -- a measure of earnings without some one-time charges and gains -- are estimated to have risen 27% from the second quarter of 2017 to $38.65 per share across the **S&P 500**, thanks to recent federal tax cuts and higher sales. That would mark the third consecutive quarter of double-digit earnings growth for the **S&P 500**, similar in magnitude to first-quarter growth and faster than 21% growth in the fourth quarter.

The Trump administration has described the pickup as a new norm. "We've entered an investment boom," Lawrence Kudlow, Mr. Trump's top economic adviser, said in an interview. "We're going to get over 4% real GDP in the second quarter and it looks like we'll have a very strong second half of the year. The story in 2019 is going to be similar."

But the second quarter might instead be a high point in the recent growth spurt. Few outside the White House think the U.S. economy will be able to maintain this pace, in part because of the country's aging population. GDP growth has averaged 2.2% during this expansion, with previous bouts of above-trend growth giving way to slower quarters.

It is unlikely to be different this time around, some economists say. "Everyone has growth slowing next year," St. Louis Fed President James Bullard said in an interview last week, referring to the forecasts of the 15 Federal Reserve officials who meet to discuss monetary policy. "It's a temporary blip in growth."

Fed officials' median estimate calls for 2.8% GDP growth this year, 2.4% in 2019 and 1.8% in the long run.

One of the factors pushing up second-quarter GDP projections was a jump in exports during April and May. The latter month included a 28% year-to-year rise in shipments of food, feeds and beverages.

Economists at Barclays said that could reflect private-sector efforts to get ahead of impending tariff increases on goods such as soybeans and Kentucky bourbon, which U.S. trade partners have identified as targets for retaliatory tariffs. If that is the case, exports could slow in the months ahead as the Trump administration's trade dispute with China, the biggest foreign buyer of U.S. goods, heats up.

Another possible casualty of the trade dispute is business and consumer sentiment, which can affect investment and spending decisions. While sentiment is high by historical standards, the Conference Board said last week its consumer-confidence index fell more than anticipated in June.

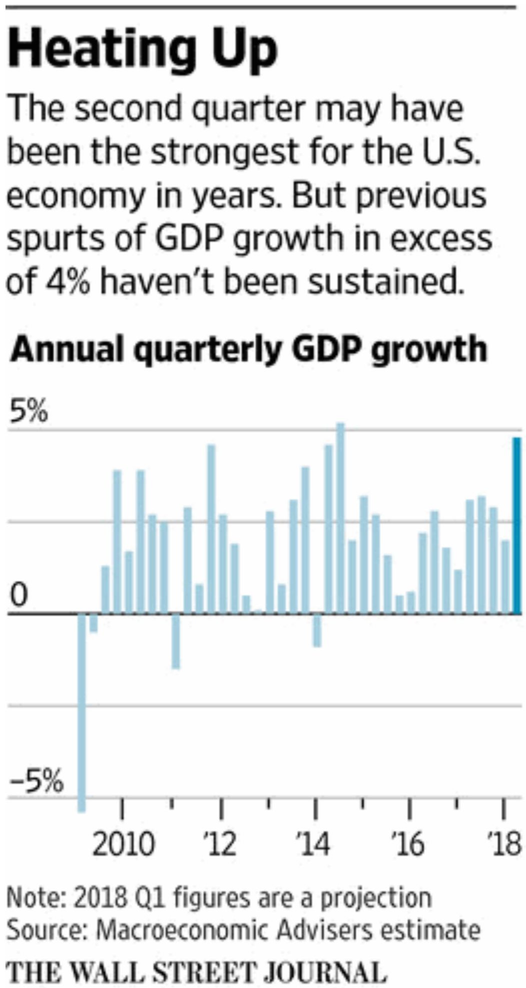
Business investment has picked up, but it is unclear if it will be sustained. It rose at a 10.4% annual rate in the first quarter, the Commerce Department said. However, orders for nondefense capital goods excluding aircraft, a forward-looking investment indicator, have failed to post two consecutive months of growth since last fall.

Perhaps the biggest concern is that the economy will overheat. A 3.8% unemployment rate suggests the labor market is as tight as it was in the late 1990s, which coincided with an unsustainable tech boom.

With inflation at a six-year high, the Fed's goal is to raise interest rates just enough to keep prices from rising faster, but not so much as to smother growth. It is a task that policy makers have never managed without tipping the economy into recession.

"The economy is kind of bumping up against capacity constraints," said Ben Herzon, an economist at Macroeconomic Advisers. "We'll just cross our fingers that we don't get a boom-bust scenario."

Harriet Torry and Nick Timiraos contributed to this article.



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THE WALL STREET JOURNAL.
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Big Tech Plunges Into Correction --- FANG group of stocks has dropped after disappointing quarterly results, guarded views

By Akane Otani
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A closely watched **stock index** of global technology giants tumbled into correction territory, showing the fragility of investors' bets on the popular FANG group of stocks.

The NYSE FANG+ Index -- which comprises Facebook Inc., Amazon.com Inc., Netflix Inc. and Google parent Alphabet Inc., as well as Apple Inc., Twitter Inc., Tesla Inc., Nvidia Corp. and Chinese behemoths Alibaba Group Holding Ltd. and Baidu Inc. -- dropped Monday as investors pulled back broadly from technology shares.

The index fell 2.8% Monday, slipping 10% below its June 20 record and entering correction territory for the second time this year -- something that last happened three years ago, according to the WSJ Market Data Group.

The FANG+ stocks have soared past the **S&P 500** this year as investors bet on technology upending the ways people shop, communicate and entertain themselves.

But over the past month, a number of the FANG group of stocks have tumbled following disappointing earnings reports and cautious outlooks about future growth, with Facebook on Thursday logging the biggest one-day loss in market value of a publicly traded company and Twitter on Friday notching its biggest one-day decline in years.

Both stocks continued slumping Monday, with Facebook off 2.2% and Twitter down 8%.

Those declines helped drag down other stocks such as Amazon.com and Alphabet, whose shares had initially jumped after their latest quarterly results flew past analysts' estimates.

Amazon tumbled 2.1%, while Alphabet slid 1.8%.

Shares of Netflix, which posted disappointing subscriber numbers earlier this month, fell 5.7%, bringing its July losses to 14%.

Apple, which is often grouped with the FANG stocks, declined 0.6% ahead of Tuesday's earnings report, which will be the next big test for the industry.

Moving forward, "there is going to be more scrutiny for the FAANG names," said Omar Aguilar, chief investment officer of equities at Charles Schwab Investment Management, adding that "clearly the valuations for certain parts of the technology sector are a little bit stretched."

In recent months, many investors have grown increasingly wary of companies in the social-media space, some of which have run into issues with slowing user growth, controversy over their handling of misinformation and harassment and scrutiny by regulators.

Reports in March showing Facebook had allowed a third-party firm to improperly access tens of millions of users' data sent many of the year's best-performing technology stocks tumbling, in what was the first correction for the NYSE FANG+ index this year.

While some investors used the spring pullback as an opportunity to scoop up shares at a discount, betting that companies dependent on data ultimately wouldn't be affected by increased scrutiny by regulators, others have remained cautious ever since -- especially after an uneven round of earnings results.

"Facebook had lower users and Twitter had lower users -- so people are wondering if this is a continuing trend of users seeking out other avenues," said Mohit Bajaj, director of ETF trading solutions at brokerage WallachBeth Capital. "I do think there's been conviction as far as profit-taking because a lot of these tech names have run up so far," he said.

At this juncture, Charles Schwab's Mr. Aguilar believes investors would do well to diversify their holdings.

He added that he thinks specific areas within the technology industry -- namely e-commerce and consumer electronics -- are more likely to fare well in the second half of the year.

To be sure, the NYSE FANG+ index is still up nearly 23% so far this year.

But as the technology rout continued Monday, short-sellers piled into bets on the industry's behemoths falling even further.

Investors betting against Facebook, Amazon, Apple, Netflix and Alphabet are down $8.1 billion for the year. But they have recouped almost one-quarter of their 2018 losses in just the past three trading days, raking in around $921 million in mark-to-market profits as of Monday afternoon, according to Ihor Dusaniwsky, managing director of predictive analytics at S3 Partners.

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The New York Times

Business Day

New Round of U.S.-China Trade War Rattles Global Markets

By Alexandra Stevenson
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HONG KONG — President Trump's escalating trade war with China weighed on global markets on Wednesday.

The selling extended to Wall Street, though declines in the United States weren't as steep as those in Europe and Asia. Companies with China exposure were among the worst hit.

The sell-off across Europe was broad, with major markets down more than 1 percent. The Chinese stock benchmarks finished the day down nearly 2 percent, after the Trump administration threatened to impose new tariffs on Chinese goods. Stocks in Japan and South Korea also fell, though by less.

China's currency was also hit by selling. China keeps a tight grip on the value of its currency, but the small amount that is traded outside of its borders — the so-called offshore renminbi — weakened against the dollar.

The intensifying trade war adds to China's challenges, including signs that its effort to tame its debt problems could slow economic growth. Investors have turned skittish as a result. China has now entered **bear market** territory — when prices drop by more than 20 percent from a peak — with its market hovering at levels not seen since a rout three years ago set off a domino effect in global trading.

The Trump administration promised Tuesday night to impose tariffs on an additional $200 billion of Chinese products, including chemicals, handbags, petroleum and fish. That move came just days after the United States started levies on $34 billion worth of Chinese goods like robotics, ball bearings and even airplane parts.

The Chinese government pledged Wednesday that it would take unspecified countermeasures. It has matched previous tariffs dollar for dollar, leading some investors to worry that trade could get costlier still.

David French, an executive at the National Retail Federation, called the latest round of tariffs by the Trump administration a "reckless strategy that will boomerang back to harm U.S. families and workers."

"The threat to the U.S. economy is less about a question of 'if' and more about 'when' and 'how bad,'" Mr. French said in an emailed statement.

China's main **stock index** lost 1.8 percent on Wednesday. In the southern city of Shenzhen, where many new technology and smaller companies are traded, the market fell by 2 percent. In Hong Kong, an index of China's biggest companies listed dropped 1.5 percent.

Reaction was more reserved in other Asian markets on Wednesday. In Tokyo, the main index fell 1.2 percent. Stocks in Seoul fell less than 1 percent. A broad index of Europe's biggest companies was down 1.1 percent in morning trading.

Cao Li contributed research. Matt Phillips contributed reporting from New York.

An electronic board in Hong Kong showing a drop in a local **stock index** on Wednesday. Shares fell after the Trump Administration threatened to impose more tariffs on China. | Vincent Yu/Associated Press

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The New York Times

Contributing Op-Ed Writer
Opinion
The Myth of Corporate America's Short-Term Thinking

By Steven Rattner
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American companies, according to their critics, are so focused on making quick profits that they have abdicated building for the long term. That idea has captivated policymakers, commentators and even some leading business executives.

The complaint has reached a fevered pitch amid news that companies are diverting much of their proceeds from the recent tax cut into buying back record amounts of their own shares.

But there is little evidence to back up the idea that American businesses are overly focused on short-term boosts to profits and stock prices.

The easiest path for companies to goose earnings would be to cut back on investment. However, business investment has remained between 11 percent and 15 percent of gross domestic product since 1970. Last year, corporate investment, which includes structures, equipment and the like, totaled 12.6 percent of G.D.P.

Included in those investments is corporate spending on research and development — an undertaking with a long payback — which has reached its highest ever percentage of G.D.P. and has become a more important part of overall investment.

I have spent three decades analyzing, advising and investing in companies, and I believe American businesses are as willing to fund worthy projects as they have ever been. Investors are fully prepared to back companies focused on the long term. Far from penalizing public companies building for the future, the **stock market** often rewards them.

Consider America's five largest public companies by market capitalization: Apple, Amazon, Alphabet (Google), Microsoft and Facebook. All have been investing heavily, and all sport heady valuations.

Amazon, in particular, often appears almost disdainful of profits; last year, it earned just $3 billion on its vast $178 billion of revenues. With a **stock market** capitalization of $805 billion, that gives it a price to earnings ratio of 268. By comparison, the average **S&P 500** company trades at 21 times earnings. On the smaller end, many biotech companies, which often have no revenues, let alone any profits, also trade at handsome (some would say absurd) valuations.

Away from the public markets, a towering wall of venture capital — hardly a short-term investment strategy — stands ready to fund pretty much any vaguely promising new idea.

That brings us back to the stock repurchases. Yes, they often bump up share prices. But they are really a consequence of the vast cash reserves — $2.4 trillion and rising — held by American companies. When top executives don't see more attractive investment opportunities, at least not in the United States, it can be a prudent use of that cash to buy back shares in their own companies.

As companies return capital to shareholders through buybacks or dividends, the money doesn't disappear. Its recipients typically reinvest it in other opportunities. That's not short-term thinking; that's efficiency.

Advocates of the recent tax legislation say it will provide more incentives for American companies to invest at home. I'd certainly welcome that. But taxes are only part of the equation. Businesses must also see the possibility of attractive returns, which are not always readily available in our relatively slow-growth economy.

That’s why many American companies see greater opportunity to expand abroad. Between 2000 and 2015, American multinationals hired 4.3 million people in the United States but added 6.2 million jobs overseas.

Meanwhile, spending on factories and equipment in the United States has become a less important part of overall business investment, consistent with the decline in manufacturing’s share as companies shift production to lower-cost countries.

Decrying “short-termism” is hardly a new phenomenon. A Harvard Business Review article pronounced that American business is “servicing existing markets rather than creating new ones” and is devoted to “short-term returns and management by the numbers.”

That was in 1980. Nine years later, Akio Morita, the co-founder of Sony, declared that “America looks 10 minutes ahead; Japan looks 10 years.”

Today, American technology firms are, of course, dominant, while Sony is a shadow of its former self.

Across the spectrum, companies in the United States continue to lead the developed world, and profits are at record levels. If American business had been short-term focused since 1980, profits would be falling, not rising, and our companies would be faltering.

Recently, the Business Roundtable — corporate America’s pre-eminent trade organization — called for eliminating quarterly earnings guidance as a means of reducing short-termism. Such recommendations are, at best, a distraction. Only 28 percent of major companies even provide quarterly guidance, and those forecasts help set investors’ expectations and smooth market **volatility**.

The Business Roundtable should make it a higher priority to call for tighter corporate governance. While the “buddy system” of picking directors has subsided considerably, boards are often still too compliant. Executive compensation, which has grown exponentially faster than workers’ pay, is out of control and should be more closely tied to long-term performance.

Shareholders should be able to nominate directors more easily. To better represent owners, the roles of chairman and chief executive officer should be split, as they are in many European companies.

But corporate executives recoil from those ideas. They prefer to complain about equity markets that often swiftly punish laggards. Isn’t that what investors are supposed to do?

Steven Rattner, who served as counselor to the Treasury secretary in the Obama administration, is a Wall Street executive and a contributing opinion writer. For latest updates and posts, please visit stevenrattner.com and follow me on Twitter (@SteveRattner) and Facebook.

A silhouette on a screen at the New York Stock Exchange. | Richard Drew/Associated Press

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THE WALL STREET JOURNAL.

Markets

Tax Wrinkle Spurs Pension Funds to Buy More Treasurys; Extra contributions have in part been spurred by the tax-code overhaul, damping long-term yields

By Ben Eisen and Daniel Kruger
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U.S. companies are funneling extra money into their pension funds to take advantage of temporary tax savings , moves that are helping suppress yields on long-term Treasurys.

S&P 500 companies are contributing to pension plans this year at a pace expected to nearly match 2017's level, which at $63 billion was the most since 2003, according to Goldman Sachs Asset Management. Last year's contributions were spurred in part by companies anticipating changes in the U.S. tax-code overhaul.

That and continued contributions this year have been a boon for the Treasury market because pension funds tend to invest in long-dated bonds to match their long-term liabilities. The yield on the 30-year bond has been falling recently, closing at 2.953%% on Thursday, down from a recent peak of 3.245% in mid-May.

Analysts are pinning the drop in yields—which happens as prices rise—partly on demand from pension funds. Long-term rates have remained low and U.S. inflation has picked up this year. Inflation poses a risk to bonds, and especially longer-dated ones, because it erodes the purchasing power of fixed-interest and principal payments.

Long-term yields are "very low because people are still putting money into Treasurys," said Torsten Slok, an economist at Deutsche Bank. The difference between yields on 30- and **10**-**year Treasury** debt has shrunk to about 0.13 percentage point this week from about 0.33 percentage point at the start of this year.

Voluntary contributions to pension funds, which already were brisk last year, have taken off recently thanks to the passage of the tax overhaul. This introduced a window for companies with underfunded plans to make additional contributions and garner a tax benefit, analysts say.

Firms that contribute through mid-September of this year can receive deductions based on the old 35% corporate tax rate, rather than the new 21% rate. A company that contributes $1 million to an underfunded pension plan could have $350,000 in tax savings before the deadline, but would have savings of just $210,000 after September.

Those making discretionary pension contributions include Verizon Communications Inc ., which added $1 billion to its pension plan in the first three months of the year, a large enough sum that the telecom giant won't have to make mandatory contributions for eight years, the company said in April. A Verizon spokesman said the tax benefit was a factor in the contribution.

PepsiCo Inc . said in April that it made a discretionary contribution of $1.4 billion. Deere & Co . and United Parcel Service Inc . both have cited the tax law as the reason for increasing their voluntary pension contributions.

"You will probably see more do it over the next few months," said Michael Moran, a pension strategist for Goldman Sachs Asset Management.

One sign that pensions have a lot of fresh money to pour into U.S. government debt is strong demand for what are called stripped long-term Treasurys. These securities are created when bond dealers cleave a bond into separate interest-only and principal-only instruments.

Pension funds often purchase the principal-only instruments, which are akin to zero-coupon bonds. The funds purchase the debt at a deep discount, forgo regular interest payments and instead receive the debt's full face value at maturity. This gives pension plans funds when a liability is coming due and provides them with more financial flexibility in the meantime.

The amount of stripped long-term Treasury bonds rose 9.4% in the first five months of 2018, putting them on track to grow at more than twice the pace of the previous year, according to data from BMO Capital Markets . That would mark the fastest growth since 2010.

Pension-fund purchases of both principal-only stripped long-term Treasurys and Treasury debt have played a key role in keeping long-term yields low, analysts said. And pension funds' debt appetite may grow in coming months as companies that have been waiting for higher rates make their move before the tax window closes, said Richard Sega , chief investment officer at Conning, who manages money for insurance companies and pension funds.

After that, though, pension funds could have a reduced appetite for longer-dated Treasurys. Combined with a quicker pace of government-debt issuance due to growing deficits, this could help to push yields higher, said Deutsche Bank 's Mr. Slok.

Demographic shifts toward an older workforce, though, could lead companies to continue increasing pension-fund contributions. Meanwhile, companies and governments in developed economies outside the U.S. will face similar demographic challenges, which also would lead to more Treasury buying, Mr. Sega said. "This is a long-term global trend," he said.

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Related

* The Risk Pension Funds Can't Escape (Feb. 20)

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THE WALL STREET JOURNAL.

Markets

Bridgewater Wins License to Sell Investment Products in China; U.S. hedge-fund firm, the world's largest, has had a Shanghai unit since 2016

By Stella Yifan Xie
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Bridgewater Associates LP, the world's largest hedge-fund firm, has won approval to sell investment products to institutional and high-net-worth investors in China.

Bridgewater (China) Investment Management Co., a Shanghai-based unit of the U.S. firm, obtained a license on June 29 to be a private fund manager, according to the Asset Management Association of China, a quasiofficial body. It has six months to launch its first onshore investment fund.

The Westport, Conn.-based firm joins a dozen other foreign asset managers—including BlackRock Inc., Schroders PLC and Fidelity International—that have gained approval to tap into China's booming asset-management industry. They are barred from selling products in China that invest in assets outside the country as Beijing remains wary of capital outflows, the Journal reported previously.

Bridgewater, which manages about $160 billion in assets globally, received approval to set up a Shanghai subsidiary in May 2016 and has been allowed to trade directly in Chinese markets. It currently manages some money from Chinese institutions and the country's government. The latest approval means it can now raise money domestically to invest within the country.

The license approval for Bridgewater, which was founded more than four decades ago by Ray Dalio, comes at a turbulent time for China's **financial markets**. The main stock benchmark has underperformed its global peers this year, and recently entered **bear-market** territory, hurt by an escalating trade war between the U.S. and China and recent weakness in the country's economy and currency.

It is unclear what type of products Bridgewater plans to sell in China. Some analysts doubt it can replicate its U.S. success, given Beijing's tight restrictions on index futures and other derivatives since the country's 2015 **stock-market** rout.

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THE WALL STREET JOURNAL.

Heard on the Street
Markets
What the Stuttering Corporate Bond Market Means for Stocks; Stocks and corporate bond returns are diverging. That's an important signal to watch

By Richard Barley
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U.S. stocks have managed to grind out gains this year, despite a wild ride. That's not true of U.S. corporate bonds, the yin to stocks' yang. But the stuttering credit market could in time become a problem for stocks, too.

While the total return for the **S&P 500** is north of 4% this year, U.S. investment-grade corporate bonds have been heading steadily in the wrong direction since February. The spread between the yield on U.S. Treasurys and that on investment-grade company debt has widened to 1.28 percentage points, from a postcrisis low of 0.9 percentage point at the start of February, ICE BofAML index data show. The index has returned minus 2.7% this year, underperforming Treasurys, down 0.9%.

The move isn't as dramatic as this year's blowup in Italian bonds, or steep drops in emerging-market currencies. But it has shown little sign of reversing, even as more economically sensitive assets such as stocks and high-yield bonds have posted modest gains, shored up by the idea that U.S. growth is strong relative to the rest of the world.

The selloff has taken the yield on corporate bonds above 4% for the first time since 2011. Company debt was previously buoyed by ultraloose monetary policy. Now the Federal Reserve is raising interest rates and starting to wind down its balance sheet. This brings companies into greater competition for dollar funding, especially with short-dated U.S. Treasury yields now at a 10-year high. Previously there was little alternative for yield-seeking investors but to buy riskier debt.

And the corporate bond market is bigger and riskier than ever. The ICE BofAML index now contains more than $6 trillion of bonds, more than double the amount 10 years ago. Nearly half of it is rated triple-B, the lowest investment-grade category.

Previous bouts of turmoil, such as when plunging **oil prices** and fears about global growth rocked markets in early 2016, lured investors into corporate bonds. Now investors seem suspicious of buying the dip. The probability that U.S. investment-grade bond returns will beat Treasurys over the next 12 months is now 47%, down from 61% a year ago, according to a survey of over 200 investors by Absolute Strategy Research. The same investors are still relatively **bullish** on earnings but seem to see more opportunity to benefit through stocks than bonds.

The end of easy money is slowly eroding a key support for company balance sheets. This, in turn, will eat away at their earnings and risk appetite. Stock investors shouldn't ignore the trouble brewing in corporate bond markets.

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State and Local Pension Woes Are Starting to Bite --- The shortfall is hitting retirees with little time to engineer a Plan B

By Sarah Krouse
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Corrections & Amplifications

Moody's Investors Service estimates state and local pensions have unfunded liabilities of about $4 trillion, roughly equal to the output of the world's fourth-largest economy. A Page One article Tuesday about pension fund shortfalls incorrectly said $5 trillion, about the size of the world's third-largest economy, based on incorrect data provided by Moody's.

(WSJ August 2, 2018)

(END)

For the past century, a public pension was an ironclad promise. Whatever else happened, retired policemen and firefighters and teachers would be paid.

That is no longer the case.

Many cities and states can no longer afford the unsustainable retirement promises made to millions of public workers over many years. By one estimate they are short $5 trillion, an amount that is roughly equal to the output of the world's third-largest economy.

Certain pension funds face the prospect of insolvency unless governments increase taxes, divert funds or persuade workers to relinquish money they are owed. It is increasingly likely that retirees, as well as new workers, will be forced to take deeper benefit cuts.

In Kentucky, a major pension plan covering state employees had about 16% of what it needs to fulfill earlier promises, according to the Public Plans Database, which tracks state and local pension funds, based on 2017 fiscal year figures. A fund covering Chicago municipal employees had less than 30% of what it needed in that fiscal year, according to the same database. New Jersey's pension system for state workers is so underfunded it could run out of money in 12 years, according to a Pew Charitable Trusts study.

When the math no longer works the result is Central Falls, R.I., a city of 19,359. Today, retired police and firefighters are wrestling with the consequences of agreeing to cut their monthly pension checks by as much as 55% when the town was working to escape insolvency. The fiscal situation of the city, which filed for bankruptcy in 2011, has improved, but the retirees aren't getting their full pensions back.

"It's not only a financial thing," said 73-year-old former Central Falls firefighter Paul Grenon, who retired from the department after a falling wall punctured his lung, broke his back and five ribs, and left him unable to climb ladders. "It really gets you sick mentally and physically to go through something like this. It's a betrayal, as far as I'm concerned."

Uncertainty over public pensions is one reason some Americans are reaching retirement age on shaky financial ground. For this group, median incomes, including Social Security and retirement fund receipts, haven't risen in years. They have high average debt, and are often using savings for their children's educations and to care for their elderly parents.

The public pension arose from the aftermath of the U.S. Civil War. New York was the first city in the U.S. with a pension fund for injured police officers in 1857 and then for firefighters in 1866. The concept of a public pension plan for government workers became widespread in the early decades of the 20th century. The understanding was employees would accept relatively lower pay in exchange for richer, guaranteed benefits once they retired.

When times were flush, politicians made overly generous promises. Public-employee unions made unrealistic demands. High-profile municipal employees, such as coaches at public universities, have drawn fire for what some consider too-rich retirement benefits, while some first responders scored rich early retirement and disability arrangements.

Extended lifespans caused costs to soar, as did increasingly expensive medical care, which unions put at the center of contract negotiations, among other benefits.

A technology-led **stock market** boom in the late 1990s produced a brief period of surpluses in pensions, according to figures from Pew, before deficits began to creep higher in the mid 2000s. Deficits accelerated following the 2008 financial crisis, which caused steep losses for many funds just as large numbers of baby boomers began to retire.

State and local pensions lost roughly $35 billion in assets between 2008 and 2009, according to Pew. Liabilities, meanwhile, ballooned by more than $100 billion a year, widening the difference between the amount owed to retirees and assets on hand. Not even a nine-year **bull market** in stocks could close that gap.

Officials, taxpayers and public-sector employees are increasingly at odds as they figure out what comes next. The board overseeing Puerto Rico, which filed for the largest-ever U.S. municipal bankruptcy in 2017, this year certified an average 10% cut in certain retiree pensions as part of a plan to restore the island to solvency. The governor has vowed not to implement it, a face-off that will likely end in court.

In the Bluegrass State, a judge in June ruled that a reduction in new worker benefits championed by Kentucky's governor was unconstitutional because of the way lawmakers passed it. The state's attorney general opposed the cuts. The case could end up at the state Supreme Court.

In California, several cases before the state's Supreme Court are testing an influential 1955 rule that stipulates benefits for public employees can't be cut. Gov. Jerry Brown is predicting pension reductions in the next recession if that rule is loosened. A change in that law might persuade other states to reach for deeper benefit reductions.

State and local pension plans in the U.S. now have less than three-quarters of the money they need to meet their promised payouts, their lowest level since at least 2001, according to Public Plans Database figures weighted by plan size. In dollar terms the hole for state and local pensions is now $5 trillion, according to Moody's Investors Service. Another estimate of unfunded state pension liabilities, from Pew, is $1.4 trillion.

The prospect of lower benefits is particularly daunting for pensioners in their 60s. Those older are likely to die before a large reckoning, while those younger have years left in their careers to make new plans. But many in their 60s have spent four decades assuming a financial promise that is no longer guaranteed.

There are few easy solutions. Cities and states can either raise taxes, cut services or become more aggressive about reducing benefits to retirees. For many years governments were unwilling to take these steps because they weren't politically palatable, although public appetite to cut public-employee benefits is emerging, in states including Wisconsin. Many governments opted to change benefits for new employees, which in some cases didn't fully alleviate funding woes.

In San Jose, Calif., voters approved cuts to police pensions in 2012 only to roll back those changes after hundreds of officers quit and the crime rate increased. The measures were revised, with savings coming in part through changes to retiree health care.

San Jose Mayor Sam Liccardo said the bulk of the police departures took place before the pension revamp as a result of earlier hiring freezes, layoffs and pay cuts. He doesn't see the pension changes as a factor in the crime rate.

San Jose has taken "our medicine perhaps earlier than others have," said Mr. Liccardo. "This is medicine that hundreds of cities and many states are going to have to take," he added.

Retirees in other cash-strapped states said they expect to lose some of what they have been promised. "It may sustain itself before I die," Len Shepard, 68, a retired teacher in Pennsylvania said of the pension system in his state. "But I don't see how it can continue to do so."

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Central Falls, which sits 7 miles north of Rhode Island's capital, is one of several former industrial towns that speckle the Blackstone River Valley.

It provided for public workers under a number of pension plans. Under one, firefighters hired after July 1972 could retire after 20 years of service, essentially in early middle age, receiving half of their final base salary. They could earn another 2% a year for up to five additional years of work and 1% a year after that, up to 65% of their end salary if they retired after 30 years.

The city's required contribution to its police and fire pensions was about $4 million in fiscal year 2011, the last fiscal year before its bankruptcy, or 20% of the total, said Finance Director Leonard Morganis.

Central Falls didn't pay that year, or in either of the previous two, given the severity of the city's economic woes. Rhode Island officials then took the rare step of passing legislation that put bondholders ahead of other creditors and pensioners in the event of a municipal bankruptcy.

After the 2011 bankruptcy, an event that received national attention amid predictions of widespread municipal failures, retirees agreed to 55% cuts because they feared facing even deeper cuts later.

The concessions helped Central Falls emerge from bankruptcy in 2012 and create a "rainy day fund" that now holds $2 million. The town hired a grant writer to help secure money for a new firetruck with smaller wheels custom-made for the town's narrow streets. The truck is emblazoned with an image of Yosemite Sam dressed as a firefighter that reads "The Wild Mile," the city's nickname.

Even though the town is on a better fiscal footing, and state contributions blunted the full impact of the cuts, retired workers are still grappling with how their lives were altered in matters big and small. Two men lost their homes to foreclosure after falling behind on their mortgages. Others had problems paying medical bills as they fought terminal illnesses.

Mr. Grenon, the firefighter who retired after he was injured, says the pension reduction left him without enough money each month to cover a $300 prescription lung medication. He has medical coverage but said the medication is beyond what is covered.

George Aissis, a retired Central Falls firefighter, says he has so little left in his checking account he has to buy groceries when they are on sale and use as little power or gas as possible.

The pension settlement cut his income by $1,200 a month to about $2,600, including an additional state contribution. On one recent Wednesday, he said there was $6.01 in his checking account.

"I never used coupons before, but I know about coupons now," Mr. Aissis said. "You gotta cut back on things when the money is not there."

Central Falls Mayor James Diossa, in an interview, called the 2011 pension cuts "unfortunate" but said they did alleviate long-term budget pressures for the city. "These aren't big pensions, but a lot of these folks built their lives around it," he said. "To see them get cut was devastating."

Under the changes, many current workers have to work longer than they thought when they signed up and some will get a lower percentage of their final salary than they would have under the old plan. Some retirees whose income was cut are now arguing their benefits should be restored to prebankruptcy levels.

The person in charge of that effort, 52-year-old former firefighter Don Cardin, acknowledged he and his colleagues have no legal recourse to restore lost benefits since they signed them away in the settlement.

One of his bleaker arguments contends that firefighters tend to have shorter lifespans because of smoke inhalation and other workplace hazards. That means the town, which also covers some health benefits, is unlikely to have to pay the added benefits for more than a decade.

Despite the city's surplus, the mayor said Central Falls is unlikely to restore the pensions.

What happened in Central Falls is "certainly not going to be a one-off," said Robert Flanders, who acted as the city's state-appointed receiver. "Because other cities and towns, not just in Rhode Island but across the country, are still in bad shape."

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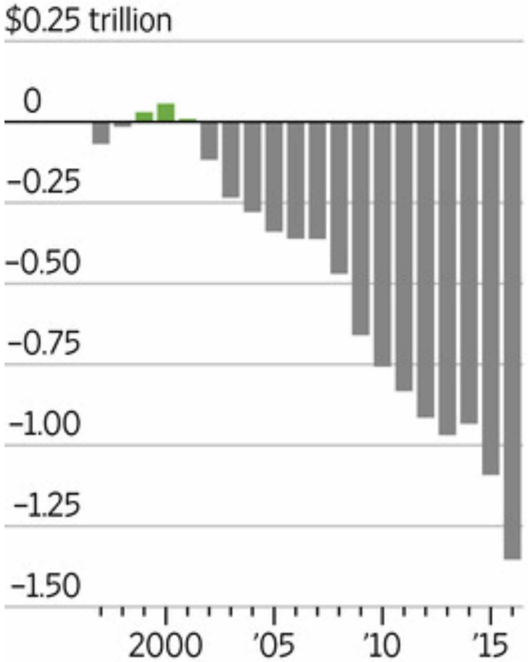
Deepening Deficit

State pension deficits have grown steadily over the past two decades.



Source: Pew Charitable Trusts

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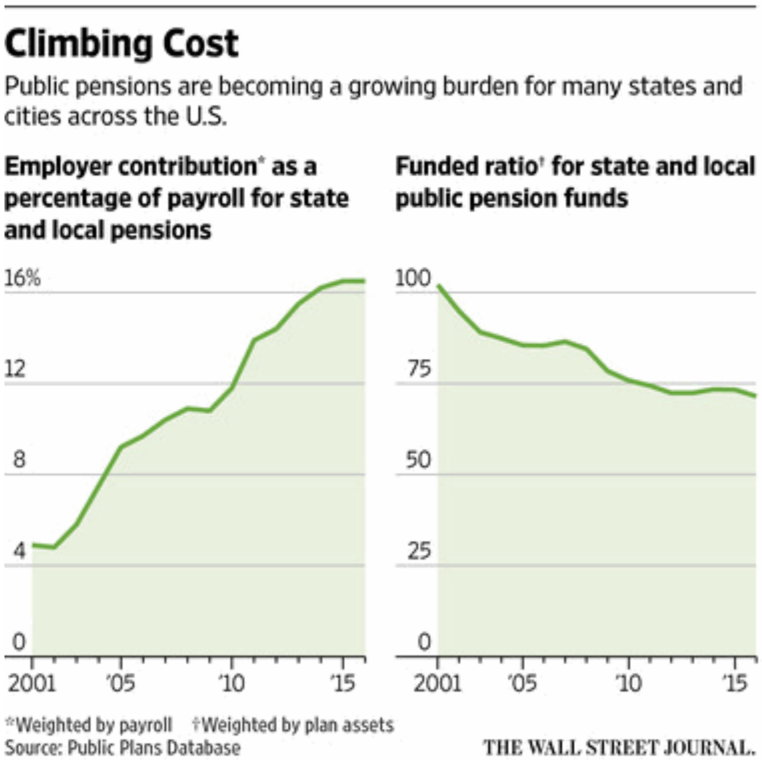

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How to Tell if the Trade War Is Starting to Damage the U.S. Economy

By NEIL IRWIN
1,232 words
25 July 2018
The New York Times
NYTF
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There's no question that some American companies are feeling the bite of the trade war that the Trump administration is waging against much of the world.

As others have reported, a Missouri nail factory is laying off people because of tariffs on imported steel; Harley-Davidson plans to move some production to Europe in response to retaliatory tariffs; soybean farmers face a loss of income resulting from new Chinese import taxes.

But it's a mistake to assume that difficulties of individual companies and industries are the same as a force powerful enough to bend the overall trajectory of the United States economy.

''The direct effects on the U.S. economy are small, because the economy is really big and it is mostly domestically driven,'' said Beth Ann Bovino, chief United States economist at Standard & Poor's Ratings Services. ''Still, tariffs hurt, and we're starting to see some precursors of an impact already.''

To assess how the trade war could affect growth, the job market and inflation at the macroeconomic level, you need data. The trouble is that much economic data operates with long time lags. By the time there would be solid evidence that the trade war was doing damage, the damage would already have been done.

But certain indicators are likely to provide early signs of trouble: data that is more big picture than individual anecdotes, but more timely than things like G.D.P. and the unemployment rate.

If you want a dashboard for evidence of economic damage from the trade war, here's what should be on it.

Business Confidence and Capital Spending: Look to Surveys

One of the key ways trade tensions can slow a nation's overall growth is by causing businesses to pull back on capital expenditures.

The hard data on business investment tends to be released with long delays. If executives become gloomier about the future, the earliest evidence will probably come from frequent surveys of them.

For example, the Federal Reserve Bank of Philadelphia surveys manufacturers about their plans for capital spending; that measure has fallen in the last few months. Other surveys, like one of small businesses by the National Federation of Independent Business, suggest more stable capital spending plans.

But while the evidence is uneven today, these market indicators and confidence surveys could amount to the canary in the trade war coal mine if they take a decisive turn for the worse.

''I am watching business sentiment very closely,'' said Nathan Sheets, chief economist of PGIM Fixed Income. ''If we started to see business sentiment turn, that would be an indication that key constituencies in the business community are getting nervous.''

The **Stock Market**: Exporters vs. the Rest

The closest thing to a real-time indicator of the trade war's possible effect on corporate profits is the **stock market**. Several household-name companies with deep exposure to global commerce, like Boeing, Caterpillar and John Deere, have become bellwethers for the trade war.

But to understand whether trade tensions are affecting the overall economy, it's worth watching whether dips in the **stock market** remain limited to those companies with direct exposure to global commerce, or start to encompass even service industries and those with mainly domestic business.

''While a few small companies have been hit very hard by the tit-for-tat tariff war, in general, smaller companies are less impacted than big multinationals with global supply chains and worldwide sales,'' said Blu Putnam, chief economist of the CME Group. ''Hence, the Russell 2000 has been outperforming the **S**.**&P**. **500** as the trade war has intensified.''

If that changes, it will be evidence that the trade war is translating into gloomier prospects for the United States economy as a whole.

Prices and Inflation: What Futures Tell Us

One likely effect of a trade war is on prices -- in most cases, increasing them for American consumers.

This will eventually show up in overall inflation numbers, but that could take time, especially since most of the early rounds of tariffs are aimed not at finished consumer goods but at raw materials and industrial products.

You can get some sense of what's coming by looking at commodity futures markets for items that are affected. Many businesses, for example, have reported higher steel and aluminum prices because of tariffs on imported metals.

Futures markets offer clues as to how long traders think the higher prices will last. For example, the current price for Midwest Domestic Hot-Rolled Coil Steel is $916 per short ton -- but futures prices imply that will fall to $759 by December of 2019.

In other words, for that particular commodity, the smart money seems to think that higher prices will be temporary.

The inverse of higher prices for metals is evident in lower prices for soybeans and other agriculture products -- caused by Chinese and European retaliatory tariffs that depress international demand.

The price of soybeans has fallen sharply. But futures markets currently imply that they will rebound, to $9.04 per bushel by early 2020 from $8.48 now.

For both goods, the market prices suggest the trade distortions will be temporary. If that changes, it will be a bigger deal for both overall price inflation facing consumers and for the incomes of farmers and other producers of commodities.

It's also worth keeping an eye on the producer price index, calculated by the Labor Department, which captures the prices of the raw materials that companies use to make finished products. If the trade war is going to feed into broader consumer inflation, it is likely to show up there first.

Jobs: Look to the Claims

The trade war is arriving amid the healthiest labor market in at least 18 years, with the unemployment rate around 4 percent. But how will we tell if it's starting to cause pain?

The earliest sign would probably be in the portions of business confidence surveys that ask about hiring intentions. The Institute for Supply Management's employment index, a subcomponent of its survey of manufacturers, pulled back a bit in June, but was still at a level indicating healthy job creation.

If indicators like that one started to fall, it would be a sign that the trade war was making companies more reluctant to hire.

Similarly, if the anecdotal reports of layoffs caused by tariffs became widespread, you would expect to see the number of people filing new claims for unemployment benefits spike upward.

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That data is released weekly, so it is the closest thing we have to a real-time barometer of layoffs. But so far it shows no hint of trouble; jobless claims have hovered near record lows in recent weeks -- including hitting the lowest level since 1969 in the most recent report.

How do things look if you put it all together? As of mid-July, the evidence that the trade war is doing meaningful economic damage is scarce. But by keeping an eye on the right tools, it's possible to get early warning signs if that starts to change.

A soybean field in Tiskilwa, Ill. The price of soybeans has fallen sharply after retaliatory tariffs from China and Europe, but futures markets suggest it will rebound. (PHOTOGRAPH BY DANIEL ACKER/REUTERS)

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THE WALL STREET JOURNAL.

Markets

IPO Market Posts Blistering First Half; U.S., global IPO fundraising is on pace for one of the best years on record

By Maureen Farrell
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Corrections & Amplifications

So far this year, 120 companies have used initial public offerings to raise $35.2 billion on U.S. exchanges. That is the highest volume since 2014. An earlier version of this article incorrectly said it was the highest volume since 2012.

An IPO market that was left for dead just two years ago has come roaring back in 2018, with companies raising public capital at a pace rarely seen in the past two decades.

So far this year, 120 companies have used initial public offerings to raise $35.2 billion on U.S. exchanges. That is the highest volume since 2014 and the fourth-busiest year-to-date on record, according to Dealogic, whose data go back to 1995.

Bankers say no single catalyst is pushing companies to tap the public markets for capital. Instead, the surge has been caused by a convergence of favorable business conditions, strong stock markets and investors' hunger for high-growth companies.

Those factors have led to offerings by an array of firms varied by size, industry and age—ranging from the web-storage and collaboration company Dropbox Inc. to home-alarm company ADT Inc. to big-box retailer BJ's Wholesale Club Holdings Inc.

The total amount raised doesn't count one of the largest and most high-profile companies to go public in the U.S. this year. Swedish music-sharing company Spotify Technology SA went public without raising any money through a so-called direct listing.

IPO issuance began to pick up pace last year after a moribund 2016. Helping along this year's rush: Companies are no longer worried they may have to go public at valuations below those they had achieved in the private markets, as a disconnect has largely been erased between public and private-market valuations.

Bankers and lawyers expect the rapid IPO pace to continue for the rest of the year.

"Our global IPO pipeline is stronger now than it's been since the financial crisis," said Evan Damast, global head of equity and fixed income syndicate at Morgan Stanley.

Companies that have gone public in the U.S. this year are trading, on average, 22% above their IPO price, and technology companies have done particularly well, up 53% above their IPO price, according to Dealogic data through Thursday's close of trading. Meanwhile, the **S&P 500** rose less than 2% for the year and the tech-heavy **Nasdaq Composite** climbed 8.7%, during the same period.

"This year we're finding the investor demand for technology IPOs is literally the highest we've ever seen both in terms of the quantity and quality of interest," said Madhu Namburi, JPMorgan Chase & Co.'s head of technology investment banking.

Not that this has dented private-market activity. Many companies continue to raise vast sums there. That companies are tapping both private and public markets defies expectations that companies would largely turn to

IPOs once private funding tightened. Activity so far this year has made it clear both markets can thrive in tandem, at least for now.

"Private markets primarily facilitate companies to raise capital. A public IPO is a landmark event for a company that goes far beyond just raising capital," said Mr. Namburi. Employees of public companies, he said, have a clear sense of the wealth they've earned, and public companies have a currency to use for acquisitions and for future capital-raising.

The largest private companies, including Airbnb Inc., Uber Technologies Inc. and WeWork Cos., which have raised vast amounts of private capital, are expected to hold off on going public until at least 2019, according to people familiar with the companies' plans.

Another closely watched IPO candidate, ride-hailing firm Lyft Inc., recently raised $600 million from mutual fund and hedge-fund investors including Fidelity Investments.

And SoftBank Group Corp. continues to pour money into private companies through its $92 billion tech-focused Vision Fund, extending the IPO timelines of its portfolio companies—and pushing up their private valuations.

Bankers expect to see a steady pace of multibillion-dollar technology companies going public in the U.S. the rest of this year. Among them: Sonos Inc.; Upwork; SurveyMonkey; and Eventbrite Inc.

Tech IPOs, mostly software companies, have been going strong, raising $12.2 billion in 28 deals in the first half of 2018, nearly double the volume from the same period in 2017 and a more-than-tenfold increase from 2016's volume, according to Dealogic.

The largest IPOs in the second half of 2018 are expected to come out of China. Many of the largest Chinese companies planning to debut in 2018, including Meituan Dianping and Xiaomi Corp., will do so in Hong Kong as its stock exchange changed its listing rules this year to allow companies with dual-class shares to list there.

An exception is Tencent Music Entertainment Group, China's largest music-streaming company, which is expected to go public in the U.S. and is expected to be one of the largest IPOs of the year, according to people familiar with the deal.

While 2018 could be a near-record year, bankers and lawyers are betting activity could continue to accelerate from there. "There's a real chance that 2019 could be even stronger than 2018," said JPMorgan Chase's Mr. Namburi.

Write to Maureen Farrell at maureen.farrell@wsj.com

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THE WALL STREET JOURNAL.

Economy

As Economy Surges, Some Fear Slowdown Looms; Expansion in latest quarter looks to be fastest since 2014; China trade dispute could trim gains

By Paul Kiernan
1,257 words
1 July 2018
The Wall Street Journal Online
WSJO
English
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Corrections & Amplifications

WASHINGTON—The U.S. economy has just completed one of its strongest quarters of this expansion, bouncing back from a modest first quarter while the rest of the world appeared to stumble.

Several closely watched models that track economic output point to the fastest growth since the third quarter of 2014, when the economy expanded at a 5.2% annualized rate. The Federal Reserve Bank of Atlanta's GDPNow model estimates a seasonally adjusted annual growth rate of 3.8%, while forecasting firm Macroeconomic Advisers' projection says gross domestic product looks to have expanded at a 4.8% rate. Only once in the 35 quarters since the recession ended has GDP growth exceeded the latter pace.

Spending by consumers, businesses and the government all appeared solid in the second quarter. Early data suggest output was further boosted by inventory investment and a surge in exports. But economists warn that output is likely outpacing the economy's long-run capacity for growth, raising the possibility of a slowdown next year.

The expansion enters its 10th year this month, building on what is already the second-longest expansion on record. Faster growth has helped to drive the unemployment rate to its lowest level in 18 years, fueled quick corporate-profit growth and lifted President Donald Trump's approval ratings.

"There's more money out there, there's more money to be made," said Todd Withrow, a 46-year-old firefighter in South Florida. "The house I bought eight years ago is now worth twice as much. I can't complain about that."

Analysts have been raising their earnings estimates for publicly traded companies, many of which are due to report results in the next month or so.

Howard Silverblatt, a senior industry analyst at S&P Dow Jones Indices, said operating earnings—a measure of earnings without some one-time charges and gains—are estimated to have risen 27% from the second quarter of 2017 to $38.65 per share across the **S&P 500**, thanks to recent federal tax cuts and higher sales. That would mark the third consecutive quarter of double-digit earnings growth for the **S&P 500**, similar in magnitude to first-quarter growth and faster than 21% growth in the fourth quarter.

"We weathered a really tough—well, the toughest—economic cycle from a commodity standpoint," said Bob Craycraft, president and chief executive of BakerCorp International Inc., a provider of liquid-storage tanks to the oil and natural-gas industry, in a conference call on June 27. He was referring to the downturn in oil and commodities prices from 2014 to 2016. "And now with a more robust market that's with higher demand, we feel like all that hard work is paying off."

Sports-apparel company Nike Inc. reported improved earnings for the three months through May 31, ending three straight quarters of declining sales in its home market of North America. The company said its effective tax rate fell to 6.4% from 13.7%, largely because of the recent tax overhaul, and sales also improved.

"Full-price sales are accelerating. Off-price sales are declining, and gross margins are expanding," Nike Chief Financial Officer Andrew Campion said in a conference call on June 28. "So we do see strong momentum, sustainable momentum, going into fiscal year '19."

The Trump administration, which advanced a tax overhaul last year in hopes it would usher in an era of renewed economic vigor, has described the pickup as a new norm. "We've entered an investment boom," Lawrence Kudlow, Mr. Trump's top economic adviser, said in an interview. "We're going to get over 4% real GDP in the second quarter and it looks like we'll have a very strong second half of the year. The story in 2019 is going to be similar."

But the second quarter might instead be a high point in the recent growth spurt. Few outside the White House think the U.S. economy will be able to maintain this pace for long, in part because of the country's aging population. GDP growth has averaged 2.2% during this expansion, with previous bouts of above-trend growth giving way to slower quarters.

It is unlikely to be different this time around, some economists say. "Everyone has growth slowing next year," St. Louis Fed President James Bullard said in an interview last week, referring to the forecasts of the 15 Federal Reserve officials who meet to discuss monetary policy. "It's a temporary blip in growth."

Fed officials' median estimate calls for 2.8% GDP growth this year, 2.4% in 2019 and 1.8% in the long run.

One of the factors pushing up second-quarter GDP projections was a jump in exports during April and May. The latter month included a 28% year-to-year rise in shipments of food, feeds and beverages.

Economists at Barclays said that could reflect private-sector efforts to get ahead of impending tariff increases on goods such as soybeans and Kentucky bourbon, which U.S. trade partners have identified as targets for retaliatory tariffs. If that is the case, exports could slow in the months ahead as the Trump administration's trade dispute with China, the U.S.'s largest trading partner, heats up.

Another possible casualty of the trade dispute is business and consumer sentiment, which can affect investment and spending decisions. While sentiment is high by historical standards, the Conference Board reported last week that its consumer-confidence index declined more than anticipated in June and that expectations fell to the lowest reading since December.

Business investment has picked up, but it is unclear whether it will be sustained. It rose at a 10.4% annual rate in the first quarter, according to the Commerce Department. However orders for nondefense capital goods excluding aircraft, a forward-looking investment indicator, have failed to post two consecutive months of growth since last fall.

"There's some amount of accelerating planned investment in order to capitalize on some of the elements of the tax-cut bill," said David Altig, director of research at the Atlanta Fed, adding that companies appear to be focused on replacing old equipment and updating their technologies to remain competitive. "We still have yet to hear too much in the way of a lot of investment that's fundamentally geared at expansion, what I would call growth-related investment."

Perhaps the biggest concern is that the economy will overheat. A 3.8% unemployment rate suggests the labor market is as tight as it was in the late 1960s, a period that led to a long pickup in inflation, and the late 1990s, which coincided with an unsustainable technology boom.

With inflation at a six-year high, the Fed's goal is to raise interest rates just enough to keep prices from rising faster, but not so much as to smother growth. It is a task that policy makers have never managed without tipping the economy into recession.

"The economy is kind of bumping up against capacity constraints," said Ben Herzon, an economist at Macroeconomic Advisers. "We'll just cross our fingers that we don't get a boom-bust scenario."

Harriet Torry and Nick Timiraos contributed to this article.

Write to Paul Kiernan at paul.kiernan@wsj.com

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* Global Week Ahead: U.S. Employment Report; Swedish Policy Meeting

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WSJ PRO CENTRAL BANKING

Economy

Transcript: Media Q&A With Atlanta Fed's Raphael Bostic in Falls Church, Va. Central banker discusses the possible impact of tariffs and capital buffers at banks

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Federal Reserve Bank of Atlanta President Raphael Bostic answered questions from reporters after speaking at a town hall event in Falls Church, Va., on Friday, July 13, 2018. He discussed the possible impact of tariffs, what an inverted yield curve could mean and capital buffers at banks. Here is a transcript of the exchange, lightly edited for clarity and length.

RAPHAEL BOSTIC: [Q&A in progress] ... So I have people throughout my district who get paid to, basically, drive around and talk to people, collect intelligence – what are you worrying about, what's working for you, what's not working for you, are you having problems hiring people, what are you – (inaudible) – wages, and then they – then we bring it all back. So we'll meet with a hundred to 120 different organizations...and that helps inform how to do this.

Q: Do you then turn around and turn to the banks and say, what kind of finance are you doing in terms of looking at capital – (inaudible) ...

MR. BOSTIC: I usually don't ask that specific but –

Q: I don't know why not.

MR. BOSTIC: Well, we – well, that would be a second tier consideration. For us right now, it's are you getting more people coming in – what are they coming in for – what sorts of deals are they trying to get done – what sorts of investments are they trying to make, right, because for us, it's really – the financing stuff, that's more – today, I think about that more in a business practices than, safety and soundness issue.

Q: OK.

MR. BOSTIC: But the way – I'm just trying to gauge is business getting more optimistic, are they being – (inaudible) – more planning, more investing, or less.

Q: And that's what you haven't seen?

MR. BOSTIC: Hmm?

Q: That's what you haven't really seen?

MR. BOSTIC: It's spotty. It's very spotty. Nothing – I mean, it's a little more but it's not – it's not off the charts to where – I think where – it's not – it's not higher than what you would have expected with the tariffs that we see, right, and it's not consistently been in the things that would lead to a long-run change.

Q: I don't see – (inaudible) – we're seeing the changes it's not happened early on. They are talking to us about planning...as much as anything in terms of – (inaudible) – holding off. But also it's closer to the tax advantage and they don't have to pay for these – you know, until they're getting closer to getting the tax benefit with the current tax laws.

MR. BOSTIC: That may be true. (Inaudible) – I learned in my first year wait until they actually do something –

Q: Well, yeah.

MR. BOSTIC: – because people talk about things a lot and then six months later it's, like, oh, things change – we decided not to – (inaudible).

Q: Well, smaller companies, I think, can hold off longer than larger companies.

MR. BOSTIC: Yeah, so those –

Q: And so there's a bit more pent-up demand at the lower end in terms of things they need to do that have just been –

MR. BOSTIC: Well, they're more constrained.

Q: Yeah.

MR. BOSTIC: I mean, a large company is – often have a lot of cash so –

Q: Yeah.

MR. BOSTIC: – as you're saying, you know, how much – how many – (inaudible) – does Apple have? If Apple wants to do something, they can just do it ...

I think there's also a fair amount of uncertainty about what consumer demand is actually going to be 12 months from now. And so, you know, the tax – tax is one consideration but I think there are a whole lot of other ones that, in some sense, are more fundamental at this point about –

Q: Like what?

MR. BOSTIC: Mainly, like, what the consumer marketplace is going to look like. Like, if prices are 15 percent higher, right, the depth of your market may be radically different.

Q: Do you think that – so is this kind of back and forth a little bit with chief economists as to what the actual impact of the tariffs will be – that it's going to be a one-off thing or if it could be, like, a sustained thing that feeds into expectations? Do you have any kind of thoughts on that?

MR. BOSTIC: It's impossible to tell. We're early. The main – with the last 34 billion [dollars], 50 billion [dollars], just a week and a half ago. I think a lot of trading partners are still formulating what that's going to look like. We proposed another 200 billion [dollars] – if those go through. So, I mean, I think there's just too much uncertainty to be able to declare definitively that we know what's going to happen with anybody in any of these instances in many different scenarios – (inaudible).

Q: Yeah. And so just to kind of follow up, like, with labor markets – the unemployment rate low and, you know, if the economy picks up, you know, have strong second-quarter growth, you know, could that make the Fed maybe more inclined – you know, if the situation was different maybe the Fed would look past a one-off – (inaudible) – the tariffs as an idiosyncratic thing but with kind of the economic situation –

MR. BOSTIC: So I don't know what you mean by a one-off hit on the tariffs. I mean, what we've seen so far in our experience is that there's been one tariff proposal that's been met by another response that has been met by another tariff proposal and then met by another response that has now been met by another tariff proposal, and now it looks like there's going to be another tariff response, and then who knows how it's going to go?

So when you say one-off, I don't actually know what that means. But we're in a dynamic setting and that dynamic character means that we're going to have to just watch and pay attention and be – I mean, it makes – it means that we – our sensitivity to how businesses are changing their strategies, how consumers are responding to this, these are things we – we're just going to have to pay close attention to.

Q: So the – Polo Rocha with S&P Global.

I'm curious –

MR. BOSTIC: Say that again.

Q: Polo Rocha with S&P Global.

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I'm curious how you're viewing the flattening of the yield curve, and you guys discuss kind of a new – (inaudible) – your new paper that some Fed economists put out. Do you view that as a kind of reliable indicator – a more reliable indicator? What's your view on this whole issue?

(Offside conversation.)

MR. BOSTIC: I haven't read the paper yet.

Q: OK.

MR. BOSTIC: What I would say is we're doing some internal analysis on yield curve stuff as well and its particular power is in the range of a whole host of alternative measures. More broadly, though, I would say two things.

One, the yield curve is a sign of many things, right. It and of itself, I don't think is what we should be focused on. But we should be focusing on the factors that are causing the prices of the different durations to move and think about how all that fits together. Then the second thing is we have to pay attention to it, and for me, it's because a lot of people believe this yield curve relationship. The market does.

So, you know, I've been teaching for a long time there. Pretty much every semester a student will come up to me and say, I agree with the yield curve because it caused the recession – (inaudible). To the extent that the whole market believes that, whether it's true or not is kind of immaterial, right, because it can become a self-fulfilling prophecy.

So as we get close to inversion, we have to worry about this just for – just for that reason. And so, you know, do I think the yield curve in and of itself would go, you know, one-tenth of a basis point into inversion we're necessarily going to have a recession? That's not really what I think. But as we get closer, I know the market gets a little nervous. And so we need to be very careful about how we articulate what we're doing and the types of policies that we pursue.

Q: Is the Fed doing any studies on the underfunding of pensions both at the state and the private – the private – (inaudible)?

MR. BOSTIC: Not that I know of.

Q: Because that seems like the next big train wreck.

MR. BOSTIC: I would say someone is probably doing it. I don't know who it is.

Q: OK.

Q: Are increases in prices from tariffs relative price changes or are they, like, from the – is there a debate about that or are they – do they move ...? Because sometimes, you know, when **oil prices** go up they say other prices go down – (inaudible) – you know, is that a – (inaudible) – question?

MR. BOSTIC: I don't think I understand the question.

Q: When **oil prices** rise, the Fed always says they look through those because even though **oil prices** are up other prices are lower relative to that. You know, so you might have a spike in the [consumer-price index] but it's not **volatile** – (inaudible).

MR. BOSTIC: Yeah. So I – there are many ways –

Q: Tariffs are different. That's –

MR. BOSTIC: I don't – I don't know. I think it depends.

Q: Right.

Q: Is it – is it something the Fed should – I guess what I was kind of getting at, when I said one-off, you know, if you get one round of tariffs that adds 10 percent onto $200 billion of items and then it stops, you know, is that something the Fed can look through and – the sense of my question, which is to get an idea of whether you think tariffs is something the Fed should respond to with monetary policy or, you know, would want to consider responding to with monetary policy, you know, as opposed to, you know, **oil prices**, which don't really – aren't really a function of monetary policy.

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MR. BOSTIC: You know, I – we respond to what tariffs – we will respond to how the economy responds to the tariffs. But I would never say we respond to a tariff, right. Like I was saying earlier, we take the conditions – the rules of the marketplace – the frameworks that exist in the marketplace and we see how the economy performs, and then we ask, given those rules, is it performing as well as it could? Is it performing too hot? Is it too cold? And then we respond that way.

So, now, the tariffs are going to lead to market responses, presumably, and then we'll see how material that is and what – a lot of the stuff that I've read, you know, in a lot of reporting like you guys have been doing about how that these tariffs are not – they're not geographically broad-based and that there is a – you know, the incidents could actually be material in a lot of places such that even at the aggregate – (inaudible) – saying, well, in 30 towns it could be existential. And so it's hard to talk about these things…

Q: What'll get you to go from three to four? What's the trigger or the – just –

MR. BOSTIC: I don't have a hard trigger.

Q: You don't have a –

MR. BOSTIC: A hard trigger. I mean, I'm not – if this number goes to 3.7 and then all of a sudden –

Q: Right.

MR. BOSTIC: No, it's more of a sense of how – of the momentum of the economy and sort of where the points are coming in, you know. We collect a lot of information and making judgments about how the economy is doing, and so, you know, it's never just one number that leads to that kind of understanding.

Q: What do you – what do you make of – if you look at – if you compare CPI to wage growth on an annual basis, wage growth has been kind of like this and CPI since 2016 has kind of gone like this. So it's, basically, caught up to wage growth. What do you make of that? I mean, we just had a story about it yesterday so –

MR. BOSTIC: (Inaudible) – write the story? (Laughter.)

Q: I'm – (inaudible) – The Wall Street Journal, man.

MR. BOSTIC: You guys have a lot of stuff in that – in there.

Q: We do. I guess the erosion of real purchasing power, if that's something that you think could continue if CPI continues to track.

MR. BOSTIC: Well, if it continues – if it continues it would be significant. Again, I mean, the pickup in inflation at the general price level is a relatively recent phenomenon. So I don't think that the market – we have not seen evidence to suggest that the market is pulling back based on the experience today.

Q: Well, what would mark the –

MR. BOSTIC: The broader consumer.

Q: Yeah. Yeah. OK.

MR. BOSTIC: – is pulling back. I mean, that – we have not seen that. So, you know –

Q: We'll just – (inaudible) – see and wait.

MR. BOSTIC: If this – I mean, if it goes on for, like, four years, there'll have been a significant fall back and, you know, I would expect the market to – the consumer to respond. But, you know, where is – I just haven't seen it long enough to – I wouldn't expect much of a move at this point.

Q: So there's been talk of raising this capital buffer for banks – the countercyclical buffer. Is that something you've thought deeply about? Is that something – I know it's not up to you on the FOMC, but is that something that you think is a good idea to bring in now?

MR. BOSTIC: You know, I talk to my folks about this. There's a diversity of opinions. I talk to [Fed] Governor [Randal] Quarles as well. So he knows – I said many times you know, it's important that we have enough capital in the marketplace in the banking sector to – for it to be resilient. If they didn't have enough in the last crisis and it caused a whole lot of pain and a lot of capital – a lot of money for taxpayers. We want to avoid that if we can. This is a proposal. There are going to be conversations about this over the next 12 months. I'm still working my way through it.

Q: So the next 12 months, you think?

MR. BOSTIC: At least.

Q: Right.

MR. BOSTIC: And, you know, so I'm an academic by training, right. So no ideas ever go away, right. It's just – it's just a question of what's the circumstance in which it gets reintroduced to – repackaged so –

Q: Right.

MR. BOSTIC: It'll be – yes.

Q: Well, some people want to do it now but you're saying not for 12 months. That's a –

MR. BOSTIC: I'm not saying – I'm not putting any kind of deadline on it.

Q: Yeah. No. No. No. But –

MR. BOSTIC: I can tell you it's not going to happen now. I mean, just the regulatory rule-writing process means that nothing's happening now. I mean, there's a lot – there's more conversation that's going to happen in that.

Related

* Atlanta Fed's Raphael Bostic Favors One More Interest-Rate Increase in 2018, Unless...

* Transcript: Town Hall Q&A With Atlanta Fed's Raphael Bostic in Virginia

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WSJ PRO CENTRAL BANKING

Economy
New York Fed's Williams Isn't Worried About Financial Market Excess Right Now; Says one of his biggest concerns is that memories of the financial crisis and its causes will fade

By Michael S. Derby
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NEW YORK—Federal Reserve Bank of New York President John Williams said Wednesday he doesn't see any evidence the financial system is overheating, adding that his staff is actively watching for signs of trouble.

Despite a strong recovery in house prices and an extended run of **stock market** gains, he said, "we are not seeing the kind of buildup in leverage in the financial system" that would cause concern among policy makers and regulators.

He said he also is "not seeing the kind of risk taking" that would worry him.

Mr. Williams spoke at an event at the Brooklyn Law School as part of his first public tour since taking the reins of the New York Fed last month. He had previously served for more than 15 years at the San Francisco Fed, including seven as its president.

Mr. Williams, who also serves as vice chairman of the interest-rate-setting Federal Open Market Committee, didn't comment in his public remarks on the outlooks for the economy or monetary policy.

He did note the very strong state of the job market, saying "employers are now struggling to fill job openings." Robust labor market conditions are a key factor driving the Fed's plans to keep gradually raising interest rates to prevent the economy from overheating.

Mr. Williams noted that one of his biggest concerns is that memories of the financial crisis and its causes will fade. But he added that experience hasn't been forgotten at the New York Fed and that the bank's staff remains vigilant for any signs of trouble.

He said it is important for policy makers to constantly consider all the ways the economy might perform under different scenarios.

He also said he is still in favor of the Fed adopting a regular periodic review of its methods of making monetary policy.

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THE WALL STREET JOURNAL.
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U.S. News: Market Is Looking For a Fourth Hike

By Chelsey Dulaney and Ben Eisen
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Investors are bracing for a period of consistently higher inflation rates, raising bets that the Federal Reserve will deliver a fourth interest-rate increase this year as an intensifying trade spat between the U.S. and China threatens to add to mounting price pressures.

Federal-funds futures, which investors use to bet on central-bank policy, on Thursday showed a roughly 60% chance that the Fed will raise rates at least four times this year, according to CME Group data. While those bets retreated by the end of the day, it still marks one of the highest levels this year and is well above a 35% probability at the start of June.

The Fed has raised rates twice already in 2018.

Increasing confidence in the Fed's plans for tightening policy come as measures of price growth for both U.S. consumers and businesses rise at their fastest pace in years. A Labor Department report Thursday showed the consumer-price index rose 2.9% from a year earlier in June, the strongest growth since February 2012, and 2.3% when excluding **volatile** categories like energy and food. A separate gauge of U.S. business prices rose at the strongest pace since 2011.

Mounting expectations are already rippling through global markets. The U.S. dollar has jumped 0.8% against a basket of major peers over the past two trading sessions, reviving pressure on the currencies, stocks and bonds of emerging markets. U.S. stocks were also rattled this week by White House plans announced Tuesday to impose tariffs on another $200 billion in Chinese goods, though the **S&P 500** rebounded 0.9% on Thursday.

"Trade wars are unambiguously going to lift inflation," said Torsten Slok, chief international economist at Deutsche Bank. "We already have inflation at the Fed's target. That is an incredible headache for the Fed."

The recent firming in inflation comes after a long period of tepid growth that had confounded investors and policy makers.

The Fed is tasked with keeping inflation stable, and some investors believe a "price shock" sparked by tariffs could lead the central bank to ramp up policy-tightening after following a slow-and-steady approach since 2015.

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THE WALL STREET JOURNAL.
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Streetwise: The Fed's Role in the Global Market Malaise

By James Mackintosh
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When money gets tight, greed turns to fear and investors retreat from the riskiest assets. Already, bets on low **volatility** have blown up; money has fled from Turkey and Argentina in particular and from emerging markets more generally; stocks of the biggest banks are under pressure; and Italian bonds have been in turmoil. For the next domino to fall, follow the debt: the banks in highly indebted China, Australia, Sweden and Canada and then on to investment-grade corporate bonds everywhere.

That, at least, is the theory of Ian Harnett, chief investment strategist at Absolute Strategy Research. What may seem like unrelated events -- including the bursting of the bitcoin bubble -- are symptoms of tighter money, most obvious in Federal Reserve rate rises and the recent jump in the greenback, he says.

The theory stands in contrast to the mainstream explanation: The events are mostly not connected, and where they are, the dollar mostly isn't the cause. The dollar rose a lot in a short period, which surely hurt some of the most vulnerable emerging markets. But the rise in the dollar wasn't the cause of slower growth in Europe and China. Indeed, its strength against the euro was clearly the result of the deceleration in the European economy. Some economies may be going through a soft patch and a trade war is a true danger, but much of the fall in asset prices reflects hope disappointed.

Mr. Harnett's theory chimes with historical patterns, however. Long periods of easy money have frequently led to excessive risk-taking and large debt build-ups, ending with a bang when monetary conditions start to return to normal. It isn't that a stronger dollar caused Italy's political ructions, for example, but that the rise in the dollar has made investors more sensitive to risks, prompting them -- belatedly -- to pay attention.

One sign that the problem is global: Stocks of the big banks rated as globally systemically important are, on average, down more than 20% from their peaks of the past 12 months.

"The happy-go-lucky great synchronized recovery is coming to an end," said Mr. Harnett.

Mr. Harnett thinks investors are starting to put China under pressure and will dig out the playbook from 2015, once again worrying about the level of Chinese debt. Chinese stocks have tumbled more than 20% from their January high, putting them in a **bear market** amid talk of economic deceleration and U.S. tariffs due to take effect on Friday. There is a fair amount of concern among investors about the falling value of the yuan, but as yet there is little sign of financial panic.

A Chinese slowdown typically drags down the price of the commodities heavily used in Chinese construction. Already, copper, which is highly sensitive to the Chinese economy, has nose-dived, dropping 12% in the past four weeks for its biggest fall over such a short period since 2015. The knock-on effects on big commodity producers and exporters to China can ripple across emerging markets and into other major exporters such as Australia, too.

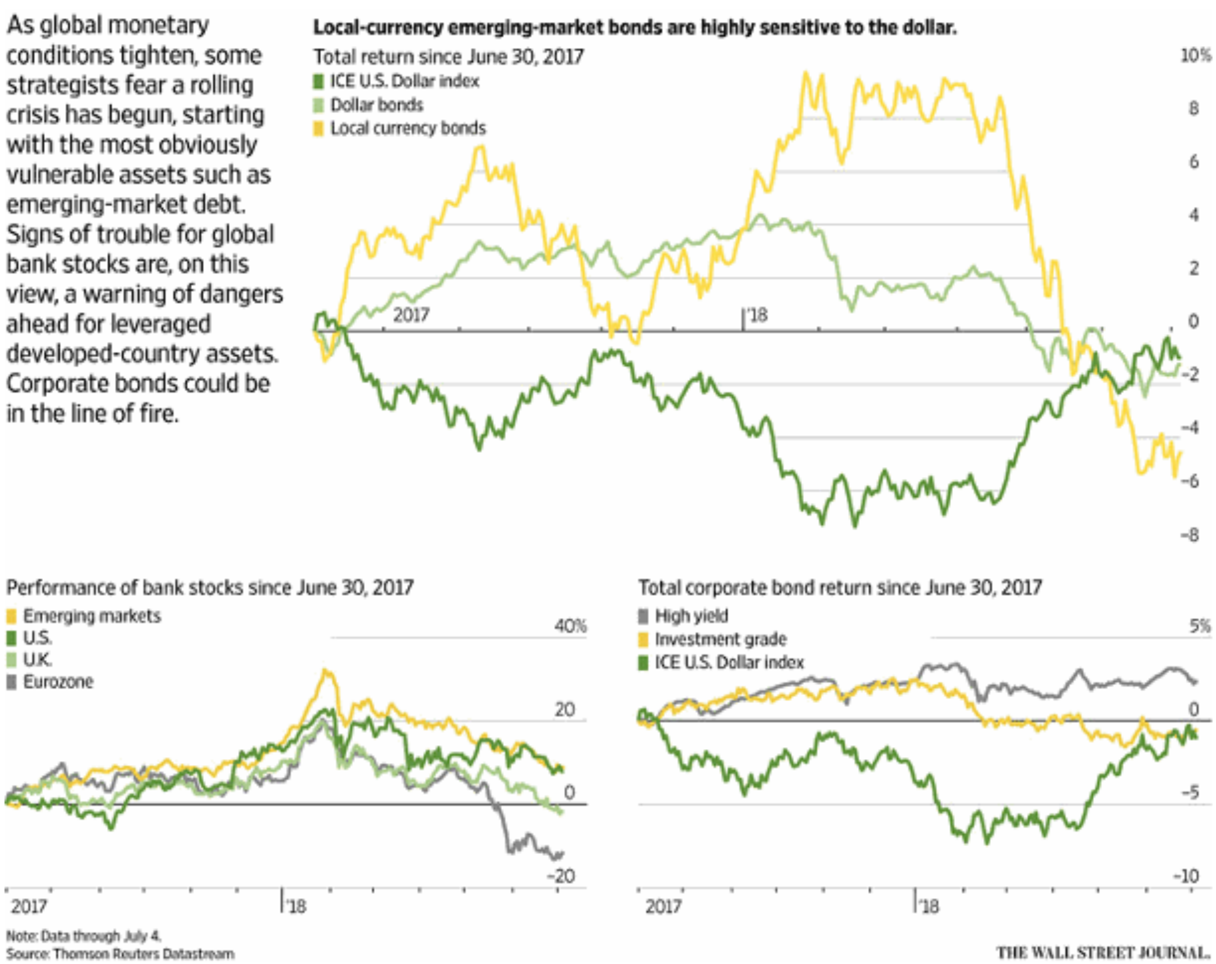
A separate but parallel threat comes from banks. The fall in bank stocks has yet to be reflected in weaker bank bonds. If and when bonds fall, too, it could drag down investment-grade corporate-bond indexes due to the heavy weighting of the bank sector -- and hurt the large numbers of investors forced out of government bonds by central-bank bond-buying programs. Investors losing money on what they regarded as the safest corporate bonds would naturally rein in risk taking, contributing to market weakness, while bank executives are less likely to extend credit when their shares are plummeting. Weak banks can weaken the economy, which in turn weakens banks.

Not all is doom and gloom. Mr. Harnett thinks it is too early to be sure that the dominoes will keep falling and recommends keeping some risk -- with the U.S. best placed to withstand a return of global caution, reflected in the outperformance of U.S. banks compared with those elsewhere.

"We're not saying hit the red button and get max defensive, because it could be that China reflates, the dollar comes down again," he said. "But if the Fed continues to tighten, the dollar continues to strengthen -- we think you will see more points of weakness." That means an end to the strategy of buying the dips in stock prices that has worked so well for the past nine years.

Hopefully, Mr. Harnett is wrong. The European economy may be merely in a soft patch, as the European Central Bank argues. China has had a run of bad economic data, but debt has been more restricted recently and trouble might be avoided if Donald Trump's trade war comes to a quick end.

Bank stocks might merely be reversing their rapid ascent from the end of last year when everyone started to believe in a synchronized global recovery -- not sending a signal of much worse to come. Hopefully.



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WSJ PRO CENTRAL BANKING

Economy

Mester Sees Two More Rate Rises | Williams Doesn't See Market Excess | BOC Raises Rate | Yuan Weakens | Hannon's Take: Too Little, Too Late? The Wall Street Journal's central banking newsletter for Thursday, July 12, 2018

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Hannon's Take: Too Little, Too Late?

Fed's Mester Says Strong Economy Justifies Two More Interest Rate Increases This Year

Fed's Williams Isn't Worried About **Financial Market** Excess Now

Bank of Canada Raises Key Interest Rate To 1.50%

Beijing Lets Yuan Weaken by Most in 18 Months

Too Little, Too Late?

The European Central Bank's key interest rate is set to remain below zero until September 2019 and possibly later. But national policy makers are increasingly taking action to prevent credit bubbles on their home turf. Whether that works will tell us a lot about the new world of macroprudential regulation.

The ECB last month said it expects to end its bond-buying program in December. But it also pledged not to raise its key interest rate, which has been set at minus 0.4% since March 2016, until after next summer.

One goal is to encourage businesses and households to take risks: to build that new factory or that new house, buy that new automobile and not put quite so much away for the rainy days to come.

But we are living in the shadow of the financial crisis, which more or less everyone agrees was the result of too much risk taking and too little thought of rainy days.

So how to ensure that in allowing the real economy time to heal the wounds inflicted by the crisis, we don't end up back where we started? Regulators have pinned their hopes on a range of mostly untested macroprudential tools. After a slow start, there are signs that eurozone regulators are deploying those measures to clamp down on risk taking where it appears excessive.

Ireland's central bank last week responded to rapidly rising house prices by requiring banks to set aside extra capital. The regulator raised its countercyclical capital buffer to 1% of assets from zero, giving banks until July 2019 to comply. The tool is intended to slow lending during the good times and require banks to build up a cushion for the bad times in the hope that their lending will fall less sharply than in previous downturns. That followed a similar move by France in June, although its concerns are focused on lending to companies.

The big question is whether those measures will have a significant effect on lending and risk-taking as long as the ECB keeps its interest rate below zero. In its Annual Economic Report, the Bank for International Settlementsexpressed doubt that they will. If they don't, it is possible that policy makers waited too long, or moved too gradually. The alternative lesson would be that the key policy rate is all that counts.

Key Developments Around the World

Fed's Mester Says Strong Economy Justifies Two More Interest Rate Increases This Year

Cleveland Fed President Loretta Mester said solid U.S. economic growth, low unemployment and stable inflation justify continued interest rate increases. "The economy can certainly handle two more increases this year," Ms. Mester said in an interview Wednesday. "We could end up getting behind if we don't keep moving things up, so I'm very comfortable, if the economy stays on the path it is going that we move rates up as appropriate this year." Ms. Mester said she expects officials would need to raise the fed-funds rate to 3% to reach a neutral level that neither stimulates nor slows economic activity. "We are still in an accommodative stance on monetary policy, and yet we have a very strong economy. And we're very near our goals," she said. "To me, that's a compelling case that we want to keep on this path" of gradually lifting rates.

Fed's Williams Isn't Worried About **Financial Market** Excess Now

New York Fed President John Williams said Wednesday he doesn't see any evidence the financial system is overheating, adding that his staff is actively watching for signs of trouble. Despite a strong recovery in house prices and an extended run of **stock market** gains, he said, "we are not seeing the kind of buildup in leverage in the financial system" that would cause concern among policy makers and regulators. He also is "not seeing the kind of risk taking" that would worry him, he said.

Bank of Canada Raises Key Interest Rate To 1.50%

The Bank of Canada on Wednesday raised its benchmark interest rate by a quarter of a percentage point to 1.50% in response to solid economic data and expectations that exports and business investment will continue to grow. However, the central bank said it would take a gradual approach to future rate increases amid mounting tensions over trade with the U.S., among other uncertainties. Talks to renegotiate the North American Free Trade Agreement stalled earlier this year, and Canada imposed retaliatory tariffs this month in response to U.S. metals tariffs. "While investment and trade are projected to expand, they are being restrained by the U.S. tariffs recently imposed on Canadian steel and aluminum imports and by uncertainty around trade policies," the central bank said in its monetary policy report, which was released alongside the rate decision.

Beijing Lets Yuan Weaken by Most in 18 Months

China guided the yuan to its largest one-day drop against the U.S. dollar in a year and a half, with an intensifying trade conflict between the world's two largest economies putting fresh pressure on the Chinese currency. The People's Bank of China on Thursday set the dollar's reference rate at 6.6726 yuan, weakening the yuan by 0.7% compared with Wednesday. The central bank determines a daily dollar-yuan exchange rate, known as the fix, and allows the currency pair to trade as much as 2% above or below that level. Still, the yuan didn't weaken by as much in the fix as many analysts had expected.

Europe Sees Trade Tensions With U.S. Eating Into Economic Growth

The European Unioncut its 2018 eurozone growth forecast Thursday, as the bloc's nascent trade conflict with the U.S. and political upheavals within the EU threaten to derail the common-currency area's economic momentum. Gross domestic product in the 19-member eurozone is set to grow 2.1% this year, the EU said in its quarterly report, cutting its 2.3% forecast from May. The rate is expected to ease to 2.0% in 2019, in line with previous expectations.

Bank of Korea Keeps Rate Unchanged, Trims Growth Forecast

South Korea's central bank on Thursday kept interest rate unchanged and lowered its 2018 growth forecast, though tighter policy could be on the horizon following its first rate increase in over six years in November. The Bank of Korea's decision to keep its base rate at 1.50% shows it isn't confident enough in the economic recovery to reduce growth support.

Quick Hits: A Glimmer of Hope for Greek Bond Inclusion in QE

European Central Bank President Mario Draghi didn't rule out the possibility of Greek government bonds being including in the central bank's quantitative-easing program, and Malaysia's central bank sounded a neutral tone in its latest policy statement. Here are quick hits on central banking and related market views from around the world.

Thursday

8:30 a.m. EDT

U.S. Labor Department releases June CPI

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12:15 p.m. EDT

Philadelphia Fed's Harker speaks in Victor, Idaho

Friday

7 a.m. EDT

Bank of England's Cunliffe speaks in Cumbria, England

11 a.m. EDT

U.S. Federal Reserve releases its latest monetary policy report to Congress

12:30 p.m. EDT

Atlanta Fed's Bostic speaks in Falls Church, Va.

The Public's Indifference Is Complicating Central Bank Efforts To Manage Inflation Expectations

Central bank officials widely believe that public expectations about future inflation strongly affect the actual pace of price increases. So central bankers try to manage expectations. One common way is to publicly set an inflation target, such as the Fed's goal of 2%, and to talk a lot about the importance of hitting it and steps being taken to achieve it, as Fed officials do in frequent speeches, interviews and news conferences. Problem is, by and large, the public isn't paying much attention to what the officials say, diminishing their influence over inflation expectations, according to a new paper published by the National Bureau of Economic Research.

Globalization and Inequality in a More Educated World

"Average education levels are increasing in developing countries, but not in high-income countries," S. Amer Ahmed, Maurizio Bussolo, Marcio Cruz, Delfin S. Go and Israel Osorio Rodarte write in a VoxEU column. They find, "this ‘education wave' in developing countries will reduce global inequality by 2030, with average incomes up to the 90th percentile all benefitting from the trend. However, this equalising effect relies on continued globalisation."

Investors Have Become Too Complacent About Inflation

"This year's ructions in global markets started with a steep climb in bond yields in part due to rising inflation," writes Richard Barley for The Wall Street Journal. "U.S. consumer price data for June, due Thursday, are forecast to show inflation at 2.9%, its highest for more than six years. With so much else to worry about, inflation may have moved too far off investors' radar…But it might only take a few eye-catching inflation numbers to shake markets that are comfortable with the consensus that central banks will only gradually withdraw crisis-era stimulus."

The Term Structure and Recessions Before the Fed

"Many market commentators are worried that the gradual flattening of the US term structure in recent months is indicative of an increased risk of a recession," but Stefan Gerlach and Rebecca Stuart argue in a VoxEU column "the term structure contained information about the likelihood of a future recession even before the establishment of the Federal Reserve, suggesting that the information content does not arise solely as a consequence of countercyclical monetary policy."

A gauge of U.S. business prices rose in June, the latest sign that inflation pressures in the economy are firming.

Send us your tips, suggestions and feedback. Write to:

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THE WALL STREET JOURNAL.

Business

Pricier Fuel to Test Airline Profits; Delta earnings this week will offer clues on industry plan for tackling higher costs

By Alison Sider
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8 July 2018
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The Wall Street Journal Online
WSJO
English
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U.S. airlines are aiming to convince investors that surging fuel costs won't knock a record stretch of profitability off course.

Some investors say airlines won't be able to raise prices fast enough to cover a roughly 55% increase in fuel costs from a year ago. The NYSE Arca Airline Index is down nearly 13% this year while the **S&P 500** is up 3.2%.

They expect carriers to commit to schedule cuts to address the rising costs when they report quarterly earnings this month. Delta Air Lines is the first to report, on Thursday.

"The first course of action may be to adjust their fall and winter schedule, while trying to raise fares in strong markets," said Helane Becker, an analyst at Cowen & Co . "Delta has repeatedly hinted at this."

Delta declined to comment ahead of its earnings report. Executives have said higher fuel costs will factor into their capacity decisions after the peak summer travel season.

"We've made money at fuel prices at $100 and we've made money at $40," Delta Chief Executive Ed Bastian said recently at the National Press Club in Washington . "There's a resiliency and a stability to our business like never before."

By many measures, airlines should be Wall Street darlings. The industry notched a record eighth-straight year of profits last year. A strong global economy is stoking demand for air travel. Global passenger traffic rose 6.1% in May from a year earlier, according to the International Air Transport Association .

Delta said last week it expects unit revenue to be up as much as 5% over the prior year in the second quarter. Unit revenue is a measure of how much airlines make for each mile they fly a passenger.

But other costs are rising too. In addition to fuel, many airlines recently agreed to labor contracts that will see them pay more in wages and benefits. And a shakier forecast for geopolitics and international trade could hurt flight demand in the months ahead if companies cut back on business travel, analysts say.

"You need to have higher fares to offset the higher fuel. To do that either demand has to be strong enough to absorb the increase, or if it's not you need to not fly those unprofitable seats," said Savanthi Syth, an analyst at Raymond James.

United Continental Holdings Inc . and Delta have each said they are paying about $2 billion more for fuel compared with last year—pressuring profit margins. Delta cited rising costs in June as it cut profit expectations for the second quarter from $1.80 to $2 a share to a range of $1.65 to $1.75 per share.

United earlier this year raised its earnings expectations for 2018 to $7 to $8.50 per share. Scott Kirby , United's president, said on May 30 that the airline can hit that target despite higher fuel costs.

Most airlines have cut back on using derivatives to hedge against fuel price increases, lowering their operational costs while **oil prices** stayed low and relatively steady. Higher fuel prices will test whether airlines can pass on rising costs to customers, said Philip Baggaley, managing director at S&P Global Ratings.

But raising prices is easier said than done, said Bob Harrell, head of Harrell Associates LLC, a consulting firm that tracks airline pricing. His research shows that while airlines have raised fares in recent weeks, they still lag behind last year's levels.

"What drives pricing is not what they're paying at the pump but the balance of supply and demand," Mr. Harrell said. "It's very hard to get prices up if you're adding seats faster than you're adding passengers," he said.

Airlines have been dogged this year by concerns that they are adding seats too quickly. United rattled investors with plans to expand capacity by 4% to 6% per year for three years. In April the airline tightened growth plans to 4.5% to 5.5% this year, and some hope it will throttle back further.

"All else equal, higher fuel leads to lower capacity at every airline," United's Mr. Kirby said at a conference recently.

Write to Alison Sider at alison.sider@wsj.com

Industry Latest

* Boeing to Take Over Embraer's Commercial-Jet Business (July 5)

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Business News: Pricier Fuel to Test Airline Profits

By Alison Sider
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U.S. airlines are aiming to convince investors that surging fuel costs won't knock a record stretch of profitability off course.

Some investors say airlines won't be able to raise prices fast enough to cover a roughly 55% increase in fuel costs from a year ago. The NYSE Arca Airline Index is down nearly 13% this year while the **S&P 500** is up 3.2%. They expect carriers to commit to schedule cuts to address the rising costs when they report quarterly earnings this month. Delta Air Lines is the first to report, on Thursday.

"The first course of action may be to adjust their fall and winter schedule, while trying to raise fares in strong markets," said Helane Becker, an analyst at Cowen & Co . "Delta has repeatedly hinted at this."

Delta declined to comment ahead of its earnings report. Executives have said higher fuel costs will factor into their capacity decisions after the peak summer travel season.

"We've made money at fuel prices at $100 and we've made money at $40," Delta Chief Executive Ed Bastian said recently at the National Press Club in Washington . "There's a resiliency and a stability to our business like never before."

By many measures, airlines should be Wall Street darlings. The industry notched a record eighth straight year of profits last year. A strong global economy is stoking demand for air travel. Global passenger traffic rose 6.1% in May from a year earlier, according to the International Air Transport Association .

Delta said last week it expects unit revenue to be up as much as 5% over the prior year in the second quarter. Unit revenue is a measure of how much airlines make for each mile they fly a passenger.

But other costs are rising, too. In addition to fuel, many airlines recently agreed to labor contracts that will see them pay more in wages and benefits. And a shakier forecast for geopolitics and international trade could hurt flight demand if companies cut back on business travel, analysts said.

"You need to have higher fares to offset the higher fuel. To do that, either demand has to be strong enough to absorb the increase, or if it's not you need to not fly those unprofitable seats," said Savanthi Syth, an analyst at Raymond James.

United Continental Holdings Inc . and Delta have each said they are paying about $2 billion more for fuel compared with last year -- pressuring profit margins. Delta cited rising costs in June as it cut profit expectations for the second quarter from $1.80 to $2 a share to a range of $1.65 to $1.75 per share.

United earlier this year raised its earnings expectations for 2018 to $7 to $8.50 per share. Scott Kirby , United's president, said on May 30 that the airline can hit that target despite higher fuel costs.

Most airlines have cut back on using derivatives to hedge against fuel-price increases, lowering their operational costs while **oil prices** stayed low and relatively steady. Higher fuel prices will test whether airlines can pass on rising costs to customers, said Philip Baggaley, managing director at S&P Global Ratings.

But raising prices is easier said than done, said Bob Harrell, head of Harrell Associates LLC, a consulting firm that tracks airline pricing. His research shows that while airlines have raised fares in recent weeks, they still lag behind last year's levels.

"What drives pricing is not what they're paying at the pump but the balance of supply and demand," Mr. Harrell said. "It's very hard to get prices up if you're adding seats faster than you're adding passengers," he said.

Airlines have been dogged this year by concerns that they are adding seats too quickly. United rattled investors with plans to expand capacity by 4% to 6% a year for three years. In April the airline tightened growth plans to 4.5% to 5.5% this year, and some hope it will throttle back further.

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THE WALL STREET JOURNAL.

Markets

Once-Hot Metals Market Faces Reality of Looming Trade War; The threat of a trade war roiled industrial metals including copper during the second quarter, troubling investors who rely on their prices as economic indicators

By Amrith Ramkumar
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The threat of a trade war roiled industrial metals including copper during the second quarter, troubling investors who rely on their prices as economic indicators due to their uses in construction and manufacturing.

After hitting a four-year high earlier in June, copper tumbled 10% and posted its second consecutive quarterly drop, falling 2.3%.

The red metal in June recorded its biggest monthly trading range so far this year, with investors bracing for more swings.

The recent **volatility** is a marked shift from last year, when copper rose 31% following a furious December rally that capped an eight-quarter winning streak.

Now, investors are considering whether trade tensions will continue to hurt sentiment in the sector.

"We're at a higher level of risk than we were even a couple of weeks ago," said Marisa Hernandez, a metals and mining research analyst at Neuberger Berman. "People are pricing in a higher risk of demand being less than what we thought it was going to be."

Trade barbs between the U.S. and China have ratcheted up in recent weeks, fueling concerns that protectionist trade policies might spread, slowing the global economy and choking demand for raw materials.

Investors started taking the potential for a trade war more seriously in recent sessions, sending prices of metals including zinc and tin lower for the quarter.

In June, President Donald Trump asked his administration to name $200 billion in Chinese goods to be penalized with tariffs.

He also has threatened levies on European Union-made cars.

The threats involving China have been of particular focus to metals investors because the country is the world's largest user of commodities, accounting for roughly half the world's copper consumption.

While prices for U.S. steel and aluminum initially rose after the Trump administration unveiled tariffs for imports of the metals, they are now sliding as investors grapple with the possibility of a far-reaching economic slowdown. Shares of steel- and aluminum-producing companies also have slumped. United States Steel Corp. and Alcoa Corp. more than 20% below their multiyear highs hit in March and April, respectively.

"You've got a dark cloud hanging over the sector," said George Gero, managing director at RBC Capital Markets.

Copper's **bearish** signal on global growth also has reinforced an outlook that economic momentum has shifted from emerging markets to the U.S. That trend has pushed the WSJ Dollar Index, which tracks the U.S. currency against a basket of 16 others, to its highest level in a year.

A stronger dollar hurts commodities by making them more expensive for overseas buyers.

The changes have prompted some money managers to scale back **bullish** wagers on copper that they held on to all last year. Hedge funds and other speculative investors have cut net bets on higher copper prices by nearly 80% this year, Commodity Futures Trading Commission data show.

Data indicating steady supply has also hurt copper and other materials.

The International Copper Study Group, a group of copper producers and consumers, said in April that it expects global supply to exceed demand in 2018, after previously projecting a supply deficit. June ICSG figures showed a supply surplus for the first quarter.

Despite the recent **volatility**, some analysts still think copper and other metals can rebound if supply disruptions occur, as miners negotiate with emerging-markets countries over operating agreements and worker wages.

But many remain anxious that a rare period of synchronous growth among the world's largest economies could be ending—a development that had sent commodity prices rallying in the past year.

"The expectation was that was going to continue. Well, it's not," said David Spika, president of GuideStone Capital Management. "The growth rates that we're seeing overseas are maybe not as sustainable as we thought they were."

Write to Amrith Ramkumar at amrith.ramkumar@wsj.com

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The New York Times

Opinion
'Doomsday Prepping' for Another Round of Tariffs

By Ellen Zentner
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A protracted, escalating cycle of trade tensions has begun. In the latest action, the United States has proposed a 10 percent tariff on $200 billion in Chinese goods. This follows a tariff on $50 billion of imports from China. Together, the value of targeted goods amounts to nearly half of all American imports from China last year, and countermeasures by China are expected.

Even if all the proposed actions don't go into effect, prolonged uncertainty alone can have a measurable impact on economic growth, and we should not underestimate the risks.

Most of the Federal Reserve's policymakers agree that uncertainty and risks from trade policy have "intensified," according to the minutes of the Fed's Federal Open Market Committee meeting in June. Most private-sector economists share this view. While I don't expect today's conflict to be as severe as the Smoot-Hawley Tariff Act of 1930, which was meant to protect American workers but instead prolonged the Great Depression, it is unlikely that the global economy will escape these trade disputes unscathed.

Estimating the magnitude of the impact can be tricky. Consider this: Just the threat of trade actions, even if there is no follow-through, is enough to dent business sentiment and investment. Most business decisions are based on a five-year horizon. That means you need to be able to predict what you can charge for your product, and what it will cost to make it. Trade disputes provide a murky lens at best, which most likely delays investment.

Nevertheless, the United States is on track for G.D.P. growth of more than 4 percent in the second quarter, according to my estimates. This may lead some folks to conclude that concerns over trade are overblown.

I caution strongly against that conclusion.

First of all, this growth is taking place against the backdrop of corporate tax cuts, which are expected to lift business spending on capital and equipment. If not for the lingering uncertainty over trade, investment in the United States might have been even stronger.

Second, roughly half of the growth we are seeing now is a result of a side effect of trade tensions — "doomsday prepping." Global companies are stockpiling raw materials, intermediate goods and finished goods before tariffs take effect and raise the prices of those goods. Once the bite of tariffs hits demand, companies will no longer need to build inventories, and this boost to economic growth could end. Such a reversal is not likely to sit well with investors as they witness a potentially sharp slowdown in the second half of the year, and that could affect both stock and bond markets.

Economists who believe tariffs will have only a small impact on growth need to cast a wider net. While the most direct effects will likely come from retaliatory measures that dent American exports, those impacts are just a fraction of what should be considered. Economists also need to consider the indirect effects of tariffs on consumer demand. Of the first $50 billion of announced tariffs, less than 2 percent apply to consumer goods. So the spillover effect on consumer demand — tariffs passed on as higher prices to consumers — should be quite small. But consumer goods represent more than 30 percent of the latest round of tariffs, which affect $200 billion in Chinese goods and could go into effect as soon as September.

Not all industries can pass on the cost of tariffs to the consumer. There are a few other options. Companies can pursue cost-sharing with their trade partners to preserve business on both sides. Or they could choose to absorb higher costs and live with smaller profit margins. Of course, investors don't take kindly to companies facing margin squeezes. Finally, firms can absorb the tariffs and cut costs elsewhere, but labor is the largest line item, which means layoffs or slower hiring.

Changes in how **financial markets** respond will also amplify the effects of tariffs. We've already seen a good deal of **volatility** in markets every time there is news about escalating trade tensions. Since the start of the year, **financial markets** have become increasingly sensitive to the risks of further tensions. As the actual direct effects of each round of tariffs become clear, we should not assume that **financial markets** will continue to absorb the news smoothly.

I believe this is perhaps the single biggest risk to the global economy: At some point, investors will start to question whether global supply chains can withstand the escalating pressures from multiple rounds of tariffs, and **financial markets** may start to react in unpredictable ways.

The Fed chairman, Jerome Powell, has acknowledged that businesses are increasingly concerned, but the Fed has not built any negative effects from trade into its outlook "just yet." Perhaps a sharp slowdown in growth in the second half of the year will convince them it's time.

Ellen Zentner is the chief United States economist at Morgan Stanley.

Workers transfer cables at a steel factory in Nantong in China's eastern Jiangsu province. | Agence France-Presse — Getty Images

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THE WALL STREET JOURNAL.

Business
Tyson Lowers Outlook on Fallout From Tariffs, Commodity-Market Volatility; Food company said tariffs have hurt domestic and export prices on chicken and pork

By Bowdeya Tweh
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Tyson Foods Inc. lowered its full-year profit guidance amid trade uncertainties related to tariffs and **volatility** in commodity markets.

The company now expects an adjusted per-share profit of $5.70 to $6, down from its prior forecast of $6.55 to $6.70. It said Monday that tariffs have hurt domestic and export prices on chicken and pork. Tyson also said domestic chicken demand has weakened because of an abundance of "relatively lower-priced" beef and pork.

"The combination of changing global trade policies here and abroad, and the uncertainty of any resolution, have created a challenging market environment of increased **volatility**, lower prices and oversupply of protein," Chief Executive Tom Hayes said in prepared remarks.

The U.S. meat industry has been increasingly reliant on exports to satisfy growing demands from countries such as China and Mexico. But record production of hogs and chickens, as well as retaliatory tariffs set by both countries on U.S. pork products, have had an impact on sales and helped lift meat stockpiles in cold-storage warehouses.

The maker of Jimmy Dean, Hillshire Farms and Ball Park products also warned that its sales in its current quarter have gotten off to a "slower than expected" start.

However, Mr. Hayes also said the fundamentals of the business are strong, driven by global demand for protein.

Shares in Tyson fell 7.6% to $58.72, their sixth down day over the past seven trading sessions. Tyson's **stock price** has fallen 28% this year.

Tyson's announcement marks a change in direction from comments Mr. Hayes made in May, when he said the trade issues between the U.S. and China haven't affected the company's business.

Tyson is the latest company to cite an impact to its business from tariffs and the effect they are having on global trade. Harley-Davidson Inc. said in June that it would move more production of its motorcycles overseas to avoid European Union tariffs. The EU's tariffs would raise the cost of a motorcycle coming from the U.S. by $2,200, Harley-Davidson has said.

The adjustment to Tyson's annual guidance also included a smaller-than-expected benefit from the new tax law. Tyson said it now expects a 77-cent-a-share benefit, down from 85 cents a share.

Tyson is slated to release its full third-quarter earnings report on Aug. 6. Analysts polled by Thomson Reuters expect Tyson to report a profit—excluding special items—of $1.52 a share on $10.34 billion in revenue.

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* Meat Piles Up in U.S.

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THE WALL STREET JOURNAL.

Economy

ECB Leaves Rates on Hold as It Affirms Bond Taper Plan; With the economy slowing, most analysts consider September 2019 to be the earliest possible date for an ECB rate increase

By Tom Fairless
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FRANKFURT—The European Central Bank confirmed plans to gradually phase out easy money on Thursday but said it would probably keep rates steady through next summer, underscoring a growing policy divergence with the U.S. Federal Reserve and a widening gap in U.S.-EU growth rates.

In a policy statement Thursday, the ECB said it expects to phase out its €30 billion ($35 billion) a month bond-buying program by December and switch its focus to interest rates. Its deposit rate was held Thursday at minus 0.4%, where it has been since March 2016.

Three other major central banks—the Fed, the Bank of Japan and the Bank of England—will all hold policy meetings next week. All could signal or confirm moves toward higher interest rates after years of easy money, in a nod to strengthening economic growth.

Furthest along the path is the Fed, which has increased interest rates seven times since the end of 2015 including twice this year, pushing its key rate to a range to 1.75% to 2%. It is expected to raise rates twice more this year.

The gap between the world's two largest central banks—the Fed and the ECB—reflects "different positions in the business cycle," ECB President Mario Draghi said at a press conference.

Economic data published in the coming days are expected to underscore a widening gap between the U.S. and Eurozone economies, which grew at a similar pace last year. U.S. data on Friday are expected to show the world's largest economy expanded more than 4% at an annualized pace during the second quarter. That is probably more than double the pace of the eurozone economy, whose second-quarter growth figures will be published on Tuesday.

The U.S. is outpacing the eurozone in part thanks to a burst of budgetary stimulus provided by tax cuts that were enacted late last year. The U.S. is also more insulated from external threats such as rising **oil prices** and trade conflict because of its large domestic oil industry and lower reliance on exports.

In Europe, economies like Italy and France have struggled to shift into a higher gear since the region's debt crisis, while the bloc's largest economy, Germany, is running into capacity constraints as unemployment has fallen below 4%.

In the U.K., the Bank of England is widely expected to increase interest rates at a meeting next Thursday, a move aimed at taming inflation that has exceeded the bank's 2% target for months.

Europe's **financial markets** have been calm in recent weeks despite the ECB's decision last month to end its bond purchases, known as quantitative easing or QE, at the end of this year. The purchases have been credited with restoring the region's economy to health.

In contrast, government bond yields in Japan jumped earlier this week amid concerns that the Bank of Japan might scale back its giant bond-buying program. Japan's central bank will hold a two-day policy meeting on July 30-31, and analysts are divided over whether the bank will move to tighten its policies, a move likely aimed at alleviating the side effects of easy money on the nation's banks.

While the ECB's decision to end QE reflects growing confidence in the recovery, ECB officials are closely monitoring recent signs of an economic slowdown as well as a series of external threats, ranging from rising **oil prices** to possible trade wars.

The latter risk appears to have receded for now. European Commission President Jean-Claude Junckerappeared to secure a reprieve for European businesses after a meeting with President Donald Trump on Wednesday. The leaders agreed to hold off on additional tariffs while the U.S. and Europe work out their differences on trade.

"It is a good sign," Mr. Draghi said. "It shows that there is a willingness to discuss trade issues in a multilateral framework."

Still, he cautioned that the threat of protectionism is still "prominent" and one of the risks to Europe's recovery.

With Europe's economy slowing, most analysts consider September 2019 to be the earliest possible date for a first ECB rate increase. Mr. Draghi was pressed on that timing at Thursday's press conference but remained vague, probably in order to leave the ECB some flexibility. Annual inflation was 2% in June, slightly above the ECB's medium target of just below 2%.

But excluding **volatile** items like food, energy and tobacco, underlying inflation was just 0.9%, giving the ECB plenty of breathing room.

"Underlying inflation remains muted," Mr. Draghi said

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WSJ PRO CENTRAL BANKING

Economy

U.S. Workers Get Biggest Pay Increase in Nearly a Decade; Employment cost index, which measures wages and benefits, grew 2.8% in the 12 months to last month

By Harriet Torry
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WASHINGTON—U.S. workers received their biggest pay increases in nearly a decade over the 12 months through June, a sign the strong labor market is boosting wages as employers compete for scarcer workers.

The Labor Department's employment-cost index rose 2.8% in the year to June compared, the government said Tuesday. Wages and salaries, which account for about 70% of all employment costs, also rose 2.8% from a year earlier, the strongest gain for both measures since September 2008.

Since the end of the most recent recession, U.S. unemployment has fallen to 4% in June from nearly 10% nine years earlier. Wage growth, stubbornly sluggish for years following the 2007-2009 downturn, has picked up as the labor market has tightened and employers have raised pay to attract and retain workers.

It is now approaching the average pace seen in earlier periods of growth. From 2001 to 2007, wages and salaries as measured by the employment-cost index increased 2.9% a year on average, well above the 1.9% average since the second quarter of 2009 when the current expansion began.

Wage gains are coming with a modest pickup in inflation, which is eating at some of the gains for workers.

A separate report Tuesday from the Commerce Department showed inflation continues to hover near the Federal Reserve's 2% year-over-year target. The price index for personal-consumption expenditures was up 2.2% in June from a year earlier and rose 0.1% from May. Excluding **volatile** food and energy costs, prices also rose 0.1% from May and increased 1.9% from a year earlier.

Some companies are raising prices to compensate for higher commodity costs. Procter & Gamble Co. said Tuesday it was raising prices on some of its biggest brands, a strategy shift after the consumer-products giant reported another quarter of lackluster revenue growth and weak demand.

Boat-engine maker Brunswick Corp. has raised average selling prices by 6% so far this year, partly in response to raw materials inflation, and the company intends to keep raising prices over the second half of the year.

People "don't like [a] price increase, but it really hasn't affected the demand or the market," Brunswick Chief Executive Mark Schwabero said during a July earnings call.

Still, many economists said the gradual pace of price and wage increases means the overall picture for inflation and the economy remains rosy as the third quarter progresses.

"What we've been seeing is a very modest, gradual acceleration in wages," said JPMorgan Chase economist Michael Feroli. The employment-cost index, a measure of wages and benefits for civilian workers, is slowly moving in the right direction, he said.

Stable inflation, gradually rising wages and low unemployment suggest the U.S. economy's Goldilocks moment is continuing, running neither too hot nor too cold. In the second quarter, the U.S. economy grew at the fastest pace in nearly four years, notching an annual growth rate of 4.1%.

A broad measure of Americans' pretax income—including that from wages and salaries and other sources, such as investments and government payments—rose at a solid 0.4% rate in June from May. Such household income is up about 5% from a year earlier, roughly keeping pace with the increase in consumer spending during that time.

The Conference Board on Tuesday said its index of U.S. consumer confidence rose to 127.4 in July from 127.1 in June. The index has eased from highs earlier in the year, as has the University of Michigan's consumer-sentiment index, which declined in July for the third time in four months.

Signs of gradually rising inflation come as U.S. central bankers meet in Washington, D.C., for a two-day policy gathering. Officials are likely to leave their benchmark federal-funds rate unchanged Wednesday and wait until September for the next increase. They raised the rate twice this year, most recently in June to a range between 1.75% and 2%, and have penciled in two more moves this year.

Fed officials believe a little bit of inflation at a consistent and predictable rate is needed to keep the economy growing steadily and at a healthy pace.

Eric Morath contributed to this article.

Write to Harriet Torry at harriet.torry@wsj.com

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WSJ PRO CENTRAL BANKING

Markets

China's Yuan Fluctuates as Trade Clash Creates Uncertainty; Chinese currency took its largest one-day tumble in two years before recovering

By Chelsey Dulaney and Saumya Vaishampayan
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The yuan took its largest one-day tumble in two years Friday before recovering, the latest sign that investors are struggling to get a grip on the trade clash between the U.S. and China and the uncertainty it is creating in **financial markets**.

China's central bank set the yuan 0.9% lower against the dollar early Friday, the largest decline in the so-called daily fixing since 2016. The yuan's decline extended a three-month pullback, a shift drawing attention on Wall Street due to concerns that China could unsettle markets and inflame tensions if it chooses to sharply weaken its currency to help counteract tariffs.

But the yuan snapped back Friday, posting gains that left it up 0.2% against the dollar, after President Donald Trump lashed out at the strength of the U.S. currency and the Federal Reserve's plans to raise U.S. interest rates.

Investors said the latest remarks add to the growing unease in markets over the U.S.-China relationship. The standoff figures to increase **volatility** in foreign-exchange and interest-rate markets.

"Fermenting all this uncertainty certainly goes against the goals of the Trump administration," said Eswar Prasad, a trade professor at Cornell University. "It creates more uncertainty in the global trading environment, and all that uncertainty ends up...putting more upward pressure on the dollar."

At the heart of Mr. Trump's complaints is that the strength of the dollar helps other countries by making U.S. goods more expensive compared to China and European exports.

During a CNBC interview Thursday, Mr. Trump said the stronger dollar "puts us at a disadvantage." On Friday morning, he said on Twitter: "China, the European Union and others have been manipulating their currencies."

The remarks echo comments Mr. Trump and other administration officials have made on the strength of the dollar over the past two years. In January 2017, before Mr. Trump took office, he told The Wall Street Journal: "Our companies can't compete with [China] now because our currency is too strong. And it's killing us."

The unease comes even as policy and economic factors, rather than political threats, seem to be the main drivers of both the dollar and yuan.

In the past month, the yuan has fallen 4.5% against the dollar in mainland trading and 3.5% against a broader basket of its trading partners' currencies, according to a Wind Info index. The dollar, meanwhile, closed at its highest level in more than a year on Thursday before a 0.7% decline on Friday.

The yuan selloff has been spurred by signs of slowing growth that would argue for a weaker currency.

Meanwhile, the U.S. economy likely just wrapped up its strongest quarter of growth in years, encouraging the Federal Reserve to raise interest rates and helping drive up the value of the dollar.

"It is difficult to successfully weaken the dollar through jawboning," said Brad Setser, a senior fellow at the Council on Foreign Relations. "The administration is between a fiscal policy that supports a strong dollar and trade action that is pushing China to allow its currency to weaken."

Many analysts and investors say Beijing has been content to see the yuan weaken in line with market prices rather than actively depressing its value—provided the moves aren't violent enough to spur panic. The central bank determines a daily exchange rate, known as the fix, based on the previous day's close and allows trading as much as 2% above or below that level in mainland China.

Yu Yongding, a former adviser to the PBOC, said Beijing was aware a weaker yuan would help the economy amid a potential trade war, but added: "The devaluation is the result of market forces."

Beijing, however, has previously been reluctant to let its currency depreciate too quickly. A modest devaluation in August 2015 sparked fears about a slowdown in the world's second-largest economy, sending global stock and commodity prices tumbling.

Authorities struggled to control subsequent capital outflows, burning through nearly $1 trillion in foreign-exchange reserves in 17 months to control the pace of depreciation.

During Asian trading hours Friday, China appeared to intervene in markets during to help support the currency, analysts said.

" Beijing is intending to send a signal to the U.S. with the recent [yuan] move. At the same time, there are potentially high costs associated with a currency war for Beijing," said Robin Brooks, chief economist at the Institute of International Finance.

"China has its own constraints, which are material and which—in my opinion—should prevent an all-out currency war," Mr. Brooks added

Write to Chelsey Dulaney at Chelsey.Dulaney@wsj.com and Saumya Vaishampayan at saumya.vaishampayan@wsj.com

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THE WALL STREET JOURNAL.

Business
Shell Kicks Off Big Oil Earnings With Growth Spurt; Oil major's profit almost triples on higher oil prices

By Sarah Kent
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Corrections & Amplifications

Shell said it would buy back a maximum of $2 billion worth of shares over the next three months. An earlier version of this article incorrectly stated that it would buy the shares back over two months. (July 26, 2018)

LONDON—The world's biggest oil companies are on a winning streak of rising profits and soaring cash flow. Investors are expecting to reap the rewards.

Royal Dutch Shell PLC opened Big Oil's earnings period Thursday, nearly tripling its net profit in the second quarter from a year earlier. Shell said its quarterly profit on a current cost-of-supplies basis—a number similar to the net income that U.S. oil companies report—was $5.2 billion, up from $1.9 billion a year earlier.

While adjusted earnings excluding identified items came in below analysts expectations, the company said that rising profit, strong cash flow and falling debt levels have given it the confidence to launch an anticipated $25 billion share buyback program, rewarding investors for years of belt-tightening when **oil prices** were low.

French oil giant Total SA also reported a sharp increase in profit Thursday, benefiting from a healthy rise in **oil prices** and years of painful cost cutting. Though earnings from Norway's Equinor ASA, formerly known as Statoil, lagged behind expectations because of maintenance costs, the company has already raised its dividend this year.

Investors are paying attention. Shares in the group of European oil companies have in recent months been trading at their highest levels in years, though the market reaction Thursday was mixed.

"The whole sector's gone through this three- or four-year transition to make the business model work at $50 a barrel and as soon as we got there the **oil price** shot up," said RBC analyst Biraj Borkhataria. "You're in the sweet spot."

The earnings mark a remarkable turnaround for an industry that has spent the past few years scrambling to convince investors it could fix a yearslong habit of profligate spending and replace it with a disciplined, low-cost business model. So far, Big Oil's new look seems to paying off. Though **oil prices** have nearly doubled since their 2016 low, the companies say they remain focused on lowering costs and rewarding shareholders.

Investors may still want more. Shell's share price fell more than 4% Thursday, as investors punished the company for coming in short of expectations. On Shell's earnings call, analysts peppered executives with questions, demanding an explanation for the company's unpredictable performance and reassurance that it will be able to continue to finance its buyback commitment.

Equinor's share price also slipped. The company emphasized that its fall in profit in the second quarter highlights the need to remain focused on costs.

Meanwhile, shares in Total ticked higher after the company's earnings met analysts' targets. The French company said it brought down the **oil price** it needs to cover its spending to less than $25 a barrel in the second quarter. Profit jumped 83% compared with a year earlier, and the company used the spare cash to move toward fulfilling its promise to raise shareholder payouts 10% by 2020 and increase share buybacks.

"Discipline on spending is resolutely maintained," Total Chief Executive Patrick Pouyanne said in the results announcement.

U.S. oil giants Exxon Mobil Corp. and Chevron Corp. are set to report earnings Friday. BP PLC reports next Tuesday.

Write to Sarah Kent at sarah.kent@wsj.com

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* Heard on the Street: Why Shell's $25 Billion Buyback Program Isn't Enough

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THE WALL STREET JOURNAL.

Markets
Yields on These Chinese Bonds Are Making Investors Squirm; Yields on more than a dozen U.S. dollar bonds issued by Chinese local governments have surged

By Manju Dalal
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Plunging **bond prices** in an obscure corner of the Asian credit markets are starting to worry investors.

In recent weeks, yields on more than a dozen U.S. dollar bonds issued by Chinese local governments have surged as their prices dropped sharply on concerns of potential defaults.

The issuers are known as local government financing vehicles, which in recent years took advantage of hospitable market conditions and bond investors' thirst for yield to raise money to fund things like roads, ports, factories and railway projects.

There are around 90 such financing vehicles with more than $40 billion in U.S. dollar debt outstanding, roughly half of which comes due in 2019 or 2020, according to ANZ Research.

One issuer, Qinghai Provincial Investment Group, has $300 million in one-year debt that comes due this September. Prices of those securities recently dropped to about 85 cents on the dollar to yield over 80%, according to Thomson Reuters data, indicating investors see a high likelihood of default.

S&P Global has a BB- rating on Qinghai and is reviewing it for a downgrade, but hasn't rated the bonds coming due this year. The issuer, according to the credit-rating firm, is an investment company that produces and sells aluminum in China. On June 21, S&P said in a note that Qinghai "does not have a concrete, credible plan" to refinance its maturing debt, though it should have enough financial resources to repay the September bonds.

Qinghai has another $300 million bond issue that matures in December, and those securities were recently trading at 83 cents on the dollar to yield around 55%. It also has $750 million in dollar bonds that come due in 2020 and 2021. The firm did not respond to a request for comment. S&P is also reviewing other Chinese local government vehicles for downgrades, while Fitch Ratings recently downgraded a pair of issuers.

Financing pressures on Chinese local governments are going to increase as more debt maturities approach, said Owen Gallimore, a credit strategist at ANZ in Singapore who expects ratings on dozens of bonds to be cut from "investment-grade" to "junk."

Some issuers may find their fundraising options limited because investors in the credit markets have turned more risk averse. Beijing has also been prohibiting implicit government guarantees on debt issued by local government financing vehicles.

To be sure, there has never been a debt default by any Chinese local government financing vehicle. Such entities have also issued roughly 7 trillion yuan (US$1 trillion) worth of local-currency debt on the mainland, and there have long been concerns about defaults by weaker borrowers. But in recent years, some bonds that were looking precarious ended up avoiding defaults thanks to early redemptions or bailouts by local authorities.

"I am surprised the first default...hasn't happened," said Edmund Goh, a portfolio manager at Aberdeen Standard Investments in Singapore.

China has been tightening policies since 2014 to curb excessive borrowing by local governments, and there has long been speculation that it could let a few small issuers default to discipline some borrowers. It is unclear, however, if that will end up happening in light of recent weakness in China's economy, the yuan and the Chinese **stock market**.

In a research note last month, J.P. Morgan said that while there is potential for one or a few defaults by local governments, China is unlikely to allow large-scale defaults from the sector. "This is because the scenario could trigger substantial damage" in the broader **financial markets**, it said.

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THE WALL STREET JOURNAL.

U.S. Markets
Markets

Tech Stocks Feel the Heat of Trade Tensions; Markets in the U.S. closed for the July Fourth holiday

By Jon Sindreu
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Concerns that disputes between the U.S. and China could hit the technology sector continued to weigh down stocks.

Tech stocks were the worst performers in Europe Wednesday, with the sector dropping 1.3%. This echoed what happened in U.S. markets on Tuesday, when shares of technology companies led the broader **S&P 500** to close down 0.5%.

The broader Stoxx Europe 600 closed up only 0.1%, despite big gains in telecom companies. Markets in Asia mostly closed lower.

The moves came after a Chinese court temporarily banned U.S. firm Micron Technology Inc. from selling chips in the country, and came one day after the U.S. moved to block China Mobile Ltd.—the world's biggest mobile operator in subscribers—from entering the U.S. market, citing national security concerns.

Shares in Micron closed down 5.5% Tuesday, while the PHLX Semiconductor Index has dropped 9.2% over the last month. U.S. markets were closed Wednesday for the July Fourth holiday.

One of the firms leading the losses in Europe on Wednesday was Siltronic, a German semiconductor manufacturer that generates 30% of its revenue from China, according to data provider FactSet. Its shares closed down 7.1%.

Shares of China Mobile edged up 0.5% after hitting a four-year low the previous day.

"The noise has gotten harder to ignore these past couple of weeks, and it certainly has dented market confidence," said Joseph Amato, chief investment officer of equities at Neuberger Berman. "Markets are not yet ready to trust the Trump administration on trade negotiations."

Tech stocks have been one of the top performers of 2018, buoyed by low long-term interest rates and expectations that the sector's behemoths—the likes of Facebook Inc., Google owner Alphabet Inc., Apple Inc. and Amazon.com Inc.—will continue to expand their global dominance in the years to come.

So far, these firms have remained relatively insulated from the tensions between the U.S. and China, which has sparked concerns about a broader trade war. A first round of U.S. tariffs imposed on Chinese goods is set to come into effect Friday.

Dan Skelly and Kevin Demers, equity strategists at Morgan Stanley Wealth Management, believe investors may have underestimated the extent to which tech stocks could be buffeted by barriers to trade.

"With most of the sector's supply chain in Asia, tariffs could cause a spike to costs and negative impact to margins," they recently told clients. "Thus, we are taking a more cautious view on consensus earnings estimates, which may prove aggressive as the full impact of these headwinds work their way into the numbers."

Over the past week, the information-technology sector has been the second-worst performer in the **S&P 500** after financial firms, shedding 0.8%.

Stephen Yiu, fund manager at Blue Whale Capital, believes trade woes will impact the tech sector unevenly.

"If you are selling a tangible product, including chips, you can be affected," he said. "One stock that we do not like is Apple, China could impose a tariff on them, or other luxury-goods firms."

By contrast, Mr. Yiu owns Amazon and Google, which he believes are likely to be shielded from such problems and could even benefit from investors demanding safer stocks.

Asian and European stock markets have been hit the hardest by the U.S. administration's move toward greater protectionism. This adds to signs that the pace of economic growth may have already peaked outside the U.S., leading investors to push further back the time at which they expect other central banks to follow the Federal Reserve's path and start tightening monetary policy.

For many investors, the big risk is that these spats escalate into a broader trade war, which could lead to "reducing global output by 2-3% in few years while also temporarily boosting inflation," said Silvia Dall'Angelo, senior economist at Hermes Investment Management.

Paul Griffiths, chief investment officer of fixed income and multi asset solutions at First State Investments, is closely monitoring the Chinese yuan as a gauge of trade issues spreading into the global economy.

On Wednesday, the yuan rose 0.2% against the dollar in the offshore market, reversing earlier weakness on the back of pledges by the People's Bank of China to shore up the currency if necessary.

"There's probably scope for a degree of depreciation that Chinese authorities will accept, but probably not much—if they intervene too much they run the risk of tipping over the economy," Mr. Griffiths said, adding that "an economic crisis in China would have real knock-on effects."

The WSJ Dollar Index, which tracks the U.S. dollar against a basket of currencies, fell 0.1% Wednesday but has risen by more than 2% in 2018, despite some weakness earlier in the year.

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WSJ PRO PRIVATE EQUITY

Markets

Property Investors Scrounge Through Retail Ruins for Bargains; Sterling Organization is part of a dwindling group of real-estate investors still turning struggling properties around

By Esther Fung
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Many property investors these days recoil from owning retail-oriented real estate, worried that most shopping centers are on their way toward extinction.

Then there is Brian Kosoy.

The chief executive office of the Sterling Organization, a private-equity firm based in Palm Beach, Fla., said his firm is poised this month to close a nearly $500 million real-estate fund to invest in grocery-anchored shopping centers, street retail and other shopping centers across the U.S.

Sterling is part of a shrinking group of investors who still believe they can find bargains among the ruins, then turn these struggling properties around. Shopping centers in high-traffic locations may be weighed down by fixable issues like a low-paying anchor tenant, poor configuration or multiple owners with conflicting views, Mr. Kosoy said.

The exodus of investor capital from retail "will adjust pricing and offer buying opportunities for us," he said.

It is one of the biggest contrarian moves in commercial real estate. Strengthening consumer sentiment hasn't done much to boost demand for retail properties. Vacancy rates of malls, neighborhood and community shopping centers in major metro areas reached their highest level since 2014 in the second quarter at 9.9%, according to data tracker REIS.

The FTSE Nareit Equity Retail Index, which tracks the shares of retail real- estate investment trusts, has tumbled about 30% since July 2016, when shares of mall and shopping center landlords started to skid. The **S&P 500** is up by around 29% over the same period.

Those returns have made it tough to raise new property funds focused on retail. This year through early July, retail specialist L3 Realty Group is the only other firm to close a retail property fund, according to Preqin.

Even Mr. Kosoy admitted it wasn't an easy task to get big investors to take a chance on shopping centers. "There was definitely some apprehension among certain institutional investors," he said of the pension funds, college endowments and charitable foundations that invested with him.

The University of Michigan and the Teachers' Retirement System of Louisiana have both invested in the Sterling fund, according to public documents.

An official at the Louisiana pension fund and a University of Michigan official confirmed their investments but declined to comment beyond that.

Sterling's new fund is its third higher-risk fund that shoots for average annual returns in the mid-to-upper teens by purchasing less stable properties that require more active management. It also has another fund that invests in more stable properties with predictable cash flows.

The fund is eyeing grocery-anchored shopping centers, street retail, open-air shopping centers and mixed-use properties in major markets like San Diego, Chicago, Los Angeles, Minneapolis, Dallas, Miami and Washington, D.C.

A flailing shopping center can boost revenue if the owner can replace the existing anchor tenant, with a decades-old lease that is about to expire, with a new tenant paying market rent.

That can mean upgrading from around $2 per square foot to about $14 per square foot with a market-rate lease, said James Corl, managing director and head of real estate at New York City-based private-equity firm Siguler Guff and Co. His firm has invested more than $100 million with Sterling over the years, including in the latest fund.

Retail real-estate investors say there is money to be made from unraveling property-specific problems. Retailers such as Hobby Lobby Stores Inc. and discounted sellers like TJX Cos. are expanding their store fleet. They are candidates to fill vacated spaces.

In other instances, investors could sell anchor department store space to nontraditional tenants, like churches or medical centers.

"We buy properties that are under-leased, under-managed or underloved," said Ami Ziff, director for national retail at real-estate firm Time Equities Inc., which has been an active acquirer of malls and open-air shopping centers across the country.

Investors have a lot of damage to pick through. The value of strip centers have fallen 3% over the past 12 months, the result of overbuilding and the shift to online retail.

Big box stores have been hit, too. Department store operator Bon-Ton Stores Inc. in April said it would liquidate all of its 256 stores and Toys 'R' Us closed all of its stores in the U.S. by the end of June.

Dawn Lim contributed to this article.

Write to Esther Fung at esther.fung@wsj.com

Related

* Retail Landlords Sell Assets to Raise Cash (March 27)

* Bon-Ton to Liquidate Stores (April 18)

* Toys 'R' Us Files to Wind Down Its U.S. Business (March 15)

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THE WALL STREET JOURNAL.

Markets

New York Stock Exchange Executive to Join Winklevoss Bitcoin Firm; Robert Cornish was the NYSE's top technology executive

By Alexander Osipovich
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A bitcoin exchange has hired the New York Stock Exchange's top technology executive—the latest sign that cryptocurrency trading platforms are seeking to move beyond their rebellious roots and look more like traditional **financial markets**.

Gemini, the digital-currency exchange founded by twin-brother entrepreneurs Cameron and Tyler Winklevoss, will add NYSE chief information officer Robert Cornish to its management team later this month, Gemini representatives said.

Mr. Cornish will be Gemini's first chief technology officer. His last day working at the NYSE was last week, people familiar with the situation said. Reached by telephone, Mr. Cornish declined to comment.

At the NYSE, Mr. Cornish's duties included overseeing Pillar, an ambitious project to overhaul the Big Board's aging electronic trading platforms. He was hired by the stock-exchange operator in 2016 after the first phase of the Pillar launch was marred by repeated delays and glitches.

Before joining the NYSE, Mr. Cornish worked for over a decade at the International Securities Exchange, the first all-electronic U.S. options exchange. He eventually became its chief information officer, leaving after the ISE was acquired by **Nasdaq** Inc.

Mr. Cornish will help Gemini build more reliable systems that can handle heavy trading volumes, the firm's president Cameron Winklevoss said in an interview.

"As the crypto market matures, we feel it's going to look and feel like existing, mature markets like equities, FX and derivatives," Mr. Winklevoss said.

Bitcoin exchanges have a history of being attacked by hackers and crashing at times of heavy trading activity—a checkered past that some are trying to overcome as they seek to win business from hedge funds and other institutional investors.

Coinbase, the largest U.S. bitcoin exchange by trading volume, has hired several veterans of the NYSE and Chicago-based futures exchange giant CME Group Inc. in recent months.

Many Wall Street firms are wary of bitcoin, a digital currency not backed by any government that's less than a decade old and notoriously **volatile**. Bitcoin drew widespread attention last year when massive inflows of speculative investment drove its price to about $20,000. It was recently trading at around $6,500.

Bitcoin exchanges also face regulatory scrutiny. The Securities and Exchange Commission warned in March that many crypto trading platforms were potentially unlawful.

Still, opportunities in the digital-currency markets have drawn financial-industry heavyweights who played major roles in the electronification of the U.S. **stock market** in the 1990s and 2000s.

Those include Greg Tusar, the former head of electronic trading at Goldman Sachs Group Inc. Mr. Tusar is a co-founder of Tagomi Systems Inc., a startup that is developing technology to help investors easily buy and sell large quantities of cryptocurrencies.

The NYSE's Pillar project was unveiled in 2015 and is still ongoing. It is aimed at speeding up the Big Board's trading systems and harmonizing the technology used by the NYSE's family of four equities and two options exchanges.

But its rollout has been bumpy. In April, the NYSE's flagship exchange temporarily suspended trading in shares of Google parent Alphabet Inc. and Amazon after elements of Pillar technology were added to the exchange.

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The Oil Weapon Can Fell the Ayatollahs

By Nawaf E. Obaid
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Mass protests are nothing new in Iran. But nearly 40 years into the failed experiment of the Islamic Republic, an end may be near.

Iran's economy is in shambles and its public finances are teetering. Given that about 60% of Tehran's budget comes from petroleum exports, the best way for the U.S. to hasten regime change is to tighten sanctions while closely coordinating with regional allies to increase global oil supplies and lower prices. The State Department's recent announcement that countries will face stringent sanctions if they don't halt Iranian oil imports by Nov. 4 is a crucial first step. Tehran's mullahs cannot survive a sustained **oil price** of $60 a barrel with practically no export revenue.

Regime change in Tehran is vital to Saudi Arabia's national security. Stopping Iran's efforts at establishing regional hegemony is the kingdom's highest foreign-policy priority. Riyadh is already spending tens of billions of dollars combating Iranian destabilization campaigns from Syria and Lebanon to Yemen to even Morocco. With some $500 billion in foreign reserves and one of the cheapest oil extraction costs in the world, the Saudis can weather lower **oil prices** for years.

Three main factors are pushing Iran to the financial breaking point: public-debt obligations on the brink of default, President Hassan Rouhani's massive subsidies to politically powerful farming communities, and the mounting costs of its attempts to foment chaos throughout the Arab world.

For the U.S., sustaining a policy of economic pressure will require unprecedented cooperation. There are three preconditions for success, one of which is already being met.

First, Saudi Arabia and Russia -- the world's top two oil exporters -- have reached an agreement to increase output. The Saudis plan to ramp up production to as much as 11.5 million barrels a day to drive down prices and eventually make up for lost Iranian oil. Since Moscow is in a position to benefit from a policy freeing it from production quotas and in no position to stop it, it agreed.

Second, as Iran suffers from its lack of indigenous capital and technology to increase sustained oil production and exports, Saudi Arabia and its allies, especially the United Arab Emirates, should join the U.S. in instituting sanctions against the few international oil companies that will still be willing to invest in Iran's upstream industry.

Third, because Iran lacks access to foreign **financial markets** and U.S. banks are banned from doing business there, its remaining hope is European, and to a lesser extent Asian, banks. The Treasury should send a clear message to foreign financial institutions, including those based in Dubai, that they'll lose access to U.S. capital markets if they float new credit to Tehran in any form after Nov. 4.

If President Trump, Saudi Arabia's King Salman and their allies wish to end the widespread terror caused by this so-called Islamic Republic, they should commit to using oil as a nonlethal weapon.

Mr. Obaid is a visiting fellow at the Belfer Center for Science and International Affairs at Harvard's Kennedy School of Government.

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THE WALL STREET JOURNAL.

Opinion
China Won't Be a Trade Pushover; Beijing still has plenty of tools to keep its economy growing.

By The Editorial Board
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The bad economic numbers keep coming from China. Second-quarter GDP growth slowed to 6.7%, due in part to a record low increase in fixed-asset investment. On Tuesday the manufacturing purchasing managers' index, a leading indicator, hit a five-month low, and on Monday the yuan fell to a 13-month low against the U.S. dollar. Chinese stocks have lost one-fifth of their value since January and are near a two-year low.

All these lows have caused some in Washington to conclude that Beijing is losing the trade war. With the grim statistics, the thinking goes, Chinese leaders will have to make concessions and cut a deal quickly.

Not so fast. China's biggest economic headwinds are due to government policies designed to stabilize the financial system. In the last week policy makers have signaled they will relax those measures and use both fiscal and monetary stimulus to rev up growth. While that may cause more problems in the long run, Beijing won't be forced to its economic knees by American tariffs.

Alarmed by the rapid buildup of corporate debt, China's regulators embarked on a deleveraging campaign two years ago. And it yielded results; corporate debt as a percentage of GDP fell slightly last year.

But as the economy slowed over recent months, Beijing began to reopen the money taps. The central bank promised liquidity to banks to expand credit, and last week it offered $74 billion in medium-term financing. The authorities also encouraged companies to issue bonds and eased restrictions on borrowing by local governments for public works. Tax cuts are in the works for corporations and individuals.

Looser monetary policy has contributed to the yuan's weakness. But Beijing will be wary about allowing the currency to decline much further lest it encourage capital flight. China's leaders are firm believers in exchange-rate stability, which has been a pillar of the country's fast growth.

As for share prices, the **equity market** has never been an accurate barometer of China's real economy. Most shares are issued by state-owned companies. Individual investors dominate trading and treat the **stock market** as a casino.

China's leaders are concerned about a trade war with the U.S., but they are hardly panicked. The Politburo Standing Committee, China's most powerful body, released a communique Tuesday that called for more stimulus. But it also said that deleveraging will continue. Contrast this with the government's blowout stimulus after the 2008 global crisis when fiscal and monetary measures totaled 15% of GDP.

Beijing's official growth target is still a healthy 6.5%, in line with the economy's potential as it climbs the ranks of middle-income countries. Domestic demand is becoming more important than exports as an economic engine. It's possible that the trade war will prod policy makers to undertake more aggressive reforms to hasten this transition.

The Trump Administration shouldn't assume that Beijing will buckle under the strain of tariffs. Despite debt problems and slowing growth, Chinese leaders still have plenty of options to keep the economy expanding. The smart U.S. strategy would be to work with allies to negotiate new trade rules with China rather than engage in mutually damaging tariffs.

Foreign Edition Podcast

* Foreign Edition podcast: On Iran's economic distress and Trump's offer to talk 'without preconditions.'

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WSJ PRO CENTRAL BANKING

Economy

Quick Hits: BOJ Has Unchanged View on Japan's Nine Regional Economies; The Federal Reserve reports that outstanding U.S. consumer credit rose at a 7.6% annual rate in May

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The Bank of Japan said many regional economies in the country were improving gradually, and political uncertainty in the U.K. may not stop the Bank of England from raising rates this summer. Here are quick hits on central banking and related market views from around the world.

BOJ Has Unchanged View on Japan's Nine Regional Economies

The Bank of Japan left its views on the nation's nine regional economies unchanged Monday, and described many of them as improving gradually. The bank in its quarterly Sakura Report, Japan's equivalent of the Federal Reserve's beige book, said production and capital expenditure were increasing and labor conditions and retail consumption were picking up in many regional economies, although weakness was seen in residential investment in several regions. Earlier in the day, BOJ Gov. Haruhiko Kuroda said he expected the overall economy to continue its gradual expansion and the pace of price increases to quicken going forward. He said monetary conditions were very accommodative and the central bank would continue its easing until it achieves its 2% inflation target.

Kosaku Narioka

Political Uncertainty Won't Prevent BOE Rate Rises: AllianceBernstein

Political uncertainty won't stop the Bank of England from raising interest rates in August, as recent U.K. economic data supports such a move, says Darren Williams, director of global economic research at AllianceBernstein. "The best possible scenario for markets is a soft Brexit delivered by the Conservative Party," which would enable rate increases, he says. Only a hard Brexit and deteriorating economic conditions could prompt the BOE to reverse its pledge to tighten monetary policy in the longer term. The comments come after the resignations of Brexit Secretary David Davis and Foreign Secretary Boris Johnson.

Lorena Ruibal

U.S. Consumer Credit Rose $24.56 Billion in May

Borrowing by U.S. consumers grew in May, according to Monday's consumer credit report released by the Federal Reserve. Outstanding consumer credit, a measure of non-real-estate debt, rose at a 7.6% seasonally adjusted annual rate, or up $24.56 billion in May from the previous month. Economists surveyed by The Wall Street Journal expected a $12.75 billion increase from April. Revolving credit outstanding, which is primarily credit-card debt, increased at a 11.4% annual rate in May. Nonrevolving credit outstanding, which is mostly student and auto loans, in May grew at a 6.25% annual pace. The U.S.'s low unemployment rate, continued job growth and rising take-home pay have helped buoy consumer spending and debt accumulation.

Sharon Nunn and Sarah Chaney

Volatility May Hit Polish Bonds Ahead of Central Bank Meet: Raiffeisen

Some **volatility** may be ahead for Polish government bonds given the possibility of overly dovish wording from the Polish central bank at its monetary policy meeting later this week, says Raiffeisen. On the other hand, Raiffeisen expects Central and Eastern European local currency debt to start the week on stronger footing "assuming lower global **volatility** would also cut risk aversion," says Raiffeisen analyst Gintaras Shlizhyus.

However there will be a busy backdrop this week, with a series of inflation data due from Romania, Czech Republic, Hungary and Serbia, along with rate-setting meetings in Poland, Serbia and Ukraine.

Emese Bartha

Hurdle for Aussie Rate Cut Is Very High: NAB

There is some chatter that rising trade tensions, pressure on bank-funding costs and a tightening in credit conditions means the next Australian move in interest rates could in fact be a cut, says NAB. It also thinks it is conceivable that investors soon start pricing in some chance of that happening. But the central bank's elevated concern about high household debt makes the hurdle to cut rates very high, contends NAB. The Reserve Bank of Australia has said record household debt is the economy's biggest issue.

James Glynn

(Most of the items in this column come from Market Talk, a feature of Dow Jones Newswires that provides real-time analysis of news developments and market activity.)

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THE WALL STREET JOURNAL.

Opinion

The Markets Will Stop a Trade War; If the tariffs hurt growth, expect a major selloff. President Trump will be forced to reverse course.

By Roger C. Altman
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The Trump administration is on the verge of launching a global trade war, the magnitude of which the world hasn't seen in a century. The president got elected promising to end what he calls "cheating" on trade by China and other nations. He believes America's trade partners have more to lose in such a battle than does the U.S. But if all the threatened Trump tariffs take effect, and the targeted countries respond with the expected retaliatory tariffs on American exports, everyone will lose.

Fortunately, the global **financial markets** will act as a safety net. If the Trump trade war starts to squeeze economic growth, markets will react badly. When this happens, the impatient American president will have no choice but to declare victory, call off the war, and limit the damage.

As of today, the Trump administration has imposed a 25% tariff on a small range of Chinese exports to the U.S. This is the equivalent of a huge sales tax. Washington has also slapped similar tariffs on exports of steel and aluminum from the European Union, Canada and Mexico. Every affected party retaliated with identical penalties on American exports. That prompted new threats, with Washington declaring that 10% tariffs will shortly be applied to another $200 billion of annual Chinese exports—and Beijing again promising full retaliation. Then Mr. Trump upped the ante dramatically by further threatening to extend tariffs to all vehicle and vehicle-parts exports, wherever they come from, and to the entire $500 billion of annual Chinese exports to the U.S.

This is dangerous business. Tariffs raise prices on imports. Those higher prices are passed on to domestic consumers and businesses. Higher prices put a damper on demand for the affected goods and services, which, in turn, slows down economic growth. A 25% tariff on all vehicle imports would eventually raise the retail price of those cars by the same amount, meaning that fewer will be sold.

There is disagreement among economists as to the economic effects of an all-out trade war. Some economic models predict only a mild hit to the American economy because the export share of U.S. gross domestic product is a relatively low 12%. Moody'sprojects that U.S. growth would be half a percentage point lower next year, going from a possible 3% to 2.5%. Such a slowdown would cost the American economy about 700,000 jobs. Globally the effects could be similar. Earlier this month the International Monetary Fund forecast a possible tariff-related decline in global economic output of 0.5% below its current projection for 2020.

Economic models aren't perfect. Many estimate the effects of tariffs only on the sale of imported finished goods. They don't consider what the rising cost of intermediate goods, such as the steel used to produce American cars, does to demand. And they can't estimate what tariffs and trade wars do to the confidence of consumers, businesses or investors. There is, therefore, a bigger downside risk to this dangerous business than these initial economic models suggest.

The chances that confidence suffers are high. The overwhelming majority of American businesses are against these tariffs, just as they would oppose a large new sales tax on the goods they export or the intermediate goods they import. At the moment, American investors seem to doubt that Mr. Trump will actually follow through on his more bellicose threats. But investors are always calm until they're not.

Global **financial markets** may ultimately have to serve as a trade-war safety net. They are, after all, the most powerful force on earth, more so even than nuclear weapons. When **financial markets** get spooked, they can cause governments to change policy almost overnight. We saw this in the late 1970s when market pressure on the dollar forced President Carter into a more conservative budget policy. Markets also forced the IMF and World

Bank to bail out Russia in the late 1990s, and in 2008 they forced Congress to reverse itself and create the Troubled Asset Relief Program. Mr. Trump has tied his political brand as tightly to rising markets as to trade complaints. The markets may be the one force that can cause him to back off.

The first glimmer of global **financial markets**' anxiety about a trade war can already be seen in Chinese equity markets and in the yuan's recent slide. The good news is the markets' corrective power can work whether the economic effects of this trade war turn out to be modest or large. If they turn out to be small, markets will take them in stride. Alternatively, if the new barriers to trade begin to choke economic growth, the **stock market** will probably see a major selloff. A steady three to four week **stock-market** decline would surely force the president to change tactics. He would declare victory and suspend most of the tariffs not directed at China. Either way, the damage will be contained and the American public protected.

Mr. Altman, a former deputy Treasury secretary (1993-94), is founder and senior chairman of Evercore Partners.

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WSJ PRO CENTRAL BANKING

Economy

ECB Charts Its Own Course | CFTC Nears Full Strength | Bitcoin Fever Persists With Fresh ETF Proposal | Blackstone's Take: ECB Needs Some Reverse Guidance; The Wall Street Journal's central banking newsletter for Wednesday, July 25, 2018.

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Blackstone's Take: The ECB Needs Some Reverse Guidance

As the Fed Moves Rates Higher, the ECB Charts Its Own Course

Turkish Lira's Plunge Prompts Concern About a Currency Crisis

CFTC Nears Full Strength as Democrat Coasts Through Nomination Hearing

Financial Regulation Roundup: Bitcoin Fever Persists With Fresh ETF Proposal

The ECB Needs Some Reverse Guidance

It might be time for the ECB to put its forward guidance into reverse.

Last month, the European Central Bank said it would wind down its bond-buying program at the end of this year. But it also said it would keep policy rates—which notably include a minus 0.4% deposit rate—where they are "at least through the summer of 2019."

The latter was a bit of a head scratcher. After all, annual inflation in the eurozone has increased rapidly in recent months, and at 2% in June was a bit above the bank's goal of just under 2% over the medium term.

So why handcuff itself on rates, especially when they are so low and increasingly out of whack with a growing European economy and rising inflation?

The answer probably has more to do with **financial markets** than the economy. Central bankers are hypersensitive to how the unwinding of stimulus affects markets. With the ECB signaling an end to bond purchases, the superlong forward guidance on rates kept stock and **bond prices** from falling and the euro from strengthening.

But the side effect could be damage to the ECB's credibility at a time when the U.S. Federal Reserve is already well into raising rates and other central banks in Europe are expected to lift them in the coming months.

"It is hard to exaggerate the dovishness of the [ECB's] current forward guidance," J.P. Morgan analysts wrote in a recent note.

It raises "the question of whether the ECB is willing to tolerate an overshoot of its inflation objective. Alternatively, its guidance will have to change abruptly some time next year, in our view," they wrote. ECB President Mario Draghi has a chance to backtrack, or at least soften, the rate guidance at his press conference on Thursday after the ECB's policy meeting.

With the Fed and other banks tightening policy, the ECB can probably afford to give itself wiggle room without sparking a big jump in the euro or in European bond yields.

Doubling down on its current guidance, however, could leave the ECB a major outlier on monetary policy with little or no maneuvering room when the next downturn eventually hits.

Key Developments Around the World

As the Fed Moves Rates Higher, the ECB Charts Its Own Course

The European Central Bankis expected to signal its intention to keep its key interest rate below zero for at least another year on Thursday, underscoring a widening gap with the Federal Reserve, which is steadily raising rates. The divergence between the world's top two central banks, reflecting a difference in economic fortunes, received renewed attention last week after President Donald Trump said on CNBC that he wasn't happy with the Fed's recent decisions because every time the economy strengthens "they want to raise rates again." He also chided officials in China and Europe for weakening their currencies. The euro has fallen to $1.17 from as high as $1.25 earlier this year after the ECB signaled increases from the current minus 0.4% policy rate were off the table for now, helping to support the region's export-focused companies. In contrast, the Fed's key rate is in a range between 1.75% and 2% and is likely to rise further this year.

Why Treasury Hasn't Labeled China, EU as Currency Manipulators

Turkish Lira's Plunge Prompts Concern About a Currency Crisis

Turkey's currency fell sharply amid investor concerns that President Recep Tayyip Erdogan's growing influence over the central bank could push the country toward a currency crisis. In its first monetary-policy decision since Mr. Erdogan's was re-elected in June and inherited vastly expanded executive powers, the central bank left its main rate unchanged at 17.75%. Many analysts had anticipated a rise of at least a percentage point to combat inflation, which hit 15.4% in June, its highest annual rate in 15 years. The decision sent the lira down by about 3% against the dollar in late European trading on Tuesday, while government bonds sold off, reflecting investors' fear that the central bank is bowing to Mr. Erdogan's preference for lower interest rates to support investment and consumer demand.

Global Central Bank Chatter Rattles Bond Market

Government **bond prices** world-wide tumbled Monday, roiled by reports that central banks could be on the verge of taking another step back from the easy-money policies that have characterized the postcrisis period. News reports that the Bank of Japan might consider changing its interest-rate targets helped push the yield on the 10-year Japanese government bond as high as 0.09% in Monday trading in Tokyo from 0.03% late Friday. While The Wall Street Journal later reported that Japan's central bank would likely stick close to current policy at its next meeting, citing people familiar with the matter, the market reaction underscores how even small shifts can spur significant market reaction after years of little change.

CFTC Nears Full Strength as Democrat Coasts Through Nomination Hearing

The Commodity Futures Trading Commissionmoved a step closer to having a full commission for the first time in four years, with a Democratic nominee getting almost no pushback at a Senate confirmation hearing. Dan Berkovitz, a partner at law firm WilmerHale and former CFTC general counsel during the Obama administration, said he would work to complete and safeguard postcrisis derivatives rules in a hearing before the Senate Agriculture Committee on Tuesday. Mr. Berkovitz will likely be confirmed soon alongside Republican nominee Dawn Stump, under traditional Senate procedure, though no vote has been scheduled. Their confirmation will allow the CFTC to work on some complex rules that had been temporarily shelved by CFTC Chairman J. Christopher Giancarlo, who has said he wants a full commission to address the issues. Those rules include position limits in derivatives trading, meant to limit speculation in commodities such as oil and gold.

Heard on the Street: China Stimulates Again, but Don't Expect Fireworks

Cash-strapped Chinese companies surviving on a wing and a prayer received welcome news: Beijing is yet again kicking the stimulus engine into gear. The country's main stock benchmark was up 1.6% Tuesday, after a call from China's cabinet overnight for more fiscal spending, abundant liquidity, and—perhaps most significant—support for the "reasonable" fundraising needs of local governments' notorious off-balance-sheet financing vehicles, a key locus of bad debt. The announcement follows a half-trillion yuan ($74 billion) central bank injection into the banking system Monday and, according to local media, incentives for banks to buy low-rated corporate bonds.

Financial Regulation Roundup

U.K. to Block Takeovers on Security Grounds

The U.K. government, following a similar effort in the U.S., plans to further bolster its powers to block foreign acquisitions of British companies, patents and other assets it believes could compromise the country's national security. The proposals, unveiled Tuesday, come as China's appetite for technology and intellectual property developed in other countries pushes Western governments to adopt tools to review deals that could cause economic and military harm.

Bitcoin Fever Persists With Fresh ETF Proposal

A new request for Wall Street's top regulator to allow the launch of a cryptocurrency exchange-traded fund came from Bitwise Asset Management Inc., a San Francisco asset manager specializing in cryptocurrencies. The bid comes as bitcoin prices are making a comeback, crossing $8,000 for the first time in two months.

Deutsche Bank Posts Profit but Trading Weakness Lingers

Deutsche Bank on Wednesday reported net income of €401 million ($469 million) for the second quarter, a decline driven in part by weak trading results but still a relief for investors used to bad news from the Frankfurt-based lender. The results, which come three months after longtime executive Christian Sewing replaced John Cryan as chief executive, have been welcomed by investors following a string of disappointing quarters and three full-year after-tax losses.

UBS Profit Boosted by Investment Banking

UBS Group AG on Tuesday said strong gains at its investment bank boosted overall profit in the last quarter, but warned political and trade tensions could shake investor confidence in **financial markets**. The better-than-expected results could help the Swiss bank convince investors about its strategy of focusing on managing money for wealthy clients while maintaining a streamlined investment-banking operation.

Wednesday

7:50 p.m. EDT

Bank of Japan releases June services producer-price index

Thursday

7:45 a.m. EDT

European Central Bank releases policy statement

8:30 a.m. EDT

ECB's Draghi holds press conference in Europe

In-migration and Dilution of Community Social Capital

Julie L. Hotchkiss and Anil Rupasingha study the impacts of higher levels of in-migration on social capital. The find in a Federal Reserve Bank of Atlanta working paper higher levels of such migration dilutes "multiple dimensions of a community's level of social capital... In-migration may increase a community's demographic heterogeneity," which has previously been "found to diminish the community's level of social capital." In addition, "communities with high migration rates may not bother to invest in social capital development... And, since migrants are less likely to have close family ties in their new communities, high levels of in-migration may very well undermine feelings of trust," they write.

Trump Wants the Fed to Roll Back the U.S. Economy

"Higher interest rates could revive manufacturing and exports. That will hurt consumers and workers," Conor Sen writes for Bloomberg View. "The Fed established its credibility on inflation over the past few decades by setting real interest rates at a high level, which helped to orient the economy around financial activities, consumption and imports rather than production, labor and exports. This economy had winners and losers, of course: American consumers benefited, at the expense of many workers in the manufacturing sector. Trump wants a different model. It's what his tariff threats seek to accomplish: making the U.S. economy more production-oriented rather than consumption-oriented. And he wants monetary policy to help do the same thing. If the Fed stops increasing interest rates over the next few quarters, then we'll never get those high real interest rates in this economic cycle that we've gotten in past cycles. This should put downward pressure on the dollar, making U.S. exports more competitive, but at the cost of cheaper imports for U.S. consumers."

Economists can't write economically. A backlash is building against inflation—the kind showing up in economics journals. The average length of a published economics paper has more than tripled over the past four decades, and some academics are sick of wading through them. At this year's American Economics Association conference, Massachusetts Institute of Technology professor David Autor compared a 94-page working paper about the minimum wage to "being bludgeoned to death with a Nerf bat" and started a Twitter hashtag, #ThePaperIsTooDamnedLong.

Mexican inflation picked up speed in the first half of July, with bigger-than-expected consumer price increases led by energy and fresh produce.

Eurozone business activity slipped in July after a brief rebound in June, amid signs that trade tensions between the world's largest economies are making businesses more wary of undertaking new investments.

Send us your tips, suggestions and feedback. Write to:

Jon Hilsenrath; Michael Derby; Nell Henderson; Jason Douglas; Paul Hannon; Harriet Torry; Kate Davidson; David Harrison; Kim Mackrael; Tom Fairless; Michael Maloney.

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WSJ PRO CENTRAL BANKING

Economy

Powell Says Trade Policies Complicate Outlook | Harker Expects Inflation to Determine Number of Rate Increases | ECB Open to QE Extension | Timiraos's Take: Powell OK With Not Having All the Answers; The Wall Street Journal's central banking newsletter for Friday, July 13, 2018

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Fed Chair Jerome Powell Says Trade Policies Complicate Economic Outlook

Fed's Harker Says Inflation Will Determine Whether There Are Three or Four Rate Increases in 2018

Investors Bet on Higher Rates as U.S. Inflation Firms

ECB Officials Open to Extending QE Amid Trade Threat, Meeting Minutes Show

Timiraos's Take: Powell Is OK Showing You He Doesn't Have All the Answers

Powell Is OK Showing You He Doesn't Have All the Answers

Fed Chairman Jerome Powell offered another look at how he wants to speak more plainly about what the central bank is doing and why—including, notably, admitting when he doesn't have all the answers.

A revealing exchange came partway through his interview with Marketplace radio host Kai Ryssdal on Thursday. Mr. Powell explained how it was puzzling that employers, despite moaning about a lack of workers at prevailing wages, didn't appear to be raising wages in a way being captured by broad labor market measures.

"It's a good question. We don't really have the answer to that question," Mr. Powell said.

"Which is a little troubling if you're the guy running the economy," Mr. Ryssdal said.

Mr. Powell's response: "I don't think of myself as the guy running the economy. The economy is a $20 trillion economy."

Mr. Powell essentially pushed back against the idea of a Wizard-of-Oz-like, omniscient central bank chief, an image fanned by much of the positive press received by Alan Greenspan during his 19-year term as the Fed's chairman.

Mr. Powell also cautioned the public to take economists' forecasts less literally—a profession that is rigorous in its methods but that can't offer the same scientific certainty as, say, physics.

"I find very, very strongly that people attribute much too much certainty to what economists say, and much more certainty than economists really intend to convey," said Mr. Powell, who last month also called for a healthy dose of skepticism in pinpointing the precision of key unobserved variables used to guide monetary policy.

"It's not like the fact that water boils at 212 degrees. The economy doesn't boil at 4% unemployment," he said Thursday.

Much has been made of Mr. Powell being the first Fed chairman in decades who isn't a trained economist. His responses Thursday revealed ways in which he thinks that can be an asset. For example, explaining to the public and lawmakers what the Fed is doing might be easier for someone who hasn't spent 30 years teaching economics to graduate students.

Of course, the real communications puzzles could come later, when the economy surprises in one direction or the other. But so far, Mr. Powell has shown he's comfortable in his shoes.

Key Developments Around the World

Fed Chair Jerome Powell Says Trade Policies Complicate Economic Outlook

Federal Reserve Chairman Jerome Powell said a strong economy should allow the central bank to keep raising interest rates gradually and it was premature to judge how recent trade policy actions could alter those plans. Mr. Powell spoke in an interview on the Marketplace radio program set to air Thursday evening. He is scheduled to testify on Capitol Hill next week in semiannual congressional hearings. "I sleep pretty well on the economy right now," Mr. Powell said in the interview, according to a transcript posted online Thursday afternoon.

Read the Marketplace transcript here

Fed's Harker Says Inflation Will Determine Whether There Are Three or Four Rate Increases in 2018

Philadelphia Fed President Patrick Harker said Thursday that the direction of inflation is the key determinant of how many rate increases he will support in 2018. Mr. Harker said he still currently supports three rate increases this year, but he is willing to consider more aggressive action depending on price pressures. "We should be pragmatic and prudent about these increases," he said during an appearance in Victor, Idaho. "I am open to a fourth increase this year if we do see inflation start to accelerate."

U.S. consumer inflation rose in June to its highest annual rate in more than six years.

WSJ Survey: Economists See Fed Policy on Autopilot

Economists surveyed by The Wall Street Journal see the Fed moving in a pattern of quarterly interest-rate increases to keep the economy on a steady footing. With the labor market firing on all cylinders and with inflation at the Fed's 2% target, the central bank will put policy on autopilot unless something comes along to disrupt its plans, they said. Just about every economist surveyed said the next increase in the Fed's benchmark federal-funds rate would come at the Sept. 25-26 meeting and 84% predicted the one after that would be at the Dec. 18-19 meeting.

Investors Bet on Higher Rates as U.S. Inflation Firms

Investors are bracing for a period of consistently higher inflation, raising bets that the Fed will deliver a fourth interest-rate increase this year as an intensifying trade spat between the U.S. and China threatens to add to mounting price pressures. Federal-funds futures, which investors use to bet on central bank policy, on Thursday showed a roughly 60% chance that the Fed will raise rates at least four times this year, according to CME Group data. That marks one of the highest levels this year and compares to a 35% probability at the start of June.

ECB Officials Open to Extending QE Amid Trade Threat, Meeting Minutes Show

European Central Bank officials explicitly left open the option of extending their €2.5 trillion ($3 trillion) bond-buying program again at a policy meeting last month, worried that international conflicts over trade could aggravate a recent slowdown in the eurozone economy, according to meeting minutes published Thursday. The minutes underscore the careful balancing act facing the world's No. 2 central bank, which is starting to phase out years of easy money just as the region's economy slows and faces headwinds from trade tensions and fractious **financial markets**. The minutes of the June 13-June 14 meeting show that, even as they decided to end QE, officials worried about signs of an economic slowdown in the 19-nation currency union and threats stemming from "increased protectionism, geopolitical tensions and renewed **financial market** risks." "Given prevailing uncertainty, it was considered prudent to leave the end of net asset purchases still conditional on incoming data," the minutes said. Policy makers "widely felt that monetary policy had to remain patient, prudent and persistent," the minutes show.

Global Regulators Push for Faster Transition Away From Libor

Global regulators made a coordinated push Thursday urging banks and traders to hasten their transition away from using the scandal-plagued London interbank offered rate. In meetings and speeches around the world, regulators pressed banks to cease launching new contracts that reference Libor, and to come up with a plan for legacy contracts that will expire after the agreed-on transition date away from Libor, at the end of 2021. Though some aspects of the transition are proceeding according to schedule, or even faster, U.K. Financial Conduct Authority Chief Executive Andrew Bailey warned in a speech in London that overall, "the pace of that transition is not yet fast enough."

Friday

7 a.m. EDT

Bank of England's Cunliffe speaks in Cumbria, England

11 a.m. EDT

U.S. Federal Reserve releases its latest monetary policy report to Congress

12:30 p.m. EDT

Atlanta Fed's Bostic speaks in Falls Church, Va.

Leaving Money on the Table: Declining Responsiveness and the Productivity Slowdown

A "decline in the degree of job reallocation in response to shocks is behind the overall fall in the rate of reallocation over the past decades. Weakening responsiveness became a drag on aggregate productivity for high-tech businesses in the 2000s, but in other sectors the problem dates back to the 1980s," Ryan Decker, John Haltiwanger, Ron Jarmin and Javier Miranda find in a VoxEU column. "Discovering the cause of changing patterns of job reallocation is important. These patterns have significant implications for aggregate productivity and living standards. Our investigation suggests that researchers should focus on potential sources of rising adjustment frictions. These could include any policies or other factors that raise the cost of, or reduce the incentive for, hiring and downsizing," they write.

Time to Untie the ECB's Hands

"The European Central Bank is now signaling its intention to end quantitative easing this year, indicating that it expects eurozone inflation to reach its target of "below, but close to, 2%." But as the ECB prepares for the next crisis, it would be well advised to revisit its longstanding price-stability objective," Stefan Gerlach writes for Project Syndicate. " it should get rid of the ambiguity inherent in the words "close to," by setting a point target to provide clarity to the public – and to ECB Governing Council members – about what its monetary policy aims to achieve. Whether that target is 1.8% or 2%, or whether it is surrounded by a range, is less important... Second, the ECB must clarify how financial stability and business conditions factor into its policy decisions."

The number of Americans filing initial applications for unemployment benefits fell last week, but interpreting a signal from the data can by tricky due to seasonal factors.

Economists expect the low U.S. unemployment rate to go even lower over the next year, reaching levels not seen in a half-century.

Send us your tips, suggestions and feedback. Write to:

Jon Hilsenrath; Katy Burne; Michael Derby; Nell Henderson; Jason Douglas; Paul Hannon; Harriet Torry; Kate Davidson; David Harrison; Kim Mackrael; Tom Fairless; Michael Maloney.

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The New York Times

Business Day
How to Prepare for a Stock Market Surprise

By Jeff Sommer
525 words
17 July 2018
10:42 AM
NYTimes.com Feed
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English
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When you consider how sharply stocks declined early in 2018 and how many problems still appear to be lurking around the world, the peaceful state of **financial markets** over the last few months has been nothing short of remarkable.

The second quarter wasn't spectacular for stocks in the United States, but it produced solid returns with relatively little **volatility**. Stocks elsewhere around the world didn't fare quite as well and the bond market gave up ground, but for the most part, investors had some very welcome breathing room.

Still, it's a good bet that difficult times will return to **financial markets** at some point, so this may be good moment to prepare for a future shock. In our quarterly report on investing, we've analyzed one time-tested approach: the balanced fund.

Our survey includes articles with reporting on where the markets have been and analysis that suggests where they may be heading. Our selection also provides an introduction to investing. And we hope that at least some of these articles will entertain you as well.

Useful Funds That Don't Inspire Fear or Greed

Balanced funds are old-fashioned and effective. Their straightforward mix of stocks and bonds can discourage investors from behaving in self-defeating ways, leading to strong returns.

Wall Street's Summer Calm May Depend on Selective Vision

Investors seem to be focusing on strong earnings and all but ignoring trade tensions, a Federal Reserve rate increase and trouble abroad. The markets have been relatively peaceful, but how long will it last?

Trade Wars? Three Funds Made Solid Profits Anyway

Despite trade tensions and global problems, some American investors have prospered by focusing on international investments. We examine how three of the better-performing mutual funds have generated strong returns over the last quarter, as well as the last five years.

Feeling That Old Urge to Merge, but in a Vertical Way

AT&T did it with Time Warner, so why not me? Our reporter asks Mark Cuban to help him get more verticality into his life.

Long Dormant, Inflation Reawakens Investors' Fears

After years in which the threat of rising prices was barely a concern, the rate of inflation has been creeping back up toward its long-term average. We discuss several coping strategies.

How It Got Riskier to Own High-Quality Corporate Bonds

Investment-grade corporate bonds — the supposed middle ground between government and junk — delivered poor returns in the first half of the year.

Bitcoin Funds Are Rare. That May Be for the Best.

As firms seek approval for specialty exchange-traded funds, some advisers warn that cryptocurrencies may be intrinsically worthless. Others say they diversify a portfolio.

As Marijuana Goes Mainstream, Investors Rush In

An exchange-traded fund focused on companies in the cannabis industry, the first listed in the United States, has attracted about $400 million.

The Lazy Person’s Guide to Successful Investing

Is it possible to create a solid, diversified investment portfolio with just three mutual funds? Yes, argues a new book from a 94-year-old author.

Document NYTFEED020180717ee7h0040h

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

Twitter's Wings Needed a Clip; Crackdown on fake accounts raises doubts about the company's recent growth

By Dan Gallagher
441 words
9 July 2018
04:23 PM
The Wall Street Journal Online
WSJO
English
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Corrections & Amplifications

A chart in an earlier version of this article incorrectly labeled Twitter's monthly active users per quarter as monthly average users. (July 18, 2018)

Rumors of Twitter's death turned out to be greatly exaggerated. So too, perhaps, were the hopes of its newfound life.

Twitter, like its main social-networking rival Facebook, has been cracking down on fake and suspicious accounts. The Washington Post reported late Friday that the company has accelerated its suspension of those types of accounts. That crackdown could lead to a decline in the number of monthly active users for the second quarter, results for which will be reported on July 27.

Twitter, which last reported 336 million monthly active users, saw its share price fall nearly 9% Monday before CFO Ned Segal tweeted that most of suspended accounts don't show up as monthly active users. Twitter's shares closed the day down more than 5%.

A decline in users would be unwelcome for a company that appeared to be enjoying a solid recovery. Just a year ago, Twitter was in a deep slump as both advertising revenues and user counts were falling. Both trends appeared to have reversed earlier this year, as the company added 6 million monthly active users in the first quarter and grew its advertising revenue by 21% year over year. That gave the already rising stock another strong boost. Twitter's share price had surged 53% from its first-quarter report to Friday's close and was up 94% for the year. The company was added to the **S&P 500** last month and is one of the index's top performers.

Cleaning up its network is the right move for the business over the long term. But Twitter was already struggling with the perception that its audience may be peaking. The company's base of monthly active users has grown by percentages in the low single digits over the past two years—much slower than that of the much larger, and far more profitable, Facebook. That was anticipated to continue, as Wall Street had been expecting Twitter's user base to grow only 4% for the current year compared with 9% projected for Facebook—even with the latter's numerous controversies of late.

Against that, Twitter's surging **stock price** looked awfully expensive, even considering the company's improving business trends. And Monday's drop still leaves the stock trading at 133 times forward earnings—more than five times Facebook's multiple. Twitter has shown it doesn't need to become the next Facebook. Investors should stop trading like it will be.

Write to Dan Gallagher at dan.gallagher@wsj.com

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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Overheard

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[Financial Analysis and Commentary]

Managing one of the world's largest stock exchanges is hard enough. It is even worse if the job includes cheerleading your own market, too.

That task of geeing up Chinese stocks has now fallen to the Shanghai Stock Exchange itself. Over the weekend it posted a statement saying that stocks listed there offer excellent "investment value."

Its detailed pitch: Valuations for Shanghai stocks are close to their trough while profit growth in the first half, especially in the pharmaceuticals and chemicals sectors, should come in strong. The increasing amount of share buybacks is another vote of confidence, the exchange said.

Ever since the recent market plunge that sank Chinese stocks into a **bear market**, state-owned Chinese media have been putting out a constant stream of **bullish** punditry. It is still notable that an actual stock exchange has felt the need to join the cheerleading chorus.

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The New York Times

Business/Financial Desk; SECT
DealBook Briefing: Trump's Latest Trade Enemy Is Europe

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NYTF
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English
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Good Monday. Want this in your inbox every morning? Sign up here.)

Trump singles out Europe as a trade foe

When CBS News asked President Trump to name America's biggest foe, he talked about Russia and China. But only after citing the European Union, because of "what they do to us in trade."

Donald Tusk, president of the European Council, shot back on Twitter: "America and the E.U. are best friends. Whoever says we are foes is spreading fake news."

Mr. Trump's remarks matched his provocative behavior at last week's NATO conference. But some commentators think Europe will simply ignore the insults. The economist Michael Ivanovitch writes for CNBC that Europeans are flaunting their trading clout, and "Trump is wasting time trying to change the existing trans-Atlantic trading regime."

Those tensions could grow today as Mr. Trump meets President Vladimir Putin of Russia in Finland. Julie Hirschfeld Davis and Katie Rogers of the NYT report fears that Mr. Trump "might offer concessions behind closed doors to a Russian president who is ready to exploit any hint of fissure within the Western alliance."

And China turns to the W.T.O.

Beijing complained formally to the World Trade Organization this morning about the U.S. plan to impose tariffs on $200 billion worth of Chinese goods. That could escalate the trade war. And U.S. officials have argued that the W.T.O. isn't the right place to resolve the fight.

Beijing, looking for allies, is hosting E.U. officials this week at a conference centered on trade issues. But the European delegation is so far said to be unmoved.

More on the trade wars: Does anyone know what the U.S. would consider victory? And American stocks are holding up.

Goldman Sachs prepares to anoint a C.E.O.

The Wall Street bank could formally name David Solomon as the successor to Lloyd Blankfein as soon as today. Here's Kate Kelly of the NYT on what that would mean:

The announcement would formally establish Mr. Solomon as the successor to Lloyd C. Blankfein as one of the most powerful executives on Wall Street. Mr. Blankfein, who presided over record earnings during his 12 years atop Goldman, will stay on for an interim period. Anointing Mr. Solomon, however, most likely makes it easier for him to put his future lieutenants in place.

Banks' profits are booming. But how about their lending?

A lot is going right for banks, including tax cuts, deregulation and a buoyant economy. JPMorgan Chase, Citigroup and PNC all reported healthy quarterly profits on Friday. But have they increased lending to keep up with all the good news?

Our colleagues Peter Eavis and Emily Flitter found scant evidence of that in earning reports. More spare cash went to shareholder dividends, leading critics to say that lenders could do more to stimulate the economy. But the banks could argue they are staying disciplined and not chasing shaky borrowers.

Bank of America announces earnings today. Will it buck the trend?

More banking news: Deutsche Bank published its earnings early -- and they were more than double what analysts expected.

China's economic growth isn't as strong as it appears

The Chinese government said overnight that its economy was 6.7 percent bigger last quarter than a year ago. It's reported pretty much the same growth rate every quarter for the past two-and-a-half years.

Keith Bradsher of the NYT sees trouble lurking behind those numbers:

Private Chinese businesses complain that government efforts to tame debt have made it hard for them to get money. A tiny but growing number of Chinese companies have defaulted on their debt. The currency has lost some of its value. Chinese stocks are in **bear market** territory.

Don't expect big media deals out of Sun Valley

Allen & Company's big C.E.O. gathering drew media moguls like Les Moonves of CBS and David Zaslav of Discovery last week. They expected courtship from the visiting tech titans -- Tim Cook of Apple, Jeff Bezos of Amazon and others. The WSJ says they didn't get it.

Masa Son of SoftBank told reporters: "I'm not interested in traditional media." Sheryl Sandberg of Facebook and Mr. Cook said similar things. Their attitude seems to be that it's better to build a content empire than buy one. If media companies want to compete with Netflix and Amazon, mergers may be their only option.

In other media news: Critics fear that AT&T will try to turn HBO into Netflix, but insiders at the network don't think it will happen.

The speed read

Deals

Debt is how a Chinese businessman bought the soccer team A.C. Milan, and how a hedge fund pushed him out. (FT)

The case for fewer rules on I.P.O.s and early-stage investing, from the chairman of the House Financial Services Committee. (WSJ)

New exchange-traded funds and a big I.P.O. show investors' hunger for the cannabis industry. (NYT)

Politics and policy

The Trump administration may dip into American petroleum reserves to depress **oil prices**. (WSJ)

ZTE's stock jumped 17 percent as it was allowed to resume U.S. operations. (NYT)

Expect economic populism as Bernie Sanders, Elizabeth Warren and others prepare to seek the 2020 Democratic nomination. (NYT)

Tech

Uber's latest headache: Its C.O.O., Barney Harford, was accused of racial insensitivity. (NYT)

How Russian spies hid behind Bitcoin in their 2016 U.S. election operations. (NYT)

Netflix is trying to break India, but it won't be easy. (FT)

Best of the rest

How the P.R. guru Sir Alan Parker bungled his own crisis as chairman of Save the Children U.K. (NYT)

The U.S. government wants to clamp down on high-frequency agricultural trading. (WSJ)

Why the Craig of Craigslist is backing journalism education. (Recode)

America will soon have only one Blockbuster video store -- in Oregon. (NYT)

We'd love your feedback . Please email thoughts and suggestions to bizday@nytimes.com.

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THE WALL STREET JOURNAL.

Markets

IEX Exchange Has Wall Street Fame But No Listings; Startup market has approached hundreds of companies including Amazon, Starbucks as it seeks to woo firms away from NYSE and Nasdaq

By Alexander Osipovich
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A startup stock exchange has discovered it isn't easy to pull corporate America away from the mighty New York Stock Exchange and Nasdaq Inc.

IEX Group Inc. made an ambitious effort to attract companies listed on the NYSE and Nasdaq after the 2014 publication of Michael Lewis's best seller "Flash Boys." The book followed IEX's founders as they built a new exchange designed to protect investors from what they called predatory high-speed trading strategies.

But so far, IEX has failed to list any companies, despite approaching hundreds over the past several years, including household names such as Amazon.com Inc., Starbucks Corp. and air carrier United Continental Holdings Inc., people familiar with the listings effort said.

Some companies that considered an IEX listing have retreated, such as casino operator Wynn Resorts Ltd. After the departure of founder and former Chief Executive Steve Wynn, a vocal IEX supporter, the company has indicated it is sticking with Nasdaq.

The timetable for IEX's listings launch has slipped repeatedly, and the executive who led the effort took a different job at the exchange in May.

Now, IEX must either offer companies greater incentives to win listings or find other ways to grow, said James Angel, a finance professor at Georgetown University. "Starting a listings business is really hard, because most companies don't want to bother changing their listing exchange," he said.

IEX declined to make anyone available for an interview. "We do not comment on hearsay and speculation," IEX President Ronan Ryan said in an emailed statement.

New York-based IEX is six years old and handles around 2.4% of daily U.S. stock-trading volume. Companies that list on IEX could get media buzz for signing on with an exchange that styles itself as a fighter for fairness in the stock market.

Amazon and United declined to comment. A Starbucks spokesman said he was unable to confirm whether the coffee giant was approached by IEX. A Wynn Resorts spokesman said, "We are satisfied with our current listing provider."

The NYSE, founded in 1792, and Nasdaq, which dates to 1971, have an effective duopoly in U.S. corporate listings. A third exchange operator, Cboe Global Markets Inc., has a listings business focused on exchange-traded funds rather than corporations.

NYSE parent Intercontinental Exchange Inc. and Nasdaq earned a combined $684 million from listings last year, according to the two exchange groups. IEX tried to snatch their companies by offering five years of free listings. Adding listings could enhance IEX's prestige and boost its market share.

IEX may still break into the club. The exchange says it employs six people dedicated to listings, and some companies were receptive to its pitch.

"We were intrigued by the IEX proposition," said DeAnne Gabel, senior director of investor relations at Spirit Airlines Inc. The discount carrier considered moving from **Nasdaq** to IEX, but switched to the NYSE in December. Spirit could move to IEX eventually, Ms. Gabel added.

IEX Chief Executive Officer Brad Katsuyama played a hands-on role in wooing companies, people with knowledge of IEX's outreach efforts said.

It helped to be the hero of "Flash Boys." For instance, David Petraeus, the retired general and former Central Intelligence Agency director, asked to meet Mr. Katsuyama after reading the book, a person familiar with the situation said.

Mr. Katsuyama grew friendly with Mr. Petraeus, now an executive at KKR & Co., and suggested bringing the private-equity giant to IEX, people briefed on the discussions said. But the company stuck to the NYSE. Mr. Petraeus declined to comment through a KKR spokeswoman.

Another global figure drawn into IEX's efforts: former Canadian Prime Minister Stephen Harper. IEX hired his consulting firm to lobby companies dual-listed in Toronto and New York, such as Royal Bank of Canada, about listing on IEX, people familiar with the situation said.

Mr. Harper's spokeswoman didn't respond to requests for comment. RBC declined to comment on its plans.

Four years ago, The Wall Street Journal reported that IEX told investors it hoped to list as many as 250 companies by 2017. By last year, IEX was telling some people that it would initially have around a half-dozen.

"As the 'Flash Boys' aura faded, listed companies increased their focus on the details of IEX as a listing venue and they came away unimpressed," said former NYSE Group President Thomas Farley.

The NYSE and **Nasdaq** fought back, with top executives like Mr. Farley and **Nasdaq** CEO Adena Friedman speaking to leaders of companies that had been courted by IEX, according to people briefed on the discussions. The Big Board and **Nasdaq** warned companies it would be risky to move to a new, untested exchange, these people added.

Caught in the middle were companies like Franklin Resources Inc. The asset manager, which operates under the brand name Franklin Templeton Investments, explored switching to IEX, but the NYSE now expects to retain it, people familiar with the matter said. A Franklin spokesman declined to comment.

IEX suffered an unforeseen setback when the Journal published an article in January detailing allegations of behavior by Mr. Wynn that cumulatively would amount to a decadeslong pattern of sexual misconduct. The casino mogul has said it was "preposterous" that he would assault a woman. He stepped down as chairman and CEO of Wynn Resorts in February. Mr. Wynn declined to comment through his lawyer.

IEX had expected Wynn Resorts to be its first listed company, making others feel more comfortable about switching, people familiar with IEX's listings effort said.

The dilemma is that most companies don't want to be first to switch to a new exchange, said Mr. Angel, the Georgetown professor.

"Nobody really wants to be the test case for IEX," he said. "Who wants to be the guinea pig?"

Vipal Monga and Laura Stevens contributed to this article.

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

Detroit Needn't Fret Yet About Pump Prices; Light truck sales, which are crucial to the profits of U.S.-based auto makers, are holding up despite pump prices nearing a psychological milestone

By Spencer Jakab
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International headlines haven't been good for companies selling autos in the U.S., but rising **oil prices** shouldn't rank very high on their list of worries.

U.S. retail gasoline prices ahead of July 4th were at their highest since 2014, shortly before oil tumbled into a **bear market**. The $3.00 a gallon mark—nearly hit in late May on a nationwide average basis and exceeded in may locations—has been seen in the past as a psychological threshold for changing consumer behavior. That tends to show up slowly in actual driving habits, but it does tend to have a surprising effect on longer-term choices such as what type of vehicle people buy. If that were to be the case then it might help somewhat for foreign auto makers being threatened by tariffs.

Year-to-date the average wholesale price of gasoline has been 26% higher than the same period of 2017, according to data from FactSet. Prices hit a peak in late May and are now approaching that level again. Nevertheless, auto sales data from major manufacturers continue to show surprisingly strong sales of heavier vehicles and weak car sales. Ford, for example, reported an 8.9% and 3.2% rise in June in SUV and truck sales compared with a year earlier, respectively and a 14% decline in car sales.

That resilience in light truck demand is a tailwind for all U.S.-based manufacturers. The traditional Detroit "big three" got 82% of unit sales and an even higher share in dollar terms from light trucks. The three biggest Japanese companies got just 54% of unit sales from light trucks.

The explanation for trucks' continued appeal may lie in the booming labor market and a strong environment for small businesses that purchase pickups. Combine that with the fact that cars and even trucks are more fuel-efficient these days and that filling them is a smaller share of disposable income than in past economic cycles and consumers can shrug away $3 gasoline.

That could reverse at some higher price point, but the U.S. Energy Information Administration recently predicted that they probably have hit their peak for the year. Detroit seems to have dodged at least one economic bullet.

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THE WALL STREET JOURNAL.

Markets

Average Gas Price Nears $3 a Gallon, Raising Worries for U.S. Economy; Drivers across the U.S. in May paid as much as $2.96 a gallon on average, the most since 2014

By Stephanie Yang
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The highest retail gasoline prices in years are the latest development to raise concerns about one of the longest-running U.S. economic expansions on record.

Drivers across the U.S. in May paid as much as $2.96 a gallon on average, the most since 2014. Prices have climbed to $3.63 in California and $3.39 in Washington, states where prices tend to be higher because of factors such as higher taxes, environmental regulations and a lack of pipelines that transport oil west. As of Monday, the national average was $2.86 a gallon.

With wages in the U.S. climbing, Americans have so far been able to weather the higher prices. But analysts say that if average gas prices hit $3.50 or even $4 a gallon as global **oil prices** rise, that could dent growth by eating into disposable income and spending.

Some analysts say the recent run-up hasn't pinched Americans too much. Drivers aren't yet reshuffling plans or changing their habits.

But U.S. airlines have already increased ticket prices, and over time higher energy and manufacturing costs can eat into company profits, slowing hiring. Industrial giant 3M Co. and appliance maker Whirlpool Corp. are among those that have cited higher material costs as challenges. And despite improved incomes, consumers boosted spending only modestly in May, undershooting expectations.

The U.S. economy has entered its 10th year of expansion, one of the longest on record, but a Wall Street Journal survey shows that a majority of economists think a recession could come in 2020. Rising energy prices can also feed into inflation, which could prompt the Federal Reserve to raise interest rates more aggressively. The central bank has increased interest rates two times this year, and is expected to raise rates another two times.

Inflation data for June are due Thursday morning: The consumer-price index reflects the costs of everything Americans pay for, including gasoline.

"People are on the lookout for a downturn," said Joseph LaVorgna, chief economist for the Americas at Natixis. "Tight monetary policy combined with rising energy costs is typically not a good development for U.S. households."

While the **stock market** and employment trends remain strong, threats loom with the U.S.-China trade dispute. On Friday, both countries slapped levies of $34 billion on each others' exports, kicking off America's biggest trade battle since the Great Depression. Late Tuesday, the White House said tariffs are planned on an additional $200 billion in Chinese goods.

Investors have also spotted signs of a slowdown in other markets. Last week, a widely watched difference between Treasury yields—known as the yield curve—fell to its lowest in nearly 11 years—a development that can suggest economic weakness.

"Every recession has been preceded by two things: an inverted yield curve and rising oil and gas," Mr. LaVorgna said.

Falling inventories and global demand have propelled oil to the highest prices in more than three years. Gasoline prices are closely linked with oil, but it can take time for increases in crude prices to translate to more expensive fuel.

And the oil market has also been **volatile**. U.S. crude futures closed near the highest levels since November 2014 on Tuesday but slid 5% Wednesday.

President Donald Trump has blamed the Organization of the Petroleum Exporting Countries for the oil rally and asked Saudi Arabia to further increase output. On July 4, he tweeted, "The OPEC Monopoly must remember that gas prices are up & they are doing little to help."

Analysts said Mr. Trump may be trying to lower gas prices ahead of this year's midterm elections. However, his tweets have had mixed effects.

"The gasoline story in the U.S. is very much a geopolitical story. It's down to OPEC, its down to Saudi Arabia and it's down to Iran," said James McCullagh, an analyst at Energy Aspects. "Ultimately, the price of crude isn't playing ball at the moment," he said.

Average gas prices are still below their peak of $4.11 in 2008, when prices eventually topped $5 in parts of the country, expediting an economic downturn. Gasoline again reached the $3.50 to $4 range between 2011 and early 2014. But then, growth in the economy was robust, helping drivers pay more at the pump.

A surging oil market is rarely the sole factor in triggering a downturn. But in recent months, rising prices have been attributed to concerns over a possible supply shock, which could pose a greater threat to the global economy than a demand-driven rally.

Other indicators on the health of U.S. energy demand are mixed. Vehicle miles traveled in April fell a seasonally adjusted 0.6% compared with the previous year, according to the Transportation Department. Gasoline demand fell from a year earlier in both May and June, the first consecutive monthly decline since the start of 2017, the financial firm Cowen & Co. estimates.

Gasoline demand tends to be fixed as drivers rely on driving to get to work and for tasks such as grocery shopping. That makes high fuel prices especially concerning for the broader economy.

Deserey Morales, who works at a nightclub in L.A., said she finds current gas prices "ridiculous."

But she said it wouldn't change how much she drives.

"You still have to do what you have to do," Ms. Morales said. "I don't really have the choice."

Ian Lovett contributed to this article.

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EXCHANGE --- Heard on the Street: Beijing's Stimulus Is Likely to Be Modest --- Chinese slowdown could lead to another, but smaller ramp-up in debt

By Nathaniel Taplin
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[Financial Analysis and Commentary]

It is an inconvenient time for a Chinese downturn -- unless you are a trade warrior in Washington. Signs of distress are clear: Chinese stocks are in a **bear market**, the yuan is at a one-year low and investment growth is at its slowest this millennium.

In the past, the Chinese state has often stepped in with lots of financial firepower to smooth downturns -- primarily by getting government-owned banks to lend more. Once the stimulus kicks in, it has resulted in higher commodity prices and big movements in currencies. The most lasting impact is an increase in China's frightening debt burden, now more than 250% of gross domestic product.

Should investors expect a repeat this time? In short, yes -- but probably less than before, because China's political landscape has changed, as has the economy. Moreover, the current downturn is unlikely to be as severe as the last big ones in 2009 and 2015.

Another reason for a more modest stimulus is that President Xi Jinping has championed higher-quality, less debt-intensive growth. Reluctance from Beijing to launch a big stimulus could enhance the Trump administration's leverage with China on trade later this year.

Although China's growth targets receive a lot of attention, that isn't what Beijing really cares about. Instead it's the labor market and financial stability. A change in employment patterns is one big reason Beijing's response to slowing growth may be more modest this time.

In the past, most Chinese not working on the farm were employed in construction and in factories producing industrial goods for the domestic economy and consumer goods for export. These companies are struggling with heavy debt and tightening credit.

But today, most urban Chinese work in the service sector for companies like tech giants Alibaba and Tencent or other companies serving China's surging consumer market. That sector is still doing well.

Nearly 100 million more Chinese worked in services in 2017 than in 2010, according to Chinese government statistics. Meanwhile employment in industry -- including the export sector -- peaked in 2012 and there are now around 130 million fewer workers than in services.

So what will a modest stimulus look like and how will it play out inside China and in global markets?

To maintain stability and keep people working, China's first priority is to ensure its overleveraged banks and businesses stay afloat by preventing housing, steel and cement prices from falling sharply as investment dips. Commodity prices are still likely to sell off further, until the new round of stimulus feeds through. But big cuts to excess steel capacity and to China's enormous housing overhang make a crash less likely.

Another goal of a modest stimulus will be to prevent heavy capital outflows and protect the country's $12 trillion bond market. Beijing will try to ease enough to keep banks lending to small businesses but not too much that people will fear a big devaluation and move their money out of the country. China's newly reinforced capital controls make this less likely, but rising U.S. interest rates will pose a test.

If Beijing can strike that balance, the **stock market** should stabilize and bond defaults will remain modest. Domestic consumption should stay healthy, though a decline in exports would hurt workers and could reduce consumer spending.

What might change the current calculus? Inside China, investors would be wise to keep a close eye on housing and factory-gate prices -- steep falls in either would hit indebted industrial and property companies hard. A more substantial stimulus effort would likely follow, pushing commodity prices back up higher and heaping pressure on the yuan.

If big capital outflows do reappear and the yuan falls further, Chinese companies or local governments could default on dollar bonds. Alternatively, a strong defense of the yuan by China's central bank could suck too much cash out of domestic money markets, triggering a deeper downturn.

Then there is the trade conflict. Exports remain solid for now. And a weaker yuan, down around 6% against the dollar since April, may help offset pressure from tariffs.

The most likely outcome remains a muddle-through. Monetary policy will be eased, if not as sharply as in the past, and some of the progress on indebtedness will be undone. China will avoid its long-feared debt crisis this time.

Less likely but still possible is a rapid fall in prices for housing or steel and a new wave of cash flowing out of China. Major turbulence in global commodity, currency and debt markets won't be far behind.

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THE WALL STREET JOURNAL.

Business

Costs Are Crashing the Party for Manufacturers; Earnings reports from firms like 3M and Whirlpool will show how much damage tariffs and higher wages can do amid strong economic growth

By Bob Tita and Doug Cameron
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Corrections & Amplifications

Caterpillar Inc. is scheduled to report second-quarter earnings on July 30. An earlier version of this article misstated the date as July 31. (July 23, 2018)

Manufacturers are booking more orders and delivering higher profits in a strong U.S. economy.

But investors are worried that the good times won't last: Costs are rising at some of the biggest industrial companies due to tariffs and a super-tight labor market.

Upcoming earnings will indicate how much of a dent those pressures are making on the bottom line. This week, 3M Co., Harley-Davidson Inc. and Whirlpool Corp. are scheduled to report.

Industrial stocks are down around 2% this year versus a 4.8% rise in the **S&P 500**. Some of the biggest manufacturers are leading the decline. Shares in Caterpillar Inc. have dropped 13% this year, while 3M is down 14%.

Shares in small- and medium-size companies have fared better than those of manufacturing heavyweights, but that has done little to reassure money managers. Assets in industrial exchange-traded funds have declined 8% in the last month alone as investors moved money into consumer staples and utilities.

"We're tracking towards the worst relative year for industrials in 20 years," said Scott Davis, chief executive at Melius Research LLC.

Shares have recovered slightly over the past week as initial earnings reports beat analysts' expectations. Fastenal Co. and W.W. Grainger Inc., which supply factories with everything from bolts to cleaning supplies, both signaled strong demand. Honeywell International Inc. on Friday reported higher sales and profit margins at all four of its divisions and said the trend is continuing in the third quarter.

But that good news has done little to offset investors' preoccupation with the effects of the Trump administration's import tariffs on manufacturers. Shares in aluminum producer Alcoa Corp. have fallen nearly 16% since Wednesday, when the Pittsburgh-based company said the 10% tariff on aluminum was driving up costs of the metal it imports to the U.S. from its smelters in Canada.

Investors' dissatisfaction stands in contrast to bulging order books and rising industrial output, buoyed by a rebound in **oil prices** that has spurred more domestic drilling. U.S. aerospace and auto manufacturers have also reported strong orders.

But near-record-low unemployment of about 4% is driving up wage bills and leaving some companies short of workers, holding back production. The labor market is particularly tight for experienced workers in cities such as Charlotte, N.C., and Houston, where steel mills are expanding production of pipe and tubing used in oil and natural-gas wells. Tariffs on imported pipe are helping to boost drilling companies' demand for those products made in the U.S.

"To make those products, they have to hire more people," said Kirk Murray, vice president of SeAH Steel America Inc. "From experience, I can say it's not easy." SeAH is expanding a tubing mill in Houston that had been dormant before the South Korean steelmaker bought it in 2016.

Other companies are scrounging for everything from low-skilled line workers to software engineers that can operate robots. The worker shortage threatens an upturn that is in its sixth month, measured by industrial output. Previous cycles have typically lasted about four years.

Manufacturing unemployment is at its lowest level in 15 years, according to the Labor Department. Companies surveyed for the closely watched Chicago Business Barometer said production fell in June from a year earlier, the fourth monthly drop since December. More than a third of companies said they had boosted salaries.

The heavy-truck market highlights the gap between strong growth signals and investor anxiety. North American orders are at a nearly 20-year high, but production hasn't kept pace, in part because of labor shortages, supply-chain disruptions and some concern that orders could be canceled.

Shares in Paccar Inc., the maker of Kenworth and Peterbilt trucks, are down nearly 12% this year.

Orders for heavy-duty trucks have surged since last fall to an annualized rate of about 430,000 vehicles. But manufacturers have been building trucks at a much slower rate. After particularly low production volume this spring, market forecaster ACT Research reduced its projection for this year to 316,000 vehicles from 328,000.

ACT President Kenny Vieth estimates that some 10,000 trucks were sidelined at assembly plants in April waiting for windshields, wire harnesses and other components. He said suppliers have been constrained by low inventories of parts from overseas and difficulty hiring workers.

Beyond the truck industry, demand signals and leading indicators such as new orders remain positive. That is calming concerns that the first months of 2018 may have been a high-water mark for construction and mining machinery, a possibility mooted by Caterpillar executives in April.

Caterpillar later said it had been misinterpreted, and expects the momentum to continue. The equipment maker reports second-quarter results on July 30.

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THE WALL STREET JOURNAL.

US

Why Americans Spend So Much on Health Care—In 12 Charts; Prices are hidden behind insurance deals, hospital consolidation pushes up costs and the health sector is a growing power in the economy

By Joseph Walker | Graphics by Angela Calderon
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The U.S. spends more per capita on health care than any other developed nation. It will soon spend close to 20% of its GDP on health—significantly more than the percentage spent by major Organization for Economic Cooperation and Development nations.

What is driving costs so high? As this series of charts shows, Americans aren't buying more health care overall than other countries. But what they are buying is increasingly expensive. Among the reasons is the troubling fact that few people in health care, from consumers to doctors to hospitals to insurers, know the true cost of what they are buying and selling.

Providers, manufacturers and middlemen operate in an opaque market that can mask their role and their cut of the revenue. Mergers give some players more heft to enlarge their piece of the pie.

Consumers, meanwhile, buoyed by insurance and tax breaks, have little idea how much they are really spending and little incentive to know underlying costs.

Despite the higher spending, the U.S. fares worse than the OECD on most major measures of health. The pace of improvement by other advanced nations has been faster on most measures since 1970.

A big part of the problem in analyzing health spending is the opacity of the industry.

The bulk of consumers' health spending now goes to paying for health insurance, a shift from when patients paid directly for health services. Since insurers negotiate prices with providers, it is hard for individuals to judge health costs and make more informed choices.

Contributions to employer-sponsored health coverage aren't taxed, which makes it less expensive for companies to pay workers with health benefits than wages. Generous benefits lead to higher spending, according to many economists, because employees can consume as much health care as they want without having to pay significantly more out of their own pockets.

The tax benefit is the country's biggest single income-tax break, costing billions to government revenue.

The prices of many medicines are hidden because pharmacy-benefit managers—the companies that administer drug benefits for employers and health insurers—negotiate confidential discounts and rebates with drugmakers.

Humira, an immunosuppressive, is the best-selling drug in the U.S. Its manufacturer, AbbVie Inc., discounted the price for insurers, PBMs and other purchasers by about 16% from its advertised price in 2016—a big jump from a decade earlier, according to a Wall Street Journal analysis. It isn't known how much of those discounts are passed to employers and consumers, and how much is pocketed by insurers and PBMs as profit.

One reason prices are rising: Hospitals are becoming more consolidated and are using their market clout to negotiate higher prices from insurers.

This consolidation contributes to the overall increase in health costs, research suggests. Hospitals with a monopoly in a geographic market charge significantly more for procedures than those in markets with four or more competing hospitals, according to researchers.

Prices for medical care started rising significantly faster than overall inflation in the mid-1960s. Prices have been the driver, not the amount of care, for the increase in U.S. spending compared with other countries, according to many economists.

Drug prices have risen the most of the three largest components of health spending since 2000, followed by hospital care and physician services.

Health care has become a larger part of the economy, creating powerful constituencies resistant to changing the way the system operates.

The health-care industry overtook the retail sector as the nation's largest employer in December, giving local economies and their workers a stake in the industry's growth. Health jobs surpassed manufacturing jobs in 2008.

The revenues of health-care companies represented nearly 16% of the total revenues of firms in the **S&P 500** last year, up from about 4% in 1984.

Health-care companies have more than doubled overall lobbying spending since 1998, and have become a bigger percentage of total lobbying by industries.

Tom McGinty and Melanie Evans contributed to this article.

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Economy

Powell Says Fed Should Keep Gradually Raising Interest Rates; Fed chief delivers an upbeat economic assessment to Congress, but opens door to potential policy shift

By Nick Timiraos
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WASHINGTON—Federal Reserve Chairman Jerome Powell delivered an upbeat assessment of the economy and said it justified continued interest rate increases. But he opened the door to a potential policy shift and outlined risks if escalating trade tensions result in permanently higher tariffs.

Mr. Powell has mostly sidestepped recent questions on trade policy because he says it is outside of the Fed's responsibilities. He offered words of caution Tuesday at a hearing before the Senate Banking Committee.

"In general, countries that have remained open to trade, that haven't erected barriers including tariffs, have grown faster. They've had higher incomes, higher productivity," said Mr. Powell. "And countries that have gone in a more protectionist direction have done worse."

Mr. Powell affirmed the Fed's plans to continue with gradual rate increases, and he said it was too soon to say if trade disputes might interfere with those plans. The central bank's rate-setting committee "believes that—for now—the best way forward is to keep gradually raising" its benchmark short-term rate, he said.

The addition of the qualifier "for now" to Mr. Powell's statement was new, emphasizing that policy decisions aren't on autopilot. The phrase also signaled less certainty about the rate path as the Fed raises its benchmark rate toward a so-called neutral level that neither spurs nor slows growth.

The Fed raised that rate in June by a quarter percentage point to a range between 1.75% and 2%, the second such increase this year. Most Fed officials penciled in a total of at least four rate increases this year and three more next year.

Most of them expect they will need to raise the rate to a neutral level, which could be reached in the next year, but they haven't resolved whether or how much higher to go after that.

The Fed expects recent tax cuts and an increase in federal spending to boost spending and investment at a time when the labor market is already tight. This has put officials on the lookout for signs the economy could be overheating.

Intensifying trade disputes, on the other hand, could hurt business confidence and roil **financial markets** if U.S. companies face higher prices or supply-chain disruptions.

Senators of both parties raised concerns Tuesday about President Donald Trump's decisions to impose new tariffs on trading partners and threaten more to come, prompting other countries to do the same to the U.S.

If the Trump administration's trade policy in the end "results in lower tariffs for everyone, that would be a good thing," Mr. Powell told lawmakers. "If it results in…higher tariffs across a broad range of traded goods and services that remain that way for a long period of time, that would be bad for our economy and for other economies, too."

Scott Minerd, chief investment officer at Guggenheim Partners, said investors needed to take more seriously the potential for disruptions. "Tariffs are a form of taxation that ultimately is paid not by the exporter, but by the U.S. consumer," he said in a client note. "Markets are clearly spooked."

The Fed has little reason to change course now because history is full of examples of tariffs that have been threatened but never imposed, or imposed only temporarily.

The Fed tries to set rates with an eye toward the economy's performance a year ahead because monetary policy operates with a lag. But the central bank has few examples from recent history of widespread trade disruptions, so Fed officials will have to rely on current data "a little more than we normally would," said Boston Fed President Eric Rosengren in an interview last month.

Trade disputes have mixed implications for Fed policy. On one hand, they could slow economic growth, causing officials to hold off on rate rises. Or tariffs could push up inflation, requiring a steeper path of increases.

"Are they fighting the war against inflation or are they trying to cushion the shock to growth?" said Ethan Harris, chief economist at Bank of America Merrill Lynch. He said the weakness in overall growth, rather than faster price increases, would be the Fed's bigger worry.

Mr. Powell, in a radio interview last week, said the Fed could ignore the price increases from tariffs if officials conclude they represent a one-time rise that won't be incorporated into businesses' and consumers' expectations of future inflation.

Interpreting the price data could grow more complicated because many Fed officials believe inflation should accelerate as unemployment falls, and vice versa. While that relationship was been very weak over the past decade, officials expect that as labor market slack disappears, wages and prices should rise more quickly.

If a tight labor market appears to be pushing wages higher at the same time tariffs are driving up prices, "it's going to be a little bit harder to disentangle," said Mr. Rosengren.

Central bankers like to maintain inflation around 2%, seeing it as a sign of a healthy economy.

Inflation is close to the Fed's 2% target after undershooting it for many years. Consumer prices in May rose 2.3% from a year earlier. Excluding **volatile** food and energy categories, they rose 2%, according to the Fed's preferred inflation gauge.

Mr. Powell said Tuesday he took comfort from signs that moderate wage growth "is not causing high inflation."

Write to Nick Timiraos at nick.timiraos@wsj.com

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Economy

Fed Faces Bond Decisions | Inflation Hit 6-Year High | Kudlow Hopes Fed Moves 'Very Slowly' | ECB Official's Bribe Charges | Blackstone's Take: Policy Rates Are Out of Whack; The Wall Street Journal's central banking newsletter for Monday, July 2, 2018

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Blackstone's Take: As Inflation Hits Targets, Policy Rates Are Out of Whack

Fed Faces Decisions on Shrinking Huge Bond Portfolio

U.S. Inflation Rate Hit 6-Year High in May

Kudlow Says White House Hopes Fed Will Raise Rates 'Very Slowly'

Latvian Prosecutors Charge Top ECB Official With Taking Bribes

As Inflation Hits Targets, Policy Rates Are Out of Whack

Attention central bankers in Europe and the U.S.: you have arrived at your destination.

In the U.S., annual inflation excluding food and energy hit 2% in May as measured by the price index for personal-consumption expenditures. That is the Federal Reserve's preferred price gauge, and it was the first time in over six years that it had been that high. Including food and energy, the price index was up 2.3%.

In the eurozone, annual inflation was 2% in June, the highest since early last year. Both the Fed and ECB target inflation rates around 2%. In the ECB's case, it aims to keep inflation a little under 2%, so inflation is actually above target there. U.K. inflation was 2.4% in May, also above the Bank of England's target.

It isn't just the biggest economies. In Sweden, the consumer-price index with a fixed interest rate, the Riksbank's preferred gauge, was up 2.1% annually in May, above its 2% inflation target. In Switzerland, inflation is running at 1%. Though that seems low, the Swiss National Bank targets inflation that is positive, but below 2%, so that rate is right in the middle.

Yet of all the central banks in these countries, only the Fed and Bank of England have policy rates in positive territory and have been raising them, albeit at varying paces with the U.S. much more aggressive.

For the ECB, Sweden and Switzerland, policy rates are still deeply negative and show no signs of being increased before 2019. This might protect European exchange rates from strengthening too much and harming exports, but negative rates carry side effects: low deposit rates for bank customers; frothy housing markets; and pressure on bank profits.

Despite a pretty clear rationale for higher rates on inflation grounds, central banks in much of Europe appear unwilling to make the first move.

In that case, here's a radical idea: coordinated rate increases from the ECB and smaller European central banks timed with a rate increase from the Fed. This might limit some of the domino effects on exchange rates.

This almost certainly won't happen. But the idea may be less wacky than keeping negative interest rates policies for years and years when inflation fundamentals no longer justify them.

Key Developments Around the World

Fed Faces Decisions on Shrinking Huge Bond Portfolio

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After the last recession, the Federal Reserve built up a mammoth $4.5 trillion portfolio of mostly mortgage and Treasury securities in an effort to boost **financial markets** and the economy. The sum was about equal in value to the total economic output of Japan, the world's third largest economy. Officials could soon take up an important debate about how much to let that portfolio shrink. Last year, they started a program to let securities in the portfolio mature without reinvesting the proceeds in other securities, putting it on a path to shrink to $3 trillion by 2020. Some officials are now wondering if they can end this "run-off" process sooner than planned and manage monetary policy with a larger portfolio in the long run.

U.S. Inflation Rate Hit 6-Year High in May

An inflation measure watched closely by the Federal Reserve hit the central bank's target for the first time in six years, a sign the growing economy is on healthier footing after a long run of slow growth. The price index for personal-consumption expenditures, excluding food and energy costs, rose 2% in May from a year earlier after running below that mark consistently since April 2012. The Fed—which has a goal of 2% inflation—looks at this measure because it strips out **volatile** categories that make it hard to see underlying inflation trends. Inflation readings over the past three months suggest the Fed's long battle with weak inflation could finally be drawing to a close, as a strong labor market nudges wages up and robust economic growth squeezes slack out of the economy.

As Economy Surges, Some Fear Slowdown Looms

The U.S. economy has just completed one of its strongest quarters of this expansion, bouncing back from a modest first quarter while the rest of the world appeared to stumble. Several closely watched models that track economic output point to the fastest growth since the third quarter of 2014, when the economy expanded at a 5.2% annualized rate. The Federal Reserve Bank of Atlanta's GDPNow model estimates a seasonally adjusted annual growth rate of 3.8%, while forecasting firm Macroeconomic Advisers' projection says gross domestic product looks to have expanded at a 4.8% rate. Only once in the 35 quarters since the recession ended has GDP growth exceeded the latter pace.

Kudlow Says White House Hopes Fed Will Raise Rates ‘Very Slowly'

President Donald Trump's top economic adviser said he hoped the Federal Reserve would raise interest rates "very slowly," breaking with a 25-year White House precedent of generally refraining from commenting on monetary policy. National Economic Council Director Lawrence Kudlow made the comments Friday during an interview on the Fox Business Network. "My hope is that the Fed under its new management understands that more people working and faster economic growth do not cause inflation—do not cause inflation," he said. "My hope is they understand that, and they will move very slowly."

Latvian Prosecutors Charge Top ECB Official With Taking Bribes

Latvian prosecutors said on Friday they had charged the Baltic nation's central-bank governor with taking bribes of half a million euros, escalating an investigation that has deprived the European Central Bank of one of its top officials. Ilmars Rimšēvičs, who sits on the ECB's 25-member rate-setting committee as head of Latvia's central bank, denies the allegations but has been prevented from performing his duties since the probe came to light in February.

BOJ Tankan: Big Manufacturers' Sentiment Worse Than Expected

Confidence among Japan's large manufacturers weakened for the second straight quarter in three months to June amid growing concerns about the potential impact of trade friction on the global economy, a central bank survey showed Monday. The main index measuring large manufacturers' sentiment was at plus 21 in the April-June period, compared with plus 24 in the previous survey in March, according to the Bank of Japan's quarterly tankan survey.

China PBOC Governor Urges More Bank Lending to Small Business

People's Bank of China Governor Yi Gang urged the country's banks to step up lending to small businesses, following recent moves to support private enterprises. In a speech published late Friday, Mr. Yi proposed lenders increase the amount of loans extended to small companies and step up the coverage of bank credit to these firms.

Bankrupt Indian Companies Are Clogging the Economy—but Now the Clock Is Ticking

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Hundreds of companies are headed for bankruptcy proceedings in India, and that is a good thing. A new bankruptcy code sets a tight timetable for a defaulting company to deal with its debt: If it doesn't come up with a solution in nine months, the company is liquidated. In May, Bhushan Steel Ltd. became the first of a group of large defaulters pushed into the bankruptcy court by the central bank to be resolved under the new rules. It was sold for $5.2 billion, and creditors recovered almost two-thirds of what they were owed.

Tuesday

12:30 a.m. EDT

Reserve Bank of Australia releases policy statement

3:30 a.m. EDT

Riksbank releases policy statement

9:30 p.m. EDT

Bank of Japan's Harada speaks to business leaders in Ishikawa prefecture

Why Have Negative Nominal Interest Rates Had Such a Small Effect on Bank Performance? Cross-country Evidence

When comparing "negative nominal interest rates with low positive rates, banks experience losses in interest income that are almost exactly offset by savings on deposit expenses and gains in non-interest income, including capital gains on securities and fees," Jose A. Lopez, Andrew K. Rose and Mark M. Spiegel find in a Federal Reserve Bank of San Francisco working paper. There are "heterogeneous effects of negative rates: floating exchange rates, small banks, and banks with low deposit ratios drive most of our results. Low-deposit banks have enjoyed particularly striking gains in non-interest income, likely from capital gains on securities. There have only been modest differences between high and low deposit-ratio banks' changes in interest expenses; high deposit banks do not seem disproportionately vulnerable to negative rates. Overall, our results indicate surprisingly benign implications of negative rates for commercial banks thus far," they write.

Inflation Is Here, What Will the Fed Do About It?

"The question of whether inflation will get to the Federal Reserve's 2% target has been answered: Yes. Now the question is what the Fed is going to do about it," Justin Lahart writes for The Wall Street Journal. "The most important question for investors right now is how much rates have to go up for the Fed to believe that monetary policy has gone from accommodative to restrictive. Right now the Fed expects to raise rates two more times this year, and three times next. That means policy, by the Fed's own measure, wouldn't turn restrictive until the end of 2019. If the Fed needs to move faster, markets would be in for a surprise."

U.S. consumers only modestly boosted their spending in May despite improved incomes, as year-over-year inflation posted its largest increase in over six years.

American households felt better in June about the current state of the economy, but lowered their expectations about the future.

Businesses in Canada expressed near-record levels of optimism during interviews that were mostly conducted in the weeks before the U.S. imposed metals tariffs on Canada, the European Union and Mexico, a Bank of Canada survey found.

The number of people without work in the eurozone fell sharply in May, a sign that a slowdown in economic growth during the first quarter hasn't derailed the currency area's broader recovery. The European Union's statistics agency Monday said the numbers of unemployed across the 19 countries that use the euro fell 125,000 from April, leaving the jobless rate unchanged at 8.4%.

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THE WALL STREET JOURNAL.

Page One

What's News: Business & Finance

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Rising wages are starting to eat into the profits of some U.S. firms, a potential headwind for the nine-year **stock-market** rally as earnings season approaches.

Starbucks and Hyatt said they would phase out single-serve plastic straws and cut packaging waste from their drinks and meals.

An ex-Goldman banker is in talks with U.S. prosecutors to potentially plead guilty to criminal charges stemming from the 1MDB scandal.

Xiaomi's shares fell 1.2% in the their first day of trading in Hong Kong, a lackluster start for the Chinese maker of smartphones.

U.S. stocks climbed, with the Dow industrials adding 320.11 points, or 1.3%, to 24776.59, the blue-chip index's best day in a month.

Hedge funds lagged behind the **S&P 500** in the first half, despite market swings tied to trade tensions and interest rate increases.

Investors in rental homes are acquiring more of them, in a bet that more well-off Americans will opt to rent rather than buy a house.

Staff at four Nissan plants in Japan falsified auto-emissions and fuel-economy data as far back as 2013, the company said.

Uber has tapped a former top official at the Justice Department to be its first chief compliance office.

Sorrell's new venture is expected to acquire digital-production agency MediaMonks, topping a WPP bid.

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THE WALL STREET JOURNAL.

Markets

KKR Second-Quarter Profit Rises; Results boosted by higher-than-expected amount of realized gains on the sale of assets

By Miriam Gottfried
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KKR & Co.'s second-quarter profit rose as the firm sold off assets into a strong **stock market**.

The New York private-equity firm said Thursday that its net income was $680.4 million, or $1.24 per share. That compares with $405.6 million, or 81 cents a share, in the second quarter of 2017.

The quarter ended June 30 was KKR's last under a partnership structure. On July 1, it completed its conversion to a corporation. When it announced the move back in May, the firm said it would no longer be reporting economic net income—the measure upon which Wall Street analysts had previously based their estimates for the firm and its peers. Instead, KKR said it would focus on after-tax distributable earnings.

KKR said that measure, which represents the portion of profits that could be paid out to shareholders, came in at $404.7 million, or 49 cents a share. Analysts polled by FactSet had forecast 45 cents a share.

The result was primarily due to a higher-than-expected amount of realized gains on the sale of assets in KKR's private-equity and credit portfolios during the quarter.

The buyout firm reported assets under management of $191.3 billion, up 29% over the prior-year period. The growth was driven by the closing of KKR's partnership with business-development company operator FS Investments, new capital raised in credit and infrastructure funds and an increase in the value of its private-equity portfolio. The portion of assets on which it collects fees was $138.8 billion, a 23% increase year-over-year.

Book value per share, another measure the firm is highlighting under its new structure, was $15.59, up 15% over the prior year.

KKR's decision to change its corporate structure, which came after Congress lowered the corporate tax rate late last year, was aimed at making its shares more accessible to a broader range of investors. So far, that appears to be working. Its shares have climbed 29% versus a 16.5% jump for rival Blackstone Group LP and an 8% increase for the **S&P 500** since it announced its plan to convert.

KKR announced a number of sizable deals in the quarter, including an agreement to buy BMC Software Inc. from a group of other private-equity firms for about $8.3 billion including debt and the purchase of publicly traded Envision Healthcare Corp. for $9.9 billion including debt.

Write to Miriam Gottfried at Miriam.Gottfried@wsj.com

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WSJ PRO CENTRAL BANKING

Economy
Federal Reserve Report Defends Use of New Tools to Set Interest Rates; Report is released ahead of Fed Chairman Jerome Powell's congressional testimony next week

By Nick Timiraos
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WASHINGTON—The Federal Reserve defended having the flexibility to set interest rates by using relatively new tools that include paying interest to banks, in its semiannual report to Congress on Friday.

Fed Chairman Jerome Powell is scheduled to testify on Capitol Hill over two days beginning Tuesday in the Senate as part of hearings mandated by law. The Fed released its report ahead of those hearings.

Some lawmakers, particularly in the House of Representatives, have criticized the Fed in recent years for the use of new facilities that enabled the central bank to guide short-term interest rates higher while maintaining a much larger portfolio of bonds and other assets than existed before the 2008 financial crisis.

Those criticisms reflect in part broader concern on the part of those lawmakers with the emergency steps the Fed undertook from 2008 through 2014 to stimulate growth after the central bank cut interest rates to near zero.

The report released Friday included a three-page overview of its new tools that could serve as a pre-emptive rebuttal against any further concerns lawmakers might raise next week.

The Fed dramatically expanded its bond portfolio after the 2008 financial crisis as it unleashed successive campaigns to stimulate the economy by purchasing Treasury and mortgage securities. Those purchases swelled the amount of deposits, known as reserves, that banks maintain in accounts at the Fed.

The vast increase in reserves, which rose to more than $2.5 trillion in 2014 from about $15 billion in 2007, made it harder for the Fed to change interest rates by buying or selling securities in the open market, as it had before 2008.

In order to raise its benchmark federal-funds rate without first draining its bondholdings and the accompanying bank reserves, the central bank implemented new tools to guide the fed-funds rate in a certain range, including by paying interest on those reserves.

Without the new tools, the Fed "would not have been able to gradually raise the federal-funds rate" while maintaining a larger portfolio, the report said. Instead, it would have had to consider "a rapid and sizable reduction" to the bond portfolio to push up borrowing costs.

"Getting the pace of asset sales just right for achieving the Federal Reserve's objectives would have been extremely challenging. Such an approach…would have run the risk of disrupting **financial markets**" and hurting economic growth, the report said.

Last fall, the Fed began gradually shrinking its bond portfolio by not replacing some bonds when they mature. That is also draining the amount of reserves in the system. The Fed hasn't decided how long the runoff will last because it doesn't know the optimal level of reserves going forward.

The size of the Fed's holdings is likely to be "much lower than it is today, though appreciably higher than it was before the crisis," in part because new liquidity requirements have made banks more eager to own those reserves.

The defense of the new tools is notable because officials, while not having formally decided on how to set interest rates over the long run, appear to prefer maintaining the current system, according to recent interviews and public statements. This would require a larger portfolio of both Treasury securities and bank reserves—and the continued payments of interest on those reserves.

The report didn't elaborate on whether or how those discussions around the longer-run rate-setting framework have proceeded. Nor did the broader 63-page report provide new clues about the immediate policy or economic outlook.

The report continued to describe valuations for a range of financial assets, including stocks and real estate, as "elevated" but said financial vulnerabilities associated with borrowing "remain moderate on balance."

The economy has largely performed in line with Fed expectations this year, though officials face puzzles determining how changes in fiscal and trade policy might influence their forecasts for growth and inflation.

For now, strong economic growth, low unemployment and stable price pressures have made it easier for Fed officials to agree on a policy of gradually lifting rates to a level they consider neutral, meaning they will seek to neither spur nor slow growth. While estimates of the so-called neutral interest rate vary, most officials believe the rate is around 2.75% or 3%.

The Fed has raised its benchmark short-term rate twice this year, most recently in June to a range between 1.75% and 2%, and officials last month penciled in two more rate increases this year and three more next year. That path means the Fed could reach its estimated neutral rate by next spring or summer.

The Fed's mandate from Congress is to maximize sustainable employment and ensure prices are stable, which the central bank defines as meeting a 2% inflation target.

The Fed is closer to meeting those goals than at any point in the past decade. The unemployment rate, at 4% in June, has for the past few months been below the level all Fed officials believe is likely to prevail over the long run.

Consumer prices in May rose 2.3% from a year earlier, and excluding **volatile** food and energy categories, rose 2%, according to the Fed's preferred inflation gauge.

Write to Nick Timiraos at nick.timiraos@wsj.com

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Economy
Trump 'Not Happy' About Rate Increases | Central Banks Ready To Raise Rates | Quarles: Publish Average Financing Rate | Financial Regulation Roundup | Timiraos's Take: Real Risks From Presidential Pressure On The Fed; The Wall Street Journal's central banking newsletter for Friday, July 20, 2018.

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TIMIRAOS'S TAKE: The Real Risks from Presidential Pressure On the Fed

Donald Trump Says He's 'Not Happy' About Federal Reserve Rate Increases

Following The Fed, Central Banks Are Ready To Raise Rates

Quarles Says Fed Should Consider Publishing Average Financing Rate Alongside LIBOR Replacement

South African Reserve Banks Holds Main Repo Rate, Cuts Growth Outlook

The Real Risks from Presidential Pressure On the Fed

Federal Reserve Chairman Jerome Powell offered a mostly **bullish** assessment of the U.S. economy over two days of congressional hearings that ended Wednesday, but there weren't many hints of hawkishness.

On Thursday, President Donald Trump went there: he publicly questioned the Fed's rationale for raising interest rates.

Mr. Trump's interview on CNBC, a portion of which aired Thursday, showed the president saying he was "not happy" and "not thrilled" by the Fed raising rates as the economy strengthened. His desire to see lower trade deficits, helped by a cheaper dollar and lower interest rates, explains much of his frustration.

Fed Chairman Jerome Powell and his colleagues have been explicit telling anyone who asks that they won't be swayed by political roughhousing. There's little in Mr. Powell's background to suggest he would. Consider: his latest turn in public service came after he scolded congressional Republicans in 2011 for playing games with the debt limit.

So if the Fed isn't going to be swayed by these comments, why are so many people exercised about them?

The real risk to the Fed is one of public legitimacy.

The central bank has just been through a bruising period. The 2008 financial crisis shattered its aura of technocratic omniscience. The slow recovery that ensued forced the central bank to resort to extraordinary measures, in a highly partisan environment, from which officials have only recently begun to extricate themselves—and, notably, with few of the ill-effects some critics had frequently predicted.

Even if the Fed wholly ignores Mr. Trump's criticism, which seems likely, the comments could compromise the bank's perceived independence if officials, on their own, were to conclude at some point soon to stop their recent campaign of slowly raising interest rates.

A related risk: What if this is just the beginning of Mr. Trump's public criticism? After all, the economy is doing better than it has been, and the Fed hasn't appeared hurried to raise rates, relative to prior tightening cycles. If Mr. Trump is willing to express displeasure now, what happens when the economy forces the Fed to make even harder decisions?

Polling shows that a large chunk of GOP voters are strongly swayed by Mr. Trump's positions. Sustained critiques by Mr. Trump—even if ignored by Fed officials—could do damage to the central bank's public standing.

So what's the Fed to do? Mr. Powell has built some goodwill on Capitol Hill by meeting with lawmakers, and he has announced plans to speak after every Fed meeting, starting in January. Both of those moves could come in handy if Mr. Trump's decision to vent about the Fed wasn't a one-off.

Key Developments Around the World

Donald Trump Says He's 'Not Happy' About Federal Reserve Interest-Rate Increases

President Donald Trump said Thursday he hoped the Federal Reserve would stop raising interest rates, delivering an unusual censure of the central bank. "I am not happy about it," Mr. Trump said about interest-rate increases during an interview conducted Thursday by CNBC. His comments depart from a convention in which presidents have refrained from speaking specifically on monetary policy. The Fed has raised interest rates twice this year, in March and in June, to a range between 1.75% and 2%. Officials at the June meeting of the policy-setting Federal Open Market Committee also penciled in two more rate increases for the year. The Fed's chairman, Jerome Powell, was tapped by Mr. Trump last November to succeed Janet Yellen, and he took his post in February.

A Brief History of White House Officials Trying to Jawbone the Fed

Candidate Trump's Comments on the Fed, Interest Rate Policy and Janet Yellen

Transcript: Trump's Comments on Fed Interest Rates

President Donald Trump, in an interview with CNBC on Thursday, July 19, expressed his dislike of Fed interest rate increases and his preference for a weaker dollar. Here is a transcript of the excerpt aired Thursday.

Following the Fed, Central Banks Are Ready to Raise Rates

A growing number of the world's central banks are poised to join the U.S. Federal Reserve in lifting interest rates in coming months amid solid global growth, though those plans could be scrambled by rising trade tensions between the major economies. Between its first postcrisis rate rise at the end of 2015, and its fifth in December 2017, the Fed ploughed a largely lonely furrow. But in the first quarter of this year, it was joined by six other central banks in tightening policy, and that number rose to seven in the March through June period.

A similar number of central banks are set to follow its lead in the three months through September, although for some the path is less certain than for others. A marked slowdown in growth could upset such plans, but that remains an increasing risk rather than a likely prospect.

Quarles Says Fed Should Consider Publishing Average Financing Rate Alongside Libor Replacement

The Fed should consider launching an average financing rate alongside its replacement for the scandal-plagued London interbank offered rate, Fed Vice Chairman Randal Quarles said on Thursday. An average financing rate would boost trading and liquidity in the Fed and banking industry's chosen Libor replacement, the secured overnight financing rate, Mr. Quarles said, speaking to The Alternative Reference Rate Committee, a group of banks and regulators.

South African Reserve Bank Holds Main Repo Rate, Cuts Growth Outlook

The South African Reserve Bankkept its main repo rate at 6.5% Thursday, despite an uptick in inflation due to higher **oil prices** and a weakening local currency. The central bank warned that it now expects Africa's most developed economy to grow by 1.2% in 2018, down from a previous forecast of 1.7%. It slightly raised its gross domestic product growth forecast for 2019 to 1.9% from the 1.7% predicted at its last meeting in May.

CFPB Nominee Promises Pro-Business Approach at Senate Hearing

The Trump administration's pick to run the Consumer Financial Protection Bureau said she would pursue the "proper balancing of all interests," including consumers and financial companies, signaling she would continue a shift in the bureau's operations from the Obama era. Kathy Kraninger, a senior official at the White House's Office of Management and Budget, faced grilling by lawmakers at the Senate Banking Committee on Thursday, her first opportunity to publicly present hew views on consumer-finance oversight. Since Trump-appointed officials took

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control of the CFPB in November, the agency has sought a friendlier approach to the companies it regulates, a change from the Obama administration.

FINANCIAL REGULATION ROUNDUP

Wells Fargo's Latest Challenge: Refunds for Pet Insurance, Legal Services

Wells Fargo & Co. is in the process of refunding tens of millions of dollars for products ranging from pet insurance to legal services added to hundreds of thousands of customers' accounts without their full understanding, according to people familiar with the matter. Known as add-on products, Wells Fargo for years charged monthly fees to customers for dozens of products they didn't understand or know how to use, the people said. The Consumer Financial Protection Bureau is probing the matter, the people said.

Congress to Toughen Foreign Investment Reviews Amid Trade Fight With China

Congress is poised to enact the first major changes in a decade to the U.S.'s process for vetting foreign investment. Negotiators from the Senate and the House of Representatives reached a deal on the final text of a provision to strengthen both the Committee on Foreign Investment in the U.S. and the U.S. export control system to block Chinese and other foreign transactions that could harm national security, according to Senate Majority Whip John Cornyn of Texas. "It's a done deal," he said in a Thursday interview. The measure, which has been attached to a must-pass defense spending bill, could become law as soon as this month.

Bank of New York Mellon Results Get Chilly Reception

Bank of New York Mellon Corp. on Thursday reported quarterly results that disappointed some investors, who sent the custody bank's stock sharply lower. Total revenue during the second quarter was $4.14 billion. The average estimate among analysts was $4.13 billion, according to S&P Global Market Intelligence. BNY Mellon and other custody banks have drawn scrutiny in recent years for failing to rack up higher fees from the key back-office functions they serve for investment managers, brokers and other financial firms.

FRIDAY

8:20 a.m. EDT

St. Louis Fed's Bullard speaks

Declining Business Dynamism and Information Technology

A VoxEU post by Gert Bijnens and Jozef Konings explores business dynamism in Belgium between 1985 and 2014. The researchers find that, similar to the U.S., business dynamism is declining. The similarities suggest "that these changes are likely due to global trends such as the rise of information and communication technology," the authors say.

Analysts React to Trump's Interest-Rate Comments

"President Trump's reported comments in a TV interview expressing displeasure about Fed rate hikes mark a worrying development for the institution, markets and the economy," wrote Krishna Guha of Evercore ISI in a note to clients. "The appearance of political pressure leads many in the market to fear that the Fed might bend in a still more dovish direction, but it might make it harder for the Fed to act dovish for fear of appearing to yield to this pressure - while potentially contributing to an inflation risk premium that would raise the cost of issuing government bonds."

Chris Rupkey of MUFG said in a note to clients, "Powell told Congress in testimony earlier this week that the Federal Reserve's policy of gradual rate hikes would continue for now, but if the President is ‘not thrilled,' maybe ‘for now' is going to end up being a much shorter period than markets had anticipated."

Adam Posen, president of Peterson Institute for International Economics, tweeted, "The surest way to get the Fed to continue raising rates is to tell it to stop raising rates. Like telling POTUS not to talk to Putin."

The U.K.'s planned exit from the European Union will have a "small" negative impact on the bloc's economy, although it will prove more damaging to countries such as Ireland, the Netherlands and Belgium that have closer links with Britain, the International Monetary Fund said Thursday.

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The number of Americans claiming new unemployment benefits fell last week to the lowest level in nearly five decades.

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THE WALL STREET JOURNAL.
U.S. EDITION

Chicago's CME Strains to Reflect Shifts in Global Grains

By Benjamin Parkin
694 words
23 July 2018
The Wall Street Journal
J
B9
English
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CHICAGO -- The world's largest exchange company is struggling to keep up with tariffs and a surge in global crop production that is reshaping agricultural trading.

CME Group Inc., whose antecedents helped invent futures contracts in the 19th century, ties its main agricultural products to the value of American crops. And while CME's futures have grown, some say the exchange risks missing out on the boom in countries, including Russia and Brazil, which now export more of some agricultural goods than the U.S.

"It's a growing problem for the CME," said Dan Basse, president of AgResource Co., a research firm.

Trade fights are hastening the shift. China, one of the world's largest crop buyers, has switched much of its soybean purchases from the U.S. to Brazil. As a result, soybean prices have surged in Brazil and fallen in the U.S., making CME contracts tied to American beans a less useful global gauge, analysts say.

And Russia has surpassed the U.S. as the world's top wheat exporter, which can make CME contracts for Midwestern wheat harder to use.

CME needs to keep up with agricultural trade patterns to retain customers such as Bunge Ltd. and other commodities merchants, whose businesses increasingly span the globe.

"You've got to go where the grain flows are," said Bobby Pelz, a partner at McDonald Pelz Global Commodities LLC.

Using crops grown near Chicago to set prices for those grown near the Black Sea in Russia and Ukraine, for instance, can expose traders to discrepancies in weather and crop quality. Grain trader Archer Daniels Midland Co. said it lost more than $20 million trying to hedge Black Sea grain using North American prices in 2017's third quarter.

CME has introduced new agricultural contracts to address these shifts, but few have caught on. The exchange company this month delisted contracts for wheat from the European Union that have failed to attract participants. A contract for Black Sea wheat from 2012 also petered out, as did one for South American soybeans introduced by the Chicago Board of Trade in 2005. The CBT and Chicago Mercantile Exchange merged to form CME Group in 2007.

Futures introduced by CME in December for Black Sea wheat have grown to about 20,000 contracts, compared with almost half a million in CME's main Chicago contract. Another introduced last year for Australian wheat has attracted some trading.

CME Chairman Emeritus Leo Melamed traveled to Ukraine around 2010 to attempt to launch wheat contracts there. That didn't work, but he said CME has to keep trying.

Exchanges in other parts of the world have gained ground. In China, the world's top soybean buyer, soybean-oil futures at the Dalian Commodity Exchange regularly trade at higher volumes than CME's, though the contract size is smaller. Euronext NV's futures for EU wheat have also become an alternative to CME.

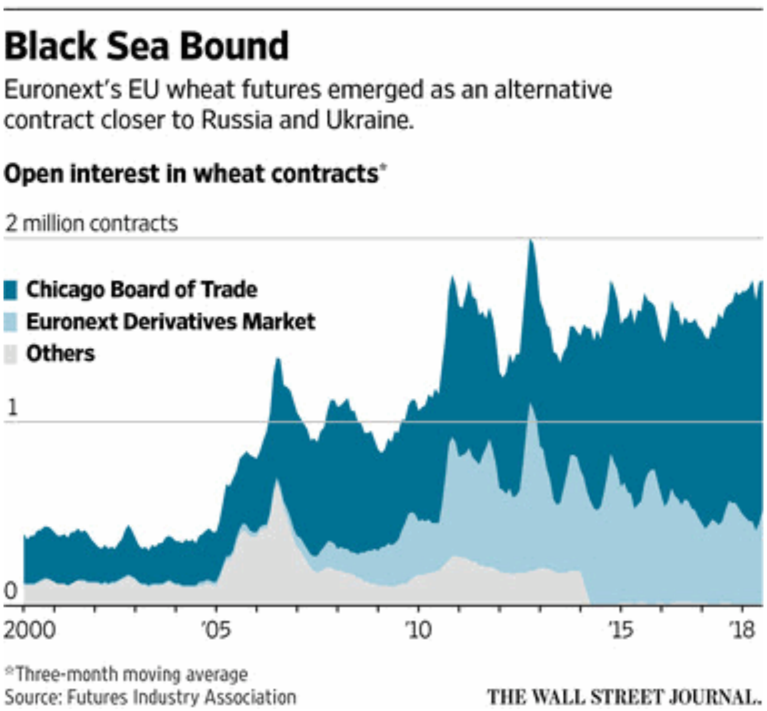
"There is a clear shift," said Nicholas Kennedy, head of commodities at Euronext, which has considered introducing its own Black Sea contracts. "The Black Sea, Ukraine and Russia are playing a greater role on the trading floors."

Still, CME's agricultural contracts are the world's most popular by far. Open interest at CME, a measure of participation, rose to a record of over 10 million contracts in June. Trading volumes also are up, including outside the U.S.

The contracts remain "the global benchmarks for price discovery and risk management," said Tim Andriesen, CME's managing director of agricultural products. "While import and export patterns may shift, the need for managing price risk has never been more important." CME derived just 11% of first-quarter revenue from agricultural commodities but still counts crops as an important business line.

CME's other businesses have thrived lately. Interest rates and market **volatility** have perked up, which boosts traders' need for CME's financial products. Shares of CME are up 16% this year, while the **S&P 500** is up about 5%.

Alexander Osipovich contributed to this article.



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THE WALL STREET JOURNAL.

Markets

Public Pensions Are Earning More Than 8%—That's Unlikely to Go On Much Longer; Funds such as Calstrs and Calpers are becoming cautious and more realistic about their investment targets

By Heather Gillers
825 words
22 July 2018
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The Wall Street Journal Online
WSJO
English
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The nation's two biggest public pension funds are doing better in 2018. The problem: They don't think it will last.

The California State Teachers' Retirement System and California Public Employees' Retirement System both earned more than 8% for the second fiscal year in a row, thanks to a robust performance by stocks and private equity. Together they manage $575 billion for 2.8 million public workers and retirees.

But the systems, known as Calstrs and Calpers, aren't counting on that type of performance over the long term. Both rolled back their investment targets this year in an effort to be more realistic about what they can earn in the future. Calstrs dropped its future goal to 7%. Calpers initiated a multistep drop this year that will end at 7% in 2021.

Many other public pensions around the country are turning more cautious about future results following a nine-year **bull market** for U.S. stocks, which remain the single largest holding for most retirement systems. The funds rely on a combination of investment income and contributions from employees, states and cities to fund their mounting obligations to retirees.

For many decades these funds clung to a belief that stocks, bonds and other holdings could earn at least 8% and that those gains would fund hundreds of billions of dollars in liabilities.

But many are now trimming those assumptions to 7% and lower. The median assumed rate of return held by 130 public pension funds tracked by Wilshire Consulting dropped in 2017 to 7.25%. That median rate was still 8% as recently as 2012.

"We probably want to temper our enthusiasm when we have a year or two years of strong returns because one thing we know for certain is that there will be challenging years," said Wilshire Consulting Chief investment Officer Steve Foresti.

Pensions long have been criticized for using unrealistic investment assumptions, which proved costly during the last financial crisis. Many funds recorded big losses in 2008 and 2009, pulling their long-term returns well below the 8% barrier despite the **bull market** that followed. As of June 2017 the 10-year annualized median return for all public pensions tracked by Wilshire Trust Universal Comparison Service was 5.57%.

"Over 10 years, we struggled," Calstrs Chief Investment Officer Christopher Ailman said at a public meeting on Friday. Calstrs has returned an average annualized 6.3% over 10 years as of June 30.

But moving expectations below 8% isn't just an accounting move. It has real-life consequences for systems that use those predictions to calculate the present value of obligations owed to retirees. Even slight cutbacks in return targets often mean budget-strained governments or workers are asked to pay significantly more to account for liabilities that are expected to rise as lifespans increase and more Americans retire.

In California, some local-government officials are concerned their costs will rise aggressively as Calpers lowers its expected return rate. Calpers has said the state and school districts participating in its system would have to pay at least $15 billion more over the next 20 years once the system's assumed rate of return drops to 7%.

Pension fund officials in other parts of the country are making the same decision to drop their future targets even as they report strong results for fiscal 2018. The Maine Public Employees Retirement System earned 10.3% for the year ended June 30 but this year dropped its long-term goal to 6.75%. It has now reduced its rate of return assumption four times since 2009.

The moves mean the system now has more work to do if it hopes to fund all future benefits. Had the fund maintained its precrisis 7.75% goal, it could today report having enough assets to cover 91% of its liabilities according to executive director Sandy Matheson. Instead it has 81%, she said.

"What we're looking for is a rate that can endure through good economic times and not-so-good economic times and low-interest-rate environments and high-interest-rate environments," Ms. Matheson said.

The Illinois State Board of Investment for years relied on an 8.5% assumed return rate for its state-employee retirement plan. In 2016 it dropped to 7%, one of many reasons it now has just 35% of what it needs to pay for future benefits.

"If we were still 8.5% it might be 50% or 60%—it would appear to be a lot better," said Illinois State Board of Investment Chair Marc Levine. But it would be total nonsense because you still owe the same amount of money. You're just fudging on the accounting."

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WSJ PRO CENTRAL BANKING

Economy

More Officials Back Rate Plans | Tax Law May Be Less Stimulative | BOC Expected to Raise Rate | Douglas's Take: U.K. Data Overhaul Gives BOE More to Chew On; The Wall Street Journal's central banking newsletter for Wednesday, July 11, 2018

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Douglas's Take: U.K. Data Overhaul Gives BOE More to Chew On

Stronger Economy Brings More Fed Officials On Board With Rate-Rise Plans

Tax Law May Stimulate Economy Less Than Expected, or Maybe Not at All, S.F. Fed Economists Say

Bank of Canada Expected to Raise Key Interest Rate

U.K. Data Overhaul Gives BOE More to Chew On

The U.K.'s official economic statistics got an overhaul this month, giving the Bank of England more data to work with when it makes its decisions.

The U.K. on Tuesday joined Canada in publishing monthly estimates for growth in the whole economy. In the U.S. and most other countries, estimates for increases in gross domestic product are published quarterly.

The new figures suggested the economy grew 0.3% between April and May, fueled by services including retail and computing and a recovery in manufacturing. Growth in the three months through May was 0.2%, or 0.6% on an annualized basis.

The figures point to a gentle upswing in the second quarter after a poor start to the year, likely reinforcing expectations the BOE is poised to raise interest rates as soon as next month.

The new data mean the BOE should get a fuller glimpse of the economy to inform policy makers' decisions. To be sure, central bank staff calculate their own estimates of GDP growth, but the statistics agency has a much greater pool of data to draw on.

The overhaul follows a review of economic statistics in Britain by former BOE Deputy Governor Charlie Bean in 2016.

He identified a bunch of deficiencies that could be applied to national accounting in other advanced economies. Chief among them measuring the output of the services sector. In Britain, services accounts for 80% of the U.K. economy, a similar figure to the U.S., yet often appeared an afterthought in national accounts compared with the exhaustive detail on manufacturing, a mere 10% of the economy.

The ONS's newest data gives a monthly glimpse into no fewer than 14 services sectors.

Time will tell whether the new measure means accurate national accounting and fewer revisions, which should make for better policy-making. But a broader look at the largest sector of the economy is a good start.

Key Developments Around the World

Stronger Economy Brings More Fed Officials On Board With Rate-Rise Plans

The boost to U.S. economic growth from recent tax cuts and spending increases, together with more stable price pressures, has made Federal Reserve officials comfortable with raising interest rates more than they anticipated earlier this year. Among them is Chicago Fed President Charles Evans, who dissented when his colleagues voted to raise rates last December because he worried then about weak inflation. In an interview Monday, he said he is now comfortable with one or two more Fed rate increases this year, following on the central bank's two moves so far this year. "The economy seems so strong it seems natural that businesses and consumers can live with" slightly higher interest rates, he said, citing the effects of the fiscal measures approved by Congress and the White House.

WSJ Transcripts: Read this partial transcript of our interview with Evans

Tax Law May Stimulate Economy Less Than Expected, or Maybe Not at All, S.F. Fed Economists Say

The tax cuts Republicans enacted in late 2017 will likely provide less of a boost to economic growth than many forecasters predict—and possibly none at all—economists at the Federal Reserve Bank of San Francisco said. That's because the changes took effect at a time when the economy was already firing on all cylinders. As a result, there are fewer unemployed workers, spare resources and idled factories ready to kick into action than there would have been during a downturn.

Bank of Canada Expected to Raise Key Interest Rate

The Bank of Canada is widely expected to raise its benchmark interest rate during a policy announcement this week, despite concerns over U.S. trade policy and the threat of tariffs on the automotive sector. Economists from 10 out of 11 primary dealers of Canadian government securities told The Wall Street Journal they anticipate the Bank of Canada will increase the key rate by a quarter of a percentage point on Wednesday, bringing it to 1.5%. A majority of those surveyed said they expect a pause after this week's rate decision, with the next increase coming in early 2019.

Investors Dump Turkish Lira as They Turn Cold on Emerging Markets

Global investors who were once eager to buy any dip in emerging markets are now backing away, fearing that a big tumble could herald more weakness ahead. A sharp decline in the Turkish lira late Monday was the latest example. The currency plunged 3.5% after President Recep Tayyip Erdogan appointed his son-in-law as finance minister and put in place measures that could curb the independence of Turkey's central bank.

Malaysia Central Bank Holds Rates Steady

Malaysia's central bankleft interest rates unchanged, maintaining its supportive stance as inflation remains soft and the net oil exporter's local currency outperforms regional counterparts on higher crude prices. All 11 economists surveyed by The Wall Street Journal had expected Bank Negara Malaysia to hold its overnight policy rate, or OPR, at 3.25% at Wednesday's meeting, the first since Governor Nor Shamsiah Mohd Yunus took the helm last month.

Quick Hits

Two Democratic senators asked the Federal Reserve for information regarding its treatment of Goldman Sachs and Morgan Stanley in recent stress tests, and analysts expect the Bank of Korea to stand pat at its policy meeting this week. Here are quick hits on central banking and related market views from around the world.

Wednesday

8 a.m. EDT

ECB's Mersch speaks at ECB statistics conference in Frankfurt

10 a.m. EDT

Bank of Canada releases monetary policy statement and report

11:15 a.m. EDT

Bank of Canada's Poloz and Wilkins hold press conference in Ottawa

11:30 a.m. EDT

ECB's Nouy speaks at ECB statistics conference in Frankfurt

4:30 p.m. EDT

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New York Fed's Williams speaks in Brooklyn, N.Y.

Thursday

Time N/A

Bank of Korea releases policy statement

8:30 a.m. EDT

U.S. Labor Department releases June CPI

12:15 p.m. EDT

Philadelphia Fed's Harker speaks in Victor, Idaho

Fiscal Policy in Good Times and Bad

The tax cuts Republicans enacted in late 2017 will likely provide less of a boost to economic growth than many forecasters predict—and possibly none at all—economists at the Federal Reserve Bank of San Francisco said. That's because the changes took effect at a time when the economy was already firing on all cylinders. As a result, there are fewer unemployed workers, spare resources and idled factories ready to kick into action than there would have been during a downturn. Citing a bevy of recent research, economists Tim Mahedy and Daniel J. Wilson said fiscal stimulus measures tend to make a bigger splash when there is more slack in the economy.

How Donald Trump and His Trade Wars Could Turn the Global Asset Bubble Into a Weapon of Mass Destruction

The "surge in the value of global trade is underpinned by buoyant **financial markets**. However, all this could be wiped out by a crisis of confidence triggered by the U.S. president's trade disputes," Anthony Rowley writes for the South China Morning Post. "The shape of the global trading system in the post-Trump era, once the damage has been done, is difficult to discern. If there is a revolt against political populism of the kind he represents, then it is possible that the vast and complex supply networks that underpin the system could be restored painstakingly. But, equally, a retreat into economic autarky is possible."

Small-business owners' confidence declined slightly in June from the prior month, as still-high rates of job creation and compensation increases helped outweigh continued concerns about finding qualified workers for open positions, according to a survey from the National Federation of Independent Business.

Corporate earnings are poised to extend a run of double-digit growth in the second quarter, providing a balm for a **stock market** that has languished as investors have grappled with threats ranging from fractious trade relations to tightening monetary policy.

Eurozone house prices rose at the fastest pace in 11 years during the first three months of 2018, a development that is likely to reinforce the European Central Bank's determination to end a key stimulus program in December.

Send us your tips, suggestions and feedback. Write to:

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WSJ PRO CENTRAL BANKING

Economy
Rising Transportation Costs Help Drive Up U.S. Business Prices; Trucking freight expenses helped drive overall costs higher

By Sarah Chaney and Sharon Nunn
563 words
11 July 2018
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RSTPROCB
English
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WASHINGTON—A gauge of U.S. business prices rose broadly in June, driven in part by a rise in transportation costs that underscores the sector's climbing labor expenses.

The producer-price index, a measure of the prices businesses receive for their goods and services, rose a seasonally adjusted 0.3% in June from a month earlier, the Labor Department said Wednesday. When excluding the often-**volatile** food and energy categories, prices were also up 0.3% in June from the prior month.

Rising prices for transportation and warehousing services helped push overall costs higher, as costs in this category grew 0.5% month-to-month and continued to climb higher on an annual basis.

Trucking freight prices rose 1.3% in June, the largest monthly increase in the category for records dating back to July 2009. Economists say the tight supply of truck drivers is putting pressure on prices.

"When you think of transportation costs, there's going to be the capital costs of providing the truck, there's going to be the energy costs and then labor costs are quite a big chunk," said Blerina Uruçi, U.S. economist at Barclays. "In the retail sector, there's been this demand for more drivers, but at the same time the supply of qualified drivers is quite tight at the moment."

The Council of Supply Chain Management Professionals' annual State of Logistics report shows freight rates jumped late last year in the wake of hurricanes in U.S. Gulf Coast states and Puerto Rico, posing capacity constraints. Just weeks later, a federal mandate took effect requiring that electronic devices be installed in trucks to log driver hours, intensifying these constraints by limiting drivers' time behind the wheel.

Ultimately, tight capacity has translated into higher prices.

Motor carrier costs rose 7.8% to $641 billion for U.S. businesses in 2017, according to the annual report. Rail transportation rose 8.2% to $80.5 billion, airfreight grew 3.1% to $67.2 billion and the cost for inventory storage was up 4.2% to $148 billion, according to the State of Logistics report.

These data point to how reduced labor market slack, combined with higher energy prices, are contributing to a firming inflationary trend. From a year earlier, overall producer prices climbed 3.4% in June, the largest year-to-year rise since November 2011.

Annual gains in the headline producer-price index have risen since the beginning of 2016. Rising **oil prices** and improved global demand have helped push the index higher.

The producer-price measure usually follows the same trends as other broad inflation gauges, though it doesn't always translate into what consumers pay. Signs of building inflation pressures have emerged within other recent reports.

The consumer-price index rose 2.8% in May from the prior year, its strongest annual reading since February 2012 when inflation was 2.9%, the Labor Department said last month. The Labor Department will release June CPI data on Thursday, and economists surveyed by The Wall Street Journal expect a 2.9% annual increase.

Erica E. Phillips contributed to this article.

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WSJ PRO CENTRAL BANKING

Economy
Inflation Is Eating Away Worker Wage Gains; For the second month in a row, annual inflation fully offset workers' average hourly wage growth

By Paul Kiernan
1,238 words
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English
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WASHINGTON—U. S. inflation hit its highest rate in more than six years, with consumer prices eating away at modest wage gains by American workers and underscoring questions about how much they are benefiting from an economy that by many other measures is booming.

The consumer-price index, which gauges what Americans pay for everything from veterinarian services to baby clothes, rose a seasonally adjusted 0.1% in June from the prior month, the Labor Department said Thursday. Excluding **volatile** food and energy components, so-called core prices increased 0.2%. Economists surveyed by The Wall Street Journal had expected a 0.2% uptick from May for both the overall index and core inflation.

Prices rose 2.9% in June from a year earlier, the fastest pace since February 2012. Core inflation ticked up to 2.3% over the past 12 months, the highest rate since January 2017.

In June, for a second month in a row, annual inflation fully offset average hourly wage growth over the previous year. That left workers' real hourly earnings flat over the 12-month period despite falling unemployment and a strong economy even as workers made up for higher prices by clocking slightly more hours a week in June.

Production and nonsupervisory employees, a category which includes blue-collar workers, saw their real average hourly wages fall 0.2% in June from a year earlier after a similar slip in May.

"It's the boiling-frog metaphor," said Marc Hall, a 58-year-old writer and corporate-communications specialist at a software firm in Rockville, Md. "You notice it a little at a time, here and there, and then at the end of the year, you say, ‘Yeah, things went up a lot, didn't they?'"

Mr. Hall said that while he received a 2% pay raise in the past year, he senses that his earnings haven't kept up with the cost of living, adding, "It's a net loss."

Economists estimate gross domestic product grew in the second quarter at one of the fastest clips measured since the recession, while corporate tax cuts enacted at the end of 2017 likely fueled record earnings by publicly traded U.S. companies, analysts say.

"Wage growth remains surprisingly weak," said David Kelly, chief global strategist at J.P. Morgan Asset Management, in a note to clients earlier this week. "The remarkable ability of firms to lure more workers back into the labor force and get stronger productivity gains from them without raising wages is a clear positive for profits."

The absence of real wage growth over the past year contrasts with the norm earlier in the expansion, when significantly lower inflation meant that even a modest raise afforded workers real wage gains. During most of 2015, for example, real hourly wages rose 2% or more in annual terms while a collapse in commodity prices depressed inflation.

The year-over-year rise in prices last month was led by energy commodities on the heels of a sharp increase in **oil prices** earlier this spring. Gasoline prices rose a seasonally adjusted 0.5% in June from May and 24% from a year earlier, the CPI report showed. Separate data from the U.S. Energy Information Administration showed the average price for a gallon of regular gasoline rose to $2.89 last month, the highest price for June since 2014.

In a sign of how higher energy prices may ripple across other sectors in coming months, Delta Air Lines Inc. said it would raise fares and add fewer flights than planned. While the carrier posted record sales in the second quarter and increased its dividend by 15%, it also signaled that fuel costs are likely to weigh on profit for the rest of the year.

"With higher fuel prices you're going to expect to see ticket prices go up as well," said Chief Executive Ed Bastian in an earnings call.

Prices for other goods and services also increased.

Shelter and rent costs, which account for about a third of overall consumer spending, rose 0.1% in June from May and were up 3.4% from a year earlier. Prices for medical-care services rose 0.5% from May and 2.5% from June 2017. And food prices rose 0.2% last month from May, though the annual increase in this category was more muted at 1.4%.

For many economists, accelerating inflation suggests the economy is behaving more or less as it should after years of fitful expansion that has brought the jobless rate near its lowest levels since the 1960s.

A separate inflation measure favored by the Federal Reserve, the personal-consumption expenditures price index, showed consumer prices rose 2.3% in May from a year earlier, and core prices rose 2%. Fed officials seek 2% inflation because they think that pace is consistent with a healthy economy.

Firming inflation and low unemployment have bolstered Fed officials' case for gradually raising short-term interest rates to keep the economy from overheating. They have lifted rates twice this year and penciled in two more increases by year's end.

At their most recent rate-setting meeting, in June, Fed "participants generally agreed that the economic expansion was progressing roughly as anticipated, with real economic activity expanding at a solid rate, labor market conditions continuing to strengthen, and inflation near the Committee's objective," according to meeting minutes released last week.

Economists said Thursday's data generally supported their view that inflationary pressures are gradually picking up.

But one important question, they say, is how far the Trump administration will take its escalating trade disputes with other countries. The White House, which imposed tariffs on $34 billion of Chinese exports of industrial goods like auto parts and electronic components, said this week it would assess 10% tariffs on an additional $200 billion in Chinese consumer goods. The administration also has imposed tariffs on imported steel and aluminum from the European Union, Canada and Mexico, leading those countries to set their own tariffs on U.S. exports.

The impact of such tariffs, wouldn't be negligible, economists say.

Tariffs on washing machines imposed by the White House in January caused the CPI's "laundry equipment" category to increase 13% over the 12 months through June.

Ian Shepherdson, chief economist at Pantheon Macroeconomics, said the Chinese goods subject to the newly proposed tariffs account for almost 6% of the core CPI, meaning that a 10% levy would lift the index by up to 0.6 percentage point.

"The latest proposed tariffs would significantly boost core inflation," Mr. Shepherdson said in a note to clients. "People will seek to be compensated for the squeeze on their real incomes as a result of higher prices, and their chance of being able to force employers to pay up is better now than at any time since the crash."

Alison Sider contributed to this article.

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More Economy News

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THE WALL STREET JOURNAL.

Markets
Cushman Testing Aging Real Estate Bull Market With Big IPO; Public offering seen valuing real-estate-services firm at around $6 billion

By Maureen Farrell and Peter Grant
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Real-estate-services firm Cushman & Wakefield aims to raise about $750 million from an initial public offering that would value the firm at around $6 billion, including debt, according to people familiar with the offering.

Cushman is expected to set its pricing range Monday and kick off its roadshow, the people said. The price range is expected to set the company's market cap between $3 billion and $4 billion, according to the people familiar with the offering.

Cushman's owners are looking to cash in at a time when shares of its largest global rivals, CBRE Group Inc. and JLL, have been trading near record highs. Those firms are enjoying rising commissions and property-management fees, thanks to expanding economies around the world.

But Cushman faces challenges, too. The firm has reported losses in recent quarters, and some investors are concerned that the **bull market** in commercial real estate—now in its ninth year—doesn't have much longer left to run.

The real-estate firm is owned by an investment group led by private-equity firm TPG, which purchased Cushman in 2015 and combined it with two other large commercial real-estate-services firms to form a global giant.

The ownership group paid about $3.5 billion for the three firms, which also included DTZ and Cassidy Turley.

Shares of Cushman are expected to start trading in early August, the people said.

Cushman filed preliminary plans for an IPO in June but didn't release pricing or valuation details at that time. Most of the proceeds of the deal are slated to pay down debt, according to Cushman's filing. Other proceeds will be used for general corporate purposes, the filing said.

The 101-year-old firm has about 48,000 employees and operates about 400 offices in 70 countries. It manages about 3.5 billion square feet of commercial property for corporations, institutions and others.

Cushman is led by industry veteran Brett White who worked at CBRE for close to two decades, the last seven years as chief executive. He stepped down from CBRE in 2012, eight years after he played a major role in that firm's IPO.

Shares of CBRE and JLL both trade at roughly 10 times their forward earnings before interest, taxes, depreciation and amortization.

Cushman expects a similar multiple when it prices its IPO, a person familiar with the process said. Cushman's 2017 revenue of $6.92 billion in 2017 was smaller than the $14.2 billion of CBRE and $7.9 billion of JLL.

But company executives and its underwriting team, led by Morgan Stanley and JPMorgan Chase & Co., are expected to say during the coming roadshow that Cushman's smaller size gives it more room for growth.

Still, the Cushman IPO is by no means a slam dunk. In Early December investor appetite was weak for an IPO by Cushman rival Newmark Group Inc., whose chairman is Howard Lutnick of Cantor Fitzgerald LP fame. Some investors and analysts were wary, partly due to adjustments in the firm's earnings that made it difficult to compare Newmark with its peers.

Cushman's debt of more than $3 billion as of March 31 also exceeds debt levels at JLL and CBRE. The firm recorded a net loss of $221 million in 2017 and a loss of $92 million in the first three months of 2018, according to the firm's June filing with the Securities and Exchange Commission. Cushman has been spending heavily on integrating the three firms, expansion and new technology.

TPG's partners in its Cushman investment include PAG Asia Capital and Ontario Teachers' Pension Plan. This group will retain voting control after the IPO, the filing says.

Founded in New York in 1917, Cushman moved its headquarters to Chicago, the home of DTZ, after being acquired by the TPG group. Cassidy Turley was based in Washington, D.C.

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WSJ PRO CENTRAL BANKING

Economy
U.S. GDP Predictions Scaled Back on Eve of Report; Growth estimates revised after underwhelming economic data

By Ben Leubsdorf
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Several forecasters tempered their high expectations for U.S. economic growth in the second quarter based on last-minute data about factory orders, international trade and business inventories.

The Commerce Department on Friday morning will release its first official estimate of second-quarter gross domestic product, a broad measure of the goods and services produced across the U.S. Many economists have predicted Friday's report will show robust growth, perhaps the best quarter in years.

But several reports out Thursday caused some to lower their forecasts.

The Commerce Department reported new orders for durable goods—products designed to last at least three years, such as industrial robots and submarines—increased a seasonally adjusted 1% in June from the prior month. That was smaller than the 3% gain economists surveyed by The Wall Street Journal had expected, though it represented a rebound after two consecutive monthly declines.

The agency separately reported the U.S. trade deficit in goods expanded 5.5% in June as imports rose and exports fell from May, and that wholesale and retail inventories were flat in June from the prior month. Inventory investment and net exports are two **volatile** components of GDP growth.

On balance, most forecasters saw Thursday's data pointing to somewhat weaker, but still-strong growth, in the second quarter, though they disagreed about specific components.

Forecasting firm Macroeconomic Advisers on Thursday projected a 4.5% seasonally adjusted annual growth rate, down from its Wednesday prediction of 4.9% growth. Economists at JPMorgan Chase cut their GDP growth forecast to 3.9% from 4.4%. Barclays kept its GDP tracking estimate unchanged at 5.2%. The Federal Reserve Bank of Atlanta's GDPNow model reduced its forecast to 3.8% from an earlier estimate of 4.5% growth.

"While we are trimming down our [second-quarter] growth estimate, [Thursday]'s reports had favorable implications for [third-quarter] growth, adding upside risk to our 2.5%" forecast for GDP growth in the current period, JPMorgan Chase economist Daniel Silver said in a note to clients.

Within Thursday's report on durable-goods orders, motor-vehicle orders in June posted their largest one-month gain in more than three years after a sharp decline in May. One possible explanation: a factory fire had idled production of Ford Motor Co. pickup trucks in May. Excluding the transportation segment, orders rose 0.4% last month after rising 0.3% in May.

Last month's headline durable-goods number would have looked stronger if not for a pullback in military purchases. Excluding the defense sector, orders were up 1.5% in June from the prior month.

The manufacturing sector has benefited from healthy demand this year, supported by higher **oil prices** that spurred energy-sector investment as well as solid growth in overseas markets and tax-law changes intended to boost capital expenditures. In the first half of 2018, total durable-goods orders rose 8.4% compared with the same period a year earlier.

A closely watched proxy for business spending on new equipment, new orders for nondefense capital goods excluding aircraft, rose 0.6% in June from the prior month. In the first six months of the year, orders in the category rose 6.8% from the same period in 2017.

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Economy

Chicago Business Barometer Rises in July; The prices paid indicator hit its highest level since September 2008

By Aisha Al-Muslim
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The Chicago Business Barometer rose in July, bolstered by new orders and production, as prices paid hit a 10-year high.

The barometer rose to 65.5 this month, up from 64.1 in June. Economists polled by The Wall Street Journal were expecting a reading of 62.

When the barometer is above 50, it means there is expansion. The reading takes into account five different components: new orders, order backlogs, production, supplier deliveries indicators and employment.

The prices paid indicator hit its highest level since September 2008. New orders recorded six-month highs and order backlogs capped a third straight rise by hitting a nine-month high. The indicator for supplier deliveries lost ground, MNI Indicators said in a news release.

MNI Indicators also asked those surveyed to predict whether new orders in the third quarter would come in higher, unchanged or lower than their respective second quarter level. Over half of firms were optimistic, expecting third quarter demand to usurp that of the second quarter, with 13.7% expecting a drop-off of some magnitude. About 25% forecast no change, while under 6% were unsure.

"Input prices continue to be a thorn in the side of businesses, however, with the Prices Paid indicator at the highest in a decade and continuing to signal pipeline inflation," MNI Indicators economist Jamie Satchi said in prepared remarks.

The Chicago report is unique because it includes firms from the bigger and better-faring service sector and isn't conducted by a Federal Reserve Bank. The index is known to be **volatile**, in part because it is influenced by swings in orders for Chicago-based Boeing Co.

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WSJ PRO CENTRAL BANKING

Economy

U.S. Household Spending, Income Rose at Solid Rate in June; Personal-consumption expenditures and personal income both increased 0.4% from previous month

By Eric Morath
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WASHINGTON—U.S. households' incomes are rising in pace with robust spending, an indication that consumers have the capacity to drive gains in economic output.

Personal-consumption expenditures, a measure of household spending on everything from hospital stays to groceries, increased a seasonally adjusted 0.4% in June from May, the Commerce Department said Tuesday. Matching that gain, personal income—reflecting Americans' pretax earnings from salaries and other sources, including investments—also rose 0.4%.

"The trajectory of real spending at the end of the second quarter should set up another solid consumption outcome for the third quarter," JPMorgan Chase economist Michael Feroli.

Forecasting firm Macroeconomic Advisers projects output will grow a 3.1% annual rate in the third quarter. That would be a slowdown from the spring, but well ahead of the average growth rate since the recession ended in 2009.

Aided by income gains and lower taxes, consumers have been spending at a solid pace throughout the spring. In addition to June's gain, household outlays were revised up in May, to a 0.5% gain from 0.2%, and April, to a 0.6% increase from 0.5%.

Those increases helped propel overall economic output to a 4.1% annual growth rate in the second quarter, the Commerce Department said last week. It was the strongest growth since 2014. The June spending and income data released Tuesday was accounted for in last week's report on gross domestic product.

Tuesday's numbers showed outlays for goods were flat, but spending on services jumped 0.6%. That was led by more robust spending on restaurants and accommodations, perhaps suggesting Americans are spending their income gains on summer vacations and other fun.

Spending gains didn't affect Americans' willingness to save. The saving rate in June was unchanged from May at 6.8%. Saving-rate data was significantly revised last week. The new data shows Americans have been saving between 6% and 8% of their monthly income in recent years. The previous estimate was between 4% and 6%.

Americans' income gains look slightly more modest when factoring in price increases. Inflation-adjusted, after-tax income increased 0.3% in June from May.

Tuesday's report showed the price index for personal-consumption expenditures, the Federal Reserve's preferred inflation measure, rose 0.1% in June from a month earlier and was up 2.2% from a year earlier.

Excluding **volatile** food and energy costs, prices rose 0.1% in June from May, and 1.9% from a year earlier.

The Fed targets 2% year-to-year inflation and has been raising short-term interest rates to prevent the economy from overheating. For most of the past six years, annual inflation was running below the Fed's target, but the headline price gauge has matched or exceeded 2% for four straight months.

U.S. central bankers start a two-day policy-making meeting Tuesday. Last month, officials voted to increase their benchmark federal-funds rate by a quarter of a percentage point to a range between 1.75% and 2.00%. They aren't expected to raise rates this week, but officials have penciled in two further quarter-point increases for 2018.

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WSJ PRO CENTRAL BANKING

Economy
Manufacturing Sector Hits a Sweet Spot; Output resumed its long climb in June after a plant fire depressed May results

By Sarah Chaney and Bob Tita
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The manufacturing sector staged a quick turnaround in June after a fire at the plant of a Ford pickup-truck supplier knocked output lower the previous month, extending a solid run of growth for U.S. industrial activity.

The fire, which occurred May 2 at a parts plant in Michigan operated by a unit of China's Wanfeng Auto Holding Group, led Ford to idle production of its flagship F-150 and Super Duty trucks for more than a week.

Output resumed, leading to a 0.8% increase in manufacturing output in June after a 1.0% decline the previous month, the Federal Reserve said Tuesday in a monthly report on U.S. industrial activity.

Manufacturing production has been rising since mid-2016, when rising **oil prices** helped reverse a hit to U.S. energy production. Manufacturing output is now up 4.2% since May 2016 and up 22% from a recession low in June 2009, according to Fed data.

It's part of a broader rebound for the U.S. industrial sector, which has added 1.2 million jobs since March 2010. The manufacturing sector was hit hard by the 2007-2009 recession and later by a big drop in **oil prices**, which hurt energy production. More broadly, it has been buffeted by years of competition from low-cost countries such as China.

Several large manufacturers report quarterly results next week, including 3M Co., motorcycle maker Harley-Davidson Inc. and conglomerate United Technologies Corp. Strong results are widely expected, though investors have become mindful lately of the potential for weakening demand next year, in part because trade disputes could disrupt global growth.

For now, the long U.S. expansion, now in its 10th year and being further fueled by recent business and individual tax cuts, appears to be paying dividends for American plants that churn out cars, appliances and business equipment.

"Activity right now is hitting on all cylinders. Demand is up, production is up, [and there's] really robust hiring overall," said Chad Moutray, chief economist at the National Association of Manufacturers.

Surveys show businesses feel confident in the economic outlook. Global growth, while slowing in some pockets, remains solid. Also, business investment has risen, a sign companies are spending to increase productivity. In the first quarter, investment in structures rose at a 16.2% seasonally adjusted annual rate, while investment in equipment climbed at a 5.8% rate.

Strength in business investment owes much to the rebound in the price of oil. **Oil prices** stopped falling in early 2016, then began to move higher, resulting in increased investment from energy firms that rippled throughout the U.S. economy.

Many larger industrial companies and manufacturers are expected to report strong second-quarter results in the next two weeks. Companies that sell parts and supplies to manufacturers are also benefiting from the improvement in the sector.

"A strong economy consumes our stuff more rapidly," said Holden Lewis, chief financial officer for Fastenal Co., a distributor of screws, work gloves and other industrial supplies used at factories and construction sites.

Fastenal's second-quarter sales rose 13% from a year earlier, and net income increased 42%. Fastenal's customers typically don't maintain large inventories of the company's products, making it a bellwether of current demand.

Bendix Commercial Vehicle Systems LLC, an Elyria, Ohio, vehicle-parts supplier, has seen demand for its brakes and other products surge over the past year and a half as the transportation industry has picked up steam. To meet that demand and maximize capacity, the company has increased investment in machinery and has added a rotation that allows it to run full shifts seven days a week.

Over the past 15 months, Bendix has added about 700 employees at its North American production operations, a 30% increase.

"Generally, as the economy has started to pick up, we've seen almost extraordinary demand in some cases," said Michael Hawthorne, chief executive officer at Bendix.

Still, the manufacturing recovery from the 2007-2009 recession and years of intense international competition is incomplete. Output is 3.5% below a 2007 peak, and factories were running at 75.5% of their capacity in June, below an 81% level that prevailed in the 1990s and signaled a healthier balance of supply and demand.

Manufacturing growth could again slow if trade disputes continue to escalate. Already, higher metal prices have put pressure on some manufacturers that use aluminum and steel in their products to cut costs or raise prices.

"We see some of the domestic mills taking advantage of the pricing umbrella being raised," said Michael Happe, CEO of recreational-vehicle manufacturer Winnebago Industries Inc. "We've had to go to the market a bit more frequently and a bit more aggressively with some price increases as of late."

Other companies say U.S. tariffs on imported steel and aluminum are helping them generate higher profits against foreign competitors.

"It's given us relief. We're able to get some margins back," said Jim Piperato, president of Benada Aluminum LLC, a Florida-based producer of aluminum framing for patio and pool enclosures.

Mr. Piperato said the company, owned by private equity firms Big Shoulders Capital and ABGB Capital, recently increased production capacity by 50% to expand into the door and window frame market.

"Our business has been extremely strong." he said. "Most of the customers I've spoken to say there's no end in sight."

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More on the Economy

* Strong Retail Sales in June Boosted Growth

* IMF Still Expects Global Economy to Grow 3.9% This Year

* Fed's Powell on Capitol Hill: What to Watch

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WSJ PRO CENTRAL BANKING

Economy

Eurozone Economy Slows Further as Exports Sputter; Business confidence has weakened on worries about future relations with large trading partners

By Paul Hannon
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English
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The eurozone's economy slowed further in the three months through June, as exports sputtered and business confidence weakened on worries over future relations with the currency area's largest trading partners.

The loss of momentum in 2018 contrasts with the U.S., where growth accelerated during the second quarter. The U.S. growth differential was the widest since the second half of 2014, the two economies having expanded at roughly the same pace since then.

If sustained, that divergence could widen the gap between the interest rates set by the Federal Reserve and the European Central Bank, while stalling progress in dealing with legacies from the eurozone's debt crisis, including very high rates of youth unemployment in its southern members.

The European Union's statistics agency Tuesday said the combined gross domestic product of the 19 countries that use the euro—the broadest measure of the goods and services they produce—increased at an annualized rate of 1.4% in the second quarter, down from 1.5% in the first. That was its slowest expansion in three years. In the U.S., growth was 4.1%.

The eurozone economy entered 2018 on a high, having racked up its most rapid expansion in a decade during 2017. However, growth slowed sharply in the first three months of this year, a setback policy makers and many economists attributed to unusually cold weather and a series of labor strikes in Germany and France. The failure of the economy to rebound in the second indicates that other forces are at work.

"It seems like excuses are running out," said Bert Colijn, an economist at ING Bank. "Factors with a longer shelf life seem to have brought eurozone GDP growth down to a lower cruising speed for the moment."

While Eurostat didn't provide any details of how different parts of the economy performed, previously released data and business surveys point to a fall off in export growth during the first half of 2018 and a waning of business optimism that appears to be linked to growing trade tensions between the U.S. and the EU and uncertainties about access to U.K. markets after Britain leaves the bloc next year.

"Externally, U.S. trade policy remains the main source of downside risk together with, to a lesser extent but resurging in importance, the ongoing Brexit negotiations," economists at Barclays wrote in a note to clients.

Confidence may rebound if there is progress in talks to resolve trans-Atlantic tensions announced July 25 by President Trump and European Commission President Jean Claude Juncker.

Higher **oil prices** are another headwind, since they eat into households' spending power.

The ECB confirmed Thursday it will press ahead with plans to end its bond-buying stimulus program in December, but a lengthening period of weaker growth may make it reluctant to raise its key interest rate in 2019.

Figures also released by Eurostat showed the annual rate of eurozone inflation rose to 2.1% in July, further above the ECB's target, although that was largely down to a jump in energy prices.

Surveys of business activity and sentiment for July show no signs of a rebound in growth during the third quarter. A sustained slowdown could aid the rise of antiestablishment political parties, since it would come at a time when some of the eurozone's members have yet to fully recover from the global financial crisis.

In a separate release, Eurostat said the unemployment rate across the eurozone was steady at 8.3% in June, but the number of people without work rose slightly for the first time since July 2017, a sign the slowdown in growth may already be weakening the jobs market.

For some eurozone members, that may be a welcome development, since they are close to exhausting their reserves of unemployed workers.

"The strength of economic growth means our economy risks hitting full capacity, which gives rise to the risk of overheating or boom-bust cycles," Mark Cassidy, director of economics at the Central Bank of Ireland warned Tuesday.

That is a very distant worry for his counterparts in Greece and Italy, which have lagged throughout the eurozone's recovery, now entering its sixth year.

Italy's statistics agency said Tuesday that economic growth in the second quarter was once again below that of the eurozone as a whole, while the country's unemployment rate rose to 10.9% from 10.7% in June. Among people aged less than 25 years, the jobless rate rose to 32.6% from 32.2%. High rates of youth unemployment have fueled a rise in support for the antiestablishment parties that comprise the new government.

In contrast, Spain's economy has been the fastest-growing of the eurozone's four largest members since the recovery began in mid-2013. However, it also slowed in the three months through June, recording its weakest expansion in four years.

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WSJ PRO CENTRAL BANKING

Economy

Fedspeak Cheat Sheet | BOJ Defies Expectations | Eurozone Economy Slows Again | Goldman Partners' Haul | Derby's Take: What's Really Driving Hawks and Doves? The Wall Street Journal's central banking newsletter for Tuesday, July 31, 2018

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Derby's Take: K.C. Fed Digs Into What's Really Driving Hawks and Doves

Fedspeak Cheat Sheet: What Fed Officials Said Ahead of This Week's Meeting

Bank of Japan Sticks to Ultra-Easy Money Policy, Defying Expectations

Eurozone Economy Slows Further as Exports Sputter

Goldman Partners' Haul on Crisis-Era Options: $3 Billion

K.C. Fed Digs Into What's Really Driving Hawks and Doves

The postcrisis difference between Federal Reserve hawks and doves reflected contrasting views about how the economy works, new research from the Federal Reserve Bank of Kansas City suggests.

Staff economists George Kahn and Amy Oksol looked at voting patterns on the rate-setting Federal Open Market Committee between 2009 and 2012. They found the so-called hawks who wanted a more aggressive path of rate rises relative to their colleagues also expected more inflation relative to the central bank's consensus outlook. Meanwhile, the doves who favored fewer rate rises expected to see less inflation compared with their colleagues.

The paper found that at the heart of the divide, Fed hawks believed in a tighter inverse relationship between unemployment and inflation, and expected bigger gains in inflation to flow from declining joblessness. The doves saw a looser link.

The paper reads a bit like a time capsule for a bygone era.

The period studied took place in the aftermath of the financial crisis and the "Great Recession," a time of great economic uncertainty and policy experimentation. All sorts of old orthodoxies were questioned, and novel stimulus strategies were tried.

Critics of the Fed's unprecedented stimulus policies, including several hawkish officials, warned that they would fuel hyperinflation and market instability.

Years later, none of that has happened. Instead, inflation has only recently risen to hit the Fed's 2% target. And markets appear buoyant but not dangerously bubbly, by the central bank's reckoning.

There also has been considerable turnover among the 12 regional Fed bank presidents and the Washington-based governors since 2012. Even the Fed chair has turned over twice since then.

Today, fewer Fed officials are consistent hawks or doves. Almost all are perched in a centrist camp that favors gradually raising the benchmark rate, moving about once a quarter at least until it reaches a neutral level that neither stimulates nor slows growth. They vary in their estimates of that level, but most foresee a total of three or four rate increases this year.

And many admit greater uncertainty about the relationship between unemployment and inflation.

Key Developments Around the World

Fedspeak Cheat Sheet: What Fed Officials Said Ahead of This Week's Meeting

Federal Reserve officials' comments since their June meeting have been all about the long game. They have done nothing to disturb market expectations they will hold short-term rates steady at their Federal Open Market Committee gathering Tuesday and Wednesday. Instead, officials have debated whether they will likely raise rates one or two more times this year, with several focused on the inflation outlook. Some argued against raising short-term rates higher than long-term rates, a situation known as an inverted yield curve that has frequently preceded recessions. Here is a sample of their recent comments on the topic.

Bank of Japan Sticks to Ultra-Easy Money Policy, Defying Expectations

The Bank of Japan kept its ultra-easy monetary policy in place, but Gov. Haruhiko Kuroda said he would let a key interest rate rise more than previously—a nod to criticism about the side effects of prolonged easing. At a news conference Tuesday following the bank's policy meeting, Mr. Kuroda said the BOJ would allow a wider range around its target of zero for the yield on the 10-year Japanese government bond. Mr. Kuroda said the target would remain zero, but the bank would let the yield rise as high as 0.2%; it has been enforcing a de facto cap of around 0.1%.

Eurozone Economy Slows Further as Exports Sputter

The eurozone's economy slowed further in the three months through June, as exports sputtered and business confidence weakened on worries over future relations with the currency area's largest trading partners. The loss of momentum in 2018 contrasts with the U.S., where growth accelerated during the second quarter. The U.S. growth differential was the widest since the second half of 2014, the two economies having expanded at roughly the same pace since then.

Turkey's Central Bank Raises 2018 Inflation Forecast

Turkey's central bank sharply raised its inflation forecasts for 2018 and next year on Tuesday, and vowed to tighten monetary policy further if needed. The central bank lifted its 2018 inflation projection to 13.4% from 8.4%, and raised its 2019 inflation forecast to 9.3% from 6.5%, citing upward revisions in the assumptions for **oil prices** and food prices as well as currency depreciation.

Swiss National Bank Returns to Profit in Second Quarter

The Swiss central bank on Tuesday said it swung to a large profit in the second quarter, offsetting a loss in the first three months of the year, mostly driven by interest income and gains from its holdings of foreign stocks. The SNB said profit for the period from April through June was just under 12 billion Swiss francs ($12.14 billion), more than offsetting a 6.8 billion franc loss in the first quarter. For the first half overall, profit was 5.1 billion francs.

Dollar Falls Ahead of Central Bank Meetings

The U.S. dollar fell for the fourth time in the past five sessions Monday as investors looked ahead to several central bank meetings and Friday's jobs report. The WSJ Dollar Index, which tracks the dollar against a basket of 16 other currencies, fell 0.2%, though it is still close to its highest level in more than a year. Growth momentum shifting back to the U.S. so far this year has supported the dollar's rally, but some analysts aren't sure recent growth rates are sustainable.

Iran's Rial at Historic Low as U.S. Sanctions Loom

Iran's local currency hit another record low against the U.S. dollar Monday, extending a historic slide on concerns about new American sanctions due to be imposed next week. Scrambling to put a floor under the rial, Iran's central bank late Sunday promised new measures to restore calm. It didn't say what those measures were, but they will likely be the first major moves for the new central bank governor, Abdolnaser Hemmati.

India Expected to Raise Rates

India's central bank is likely to raise its key lending rate Wednesday for the second time this year amid inflation concerns. The Reserve Bank of India's monetary-policy committee, headed by Gov. Urjit Patel, is scheduled to announce its rate decisions Wednesday. Of the 17 economists polled by The Wall Street Journal, 11 predicted a policy-rate increase by a quarter percentage point to 6.5%, while six expected no change.

FINANCIAL REGULATION ROUNDUP

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Goldman Partners' Haul on Crisis-Era Options: $3 Billion

In December 2008, with the financial world in a tailspin, Goldman Sachs Group issued stock options to 350 of its top executives and board members. By the time they expire later this year, these options will have earned their owners—most of whom left Goldman years ago—at least $3 billion, according to a review of regulatory filings by The Wall Street Journal. The windfall shows how far Wall Street firms, or at least their stock prices, have come since the crisis. Goldman is less profitable than it was a decade ago, but its share price last year surpassed the previous high set in 2006.

Alleged NYSE Kickback Scheme Revives Old Questions

An alleged kickback scheme at the New York Stock Exchange has revived old questions about whether the Big Board's floor traders are lining their pockets at the expense of investors. The NYSE's regulatory arm has accused Kevin Lodewick, a floor broker, of accepting about $2,000 worth of payments over the course of 11 months from an employee of an unnamed brokerage firm, in return for steering that firm millions of dollars' worth of customer orders.

Tuesday

Time N/A

U.S. Federal Reserve begins two-day policy meeting in Washington

8:30 a.m. EDT

U.S. Commerce Department releases June personal income and outlays

Wednesday

Time N/A

Central Bank of Brazil releases policy statement

Time N/A

Reserve Bank of India releases policy statement

2 p.m. EDT

U.S. Federal Reserve releases policy statement

Is Automation Labor-Displacing? Productivity Growth, Employment and Labor Share

David Autor and Anna Salomons find in a National Bureau of Economic Research paper that technological progress is broadly employment-augmenting in the aggregate. "But this is not so for labor's share of value-added, where direct labor-displacing effects dominate," the paper states.

How to Gauge the Fed's Reaction to Trump's Tweet

The central bank meets this week and probably will go out of its way to demonstrate independence, writes Mohamed A. El-Erian for Bloomberg View. "There are good reasons why so many have warned politicians away from commenting on central banks. We will likely see some of the underlying reasoning play out again this week, even though the Fed will end up behaving exactly as it would have had Trump not commented on its policies."

Quantitative Easing, a Decade Later

The gradual pace at which the Federal Reserve has raised its key interest rates leaves it low on ammunition to soften the next recession, and potentially reliant on flawed quantitative easing, writes Stephen S. Roach for Project Syndicate. "The Fed's preference for glacial normalization both in the early 2000s and now keeps monetary policy on emergency settings long after the emergency has passed," he writes. "Doing so raises the distinct possibility that the Fed will lack the ammunition it will need to counter the inevitable next recession. We can only hope that circumstances don't require another unconventional policy experiment such as QE. But in the event of another crisis, it would pay to be especially mindful of QE's shortcomings."

Many cities and states can no longer afford the unsustainable retirement promises made to millions of public workers over many years. By one estimate they are short $5 trillion, an amount that is roughly equal to the output of the world's third-largest economy.

A decade-old recession predictor is flashing warning signs, but a flattening yield curve doesn't necessarily portend falling stock prices.

China's business activities faltered in July in the first official data to reflect the impact of U.S. tariffs, adding to signs that trade tensions have started to pinch economic growth.

New Zealand's business confidence in July slumped to the lowest level since the collapse of Lehman Brothers in 2008, underscoring concerns around government policy changes and the outlook for growth.

Australian households could be subject to a severe shock if the Australian dollar were to depreciate suddenly, triggering a rise in interest rates, ratings firm Moody's Investors Service said Tuesday.

Send us your tips, suggestions and feedback. Write to:

Jon Hilsenrath; Katy Burne; Michael Derby; Nell Henderson; Jason Douglas; Paul Hannon; Harriet Torry; Kate Davidson; David Harrison; Kim Mackrael; Tom Fairless; Michael Maloney.

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THE WALL STREET JOURNAL.
U.S. EDITION

Activists Turn Up Heat in Drive for Returns

By Cara Lombardo
823 words
13 July 2018
The Wall Street Journal
J
B1
English
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Corrections & Amplifications

Conagra Brands Inc. makes Healthy Choice frozen meals. A Business & Finance article Friday about a boom in shareholder-activist campaigns incorrectly said Pinnacle Foods Inc. makes Healthy Choice.

(WSJ July 14, 2018)

(END)

CEOs beware: Surging stock prices have done little to placate activist investors.

Activists are launching campaigns at a record pace as the rise in passive investing pressures fund managers to find new ways to beat the market and letting the rabble-rousing investors into boardrooms becomes less taboo.

Activists spent $40 billion targeting 136 companies with market values of more than $500 million in the first half, according to a study released Thursday by Lazard. That is the most since the investment bank started collecting the data in 2013, around when the current wave of activism began. Only 94 companies were the subject of new activist pushes by this time in 2017.

The campaigns are having an effect. Activists won a record 119 directorships in the first half -- a 75% increase from a year earlier -- and they are increasingly looking for control of boards, the data show.

In a sign of the power the investors have come to wield in American corporations, companies they are rattling include household names like Xerox Corp., which backed out of a planned merger with Fujifilm Holdings Corp. under pressure from activist Carl Icahn and recently gave him and another shareholder control of its board. Activists have previously gotten board representation at such corporate heavyweights as Procter & Gamble Co. and Microsoft Corp.

Activists, typically hedge funds, take stakes in public companies they believe are undervalued and push management to make changes they think will boost stock prices. Their demands can range from replacing executives or directors to increased share buybacks and deal making.

As the investors become more mainstream, big asset managers such as T. Rowe Price Group Inc., traditionally loath to push publicly for change, are more open to supporting them. Directors are more amenable to dialogue, too.

"Boards are feeling more pressure because actively managed funds are increasingly supportive of activist campaigns," said William Anderson, an investment banker at Evercore Inc. who helps companies anticipate and respond to activists.

As a result, companies and activists more often reach truces to avoid drawn-out and costly proxy fights.

Activists won 85% of their board seats this year through settlements, according to Lazard.

Newell Brands Inc. was the target of dueling campaigns from Mr. Icahn and Jeff Smith's Starboard Value LP that sought to streamline the Sharpie maker, which had languished following a big acquisition, and replace board members.

Both struck settlements with the company within months, and Newell's board now includes representatives of both activists.

Those successes have encouraged more investors to experiment with activism.

Almost 20% of new campaigns this year have been initiated by first-time activists.

"For those willing to use activism as a tactic, there has never been a better time," said Jim Rossman, a managing director at Lazard and head of its shareholder-advisory practice, which defends companies against activists.

For all their success effecting change, activists don't always generate the best returns for their own investors.

An activist hedge fund index tracked by HFR Inc. returned 5.5% last year, compared with the **S&P 500**'s 22% rise with dividends. The activist index is up 2.8% this year through June, just above the **S&P 500**'s 2.7% rise.

There have also been some notable flops.

Trian Fund Management LP has suffered steep losses on its 2015 investment in General Electric Co., which recently unveiled a comprehensive restructuring plan, while William Ackman's Pershing Square Capital Management LP faces a wave of investor redemptions after stumbles including a collapsed bet on Valeant Pharmaceuticals International Inc., though its public fund is up 10.4% this year.

Nevertheless, as active stock pickers fall behind passive investors, the appeal of shareholder activists and their ability to effect stock-enhancing change has grown, said Greg Taxin of Spotlight Advisors LLC.

"Activism has proven over a long stretch of time to be an effective way to generate alpha," said Mr. Taxin, who advises companies and has also worked with first-time activists including Blackwells Capital LLC in its campaign at Supervalu Inc. "In a world where active stock picking is viewed skeptically by many, this strategy has an understandable explanation for why it ought to outperform."

Encouraging the activity is a simultaneous boom in merger and initial-public-offering volume.

Activism and M&A, in particular, go hand in hand as the investors frequently encourage deal making like the sale of a division or an entire company.

Such was the case at Pinnacle Foods Inc., whose products include Healthy Choice frozen meals. In April, activist hedge fund Jana Partners LLC disclosed a roughly 9% stake in Pinnacle and threatened to launch a proxy fight for board seats if it didn't explore a sale. By late June, Pinnacle agreed to be bought by Conagra Brands Inc. for about $8.2 billion.

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WSJ PRO CENTRAL BANKING

Markets

SEC Rejects Winklevoss Bitcoin ETF Proposal; Cryptocurrency traders have hoped an exchange-traded product would make the virtual currency more attractive

By Dave Michaels
617 words
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WSJ Pro Central Banking
RSTPROCB
English
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The Securities and Exchange Commission on Thursday rejected a proposal to package bitcoin into an exchange-traded fund, the latest indication that regulators are still uneasy with the **volatile** and largely unpoliced cryptocurrency market.

The commission's vote affirms an earlier decision in 2017 by the SEC's staff to deny the proposal, for which Cameron and Tyler Winklevoss first sought approval several years ago. Cryptocurrency traders and exchanges have hoped that an exchange-traded product would make the virtual currency more attractive to Wall Street and retail investors.

The SEC's decision, posted in an order on the regulator's website, underscores its mistrust of a Wild West-like market where manipulation may drive the asset's price swings. The annualized **volatility** of bitcoin in 2017 was about 94%.

Bitcoin was trading at about $8,287 just before the SEC order was issued, and quickly fell to under $8,000, according to data from Coinmarketcap.com.

Cboe Global Markets Inc., the exchange that sought to list the Winklevoss's ETF, had argued that bitcoin trading is too decentralized across the globe for fraudsters to manipulate the price.

But the SEC didn't accept that premise. More than three-quarters of the trading volume between bitcoin and sovereign currencies happens on overseas exchanges that regulators don't monitor, the SEC's inquiry found.

The regulator also didn't accept that Cboe had come up with an effective surveillance program to address that risk.

In effect, Cboe said it could monitor trading on the Gemini Exchange, a digital-currency trading venue owned by the Winklevoss twins, to know whether manipulation affected the asset's price. But the SEC determined that Gemini isn't large enough to provide that assurance. And as a digital asset exchange, Gemini doesn't offer the investor protections that securities and futures exchanges provide, the SEC said.

"[The SEC is] waiting to see if a regulated market of significant size is going to develop," said Michael Mundt, an attorney who advises ETF issuers at Stradley Ronon Stevens & Young, LLP. "Their statement suggests there is a long way to go."

Cameron Winklevoss and Cboe President Chris Concannon said in separate statements that they are studying the SEC's ruling and won't give up on seeking approval for a bitcoin-linked ETF.

"Given U.S. investors are clearly already accessing these unregistered financial products, we also believe that investors are better served by products traded on a regulated securities market," Mr. Concannon said

The four-member commission voted 3-1 to reject the proposal. Commissioner Hester Peirce, a Republican, said in a dissent that the SEC's decision may have the opposite effect of what regulators want.

The denial forestalls a way for many institutional investors to trade bitcoin, she wrote. That means the market remains prone to being influenced by proprietary traders and individual participants.

"More institutional participation would ameliorate many of the Commission's concerns with the bitcoin market that underlie its disapproval order," Ms. Peirce wrote.

The commission's decision on the Winklevoss's ETF doesn't by itself affect other proposals for bitcoin funds that are pending before the regulator, but Mr. Mundt said it doesn't bode well for them.

Bitwise Asset Management Inc., Van Eck Associates Corp. and startup SolidX Management LLC have all applied to the SEC to launch bitcoin ETFs.

Write to Dave Michaels at dave.michaels@wsj.com

Read More

* Read the SEC's Order

* What You Need to Know About Bitcoin Funds

* Bitcoin Fever Persists With Fresh ETF Proposal

Document RSTPROCB20180726ee7q000xd

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THE WALL STREET JOURNAL.
U.S. EDITION

Banks Face High Bar to Lure Investors --- Strong earnings are expected, but shares may need more than that to halt slump

By Rachel Louise Ensign
609 words
12 July 2018
The Wall Street Journal
J
B12
English
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Corrections & Amplifications

A graphic with a Markets article Thursday about banks' earnings contained a chart showing quarterly mortgage originations in billions of dollars. The chart didn't indicate the data were in billions.

(WSJ July 18, 2018)

(END)

Big banks are expected to report another quarter of strong profits starting Friday. But that might not be enough to get skittish investors interested in bank stocks again.

A broad index of big bank stocks is roughly flat since the start of the year, lagging behind the 3.8% gain of the **S&P 500**. Shares of major lenders including Bank of America Corp., Wells Fargo & Co. and Citigroup Inc. have performed even worse and are in the red for 2018. That marks a big shift in sentiment from the period between the 2016 presidential election and the end of 2017, when the KBW **Nasdaq** Bank index rose 42%, outpacing the broader market.

Smaller bank stocks have done somewhat better in 2018, lifted by the prospect of mergers in this part of the market where buyers pay a premium, according to Keefe, Bruyette & Woods Inc. analyst Christopher McGratty.

Since earnings are projected to be higher than in years past, while share prices have stayed flat or declined, the big four U.S. banks now trade at lower price/earnings valuations. "Sentiment doesn't seem too positive," Bernstein analyst John McDonald wrote this week, citing investor concerns that the end of the economic expansion is near and bank earnings are peaking. Still, he wrote, it is likely "the good times could also continue for a while."

Investors have grown wary of bank stocks, analysts say, because of a bond-market development known as the flattening of the yield curve: a narrowing of the difference in the yields of shorter- and longer-term Treasurys.

A flatter yield curve can be bad for banks because they earn less on loans and securities tied to longer-term Treasurys. The narrowing also potentially signals problems ahead for the economy.

But some analysts think worries about the yield curve and the subsequent retreat from bank stocks is overblown. That is because bank-lending profits are often more closely tied to differences in measures of short-term rates rather than short- and long-term ones. For example, many loans to businesses are pegged to the London interbank offered rate, or Libor. That metric has risen far more than the amount banks are paying to money-market depositors, boosting lending profits.

Roughly two-thirds of bank exposures price off the short end of the yield curve, Goldman Sachs Group Inc. analysts noted in a report this week. Because of this, they added, worries about the flattening yield curve are "largely overstated for bank earnings."

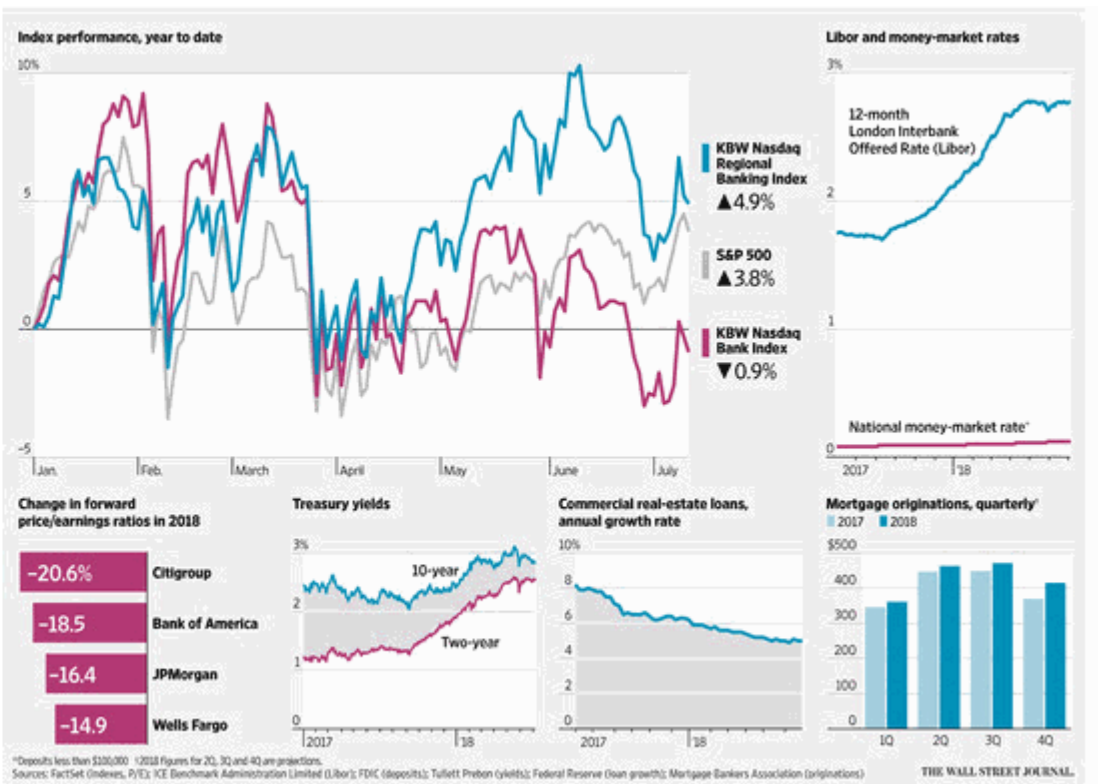
Meanwhile, broader loan growth, a major factor in profitability, has started ticking back up after a long decline that began in 2016.

Especially important, business lending has shown signs of a resurgence in recent months after a two-year slowdown in growth.

A catch is that commercial real-estate lending growth, which many banks relied on as a major source of new loans, has continued to decline. Bank executives have warned of potential credit issues in this area for years, but those have yet to materialize.

Additionally, mortgages remain a concern. As interest rates continue to rise, mortgage originations are expected to fall due to a shop drop-off in refinancing activity. That is expected to hit lending growth as well as noninterest income.

Despite such concerns, most analysts are fairly upbeat about banks' coming earnings reports. They expect firms to at least meet market expectations, which could bolster share prices that have been pricing in a more dire outlook.



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THE WALL STREET JOURNAL.

Markets

Trade Tensions Are Up, Asian Stocks Are Down; Tumble for ChiNext, other indexes follows overnight weakness in U.S. tech stocks

By Joanne Chiu
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4 July 2018
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The Wall Street Journal Online
WSJO
English
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Asia-Pacific stocks were broadly lower Wednesday, with Shenzhen-based tech-heavy ChiNext—often called China's **Nasdaq**—the weakest index with a 2% drop. The tumble followed overnight weakness in U.S. technology stocks, on fears of ratcheting tech-sector tensions between Beijing and Washington. Benchmarks in Japan, Australia and Hong Kong were meanwhile down at least 0.5%. Malaysia's major index bucked the trend with a modest 0.3% gain, as investors focused on the arrest of disgraced former leader Najib Razak.

Wednesday's Big Theme

Two separate cases involving U.S. chip maker Micron Technology Inc. and

Chinese wireless giant China Mobile Ltd.—the latest tit-for-tat retaliation between the U.S. and China—concerned investors ahead of the first round of tariffs on Friday.

What's Happening

Investor enthusiasm towards Asian tech stocks is falling. A Chinese court on Tuesday temporarily banned Micron Technology from selling a number of its memory-chip products domestically, in a patent ruling in favor of Taiwanese rival United Microelectronics Corp.

The court's move came the day after the U.S. cited national security concerns in moving to block China Mobile—the world's biggest mobile operator in terms of subscribers—from entering its telecom market.

Shares of United Microelectronics jumped 1.7% while Micron ended 5.5% lower, in Tuesday's abbreviated session ahead of the July 4 holiday.

In Hong Kong, China Mobile's shares rebounded 0.2% on Wednesday after hitting a more than four-year low the previous day, as investors shrugged off the firm's potentially-blocked U.S. entry.

Sentiment towards other regional tech stocks was also weighed, with South Korean memory-chip maker SK Hynix Inc. falling more than 1%.

Market Reaction

Eli Lee, head of investment strategy at Bank of Singapore, flagged concerns about the shift in the U.S. narrative, now focused more on issues of national security and pushback against Chinese tech and economic ambitions.

"All this injects considerable uncertainty into the markets, which are quickly looking beyond initial tariffs to price in potential endgame scenarios resulting from multi-stage 'tit-for-tat' escalation," he said.

Mr. Lee noted a trade war could particularly impact tech firms in Japan, South Korea and Taiwan, all closely intertwined with complex global supply chains.

But Felix Lam, senior portfolio manager at BNP Paribas Asset Management, said the latest U.S. ban's impact on China Mobile is muted.

China Mobile's perspective, he said, is that there isn't any revenue coming in from the U.S. as the telecom giant hasn't yet entered that market. "This is a completely different case compared with that of ZTE [Corp.], which already has quite a large portion of business from the U.S. market," he said.

Elsewhere

Tokyo's benchmark rubber futures contract hit its lowest level since October 2016 as trade fears fuel concerns about demand for tires as well as other industrial commodities. **S&P 500** futures were up 0.1% in Asia after overnight declines in the U.S.'s shortened trading session.

Lucy Craymer contributed to this article.

Write to Joanne Chiu at joanne.chiu@wsj.com

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The New York Times

Business/Financial Desk; SECTB
A Key Bank Rate Is Expiring. Wall Street Isn't Prepared.

By MATT PHILLIPS
1,351 words
19 July 2018
The New York Times
NYTF
Late Edition - Final
1
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In the world of finance, there is one number that arguably matters more than any other. You can find it in the small print on adjustable-rate mortgages and private student loans, it is the basis for enormous corporate loans, and it underpins nearly $200 trillion of derivatives contracts.

But it is on the way out, and Wall Street has not worked out how to replace it.

The number in question is called Libor, which is short for the London interbank offered rate. Published daily, Libor is an interest rate benchmark, or the basis for many other interest rates. If you have heard of it, that might be because it was at the center of a market-manipulation scandal that resulted in jail time for some traders and billions of dollars in fines for many banks.

There are other important financial benchmarks, of course -- the Federal Reserve's fed funds rate and the yield on the **10**-**year Treasury** note among them -- but Libor has emerged over time as the dominant rate for determining interest payments on almost all adjustable-rate financial products.

Now, regulators are stressing that the benchmark could be gone by 2021.

What will replace it? Nobody knows for sure.

As traders speculate about what will happen to **financial markets** when Libor disappears, regulators appear to be worried that banks are not taking the coming change seriously enough. To move away from Libor requires vast amounts of work, and given how tightly woven it is into the financial fabric, it isn't the kind of thing anyone wants to see rushed.

''I hope it is already clear that the discontinuation of Libor should not be considered a remote probability,'' Andrew Bailey, chief executive of Britain's Financial Conduct Authority, said in a speech last week.

Warning against ''misplaced confidence in Libor's survival,'' Mr. Bailey said that the number of financial contracts with interest rates derived from the benchmark continued to grow. Regulators in the United States, including the chairman of the Commodity Futures Trading Commission, have raised similar warnings.

On Thursday, a meeting that is scheduled at the Federal Reserve Bank of New York will focus on preparing for a world without Libor: A panel is expected to address crucial details, including the best ideas for language that should be used to replace Libor in contracts for financial products like business loans, derivatives and floating-rate notes.

Here's what's at stake.

A Daily Routine With a Big Impact

In simplest terms, Libor is a number produced daily in response to a theoretical question posed to a group of large banks: What interest rate would you have to pay to borrow money from other banks?

Libor is calculated by stripping out the highest and lowest estimates and averaging the rest. There are many different versions of Libor, calculated in different currencies and over different borrowing time periods.

The most widely used variant applies to borrowing dollars for three months. On Tuesday, that number -- expressed as an annual rate -- was 2.34 percent.

If you have taken a loan with a variable interest rate, there is a good chance it is based on Libor. (The interest rate on such a loan is typically Libor plus a certain number of percentage points.) The same is true for loans to big companies and other institutions that borrow money, including cities, pension funds and university endowments.

Libor's biggest use is in financial contracts known as derivatives. Some, like interest-rate swaps, are used by institutions to protect themselves from future swings in interest rates and by traders to place bets on which way rates will move in the future.

At the end of 2016, there were more than $190 trillion of these Libor-based contracts outstanding all over the world.

(That's trillions with a T.)

A Rate That's Easy to Manipulate

A big problem with Libor is that it has been incredibly easy to manipulate.

In part, that is because the question on the Libor survey does not ask the banks, "What did you pay to borrow this morning?" Instead, it asks the more subjective "What do you think you would have to pay?"

With a relatively small number of banks responding to the survey, it did not take traders long to realize they could skew the number higher or lower by coordinating with colleagues at other banks.

Because bank traders make high-stakes wagers using derivatives whose values are based in part on Libor, they could vastly improve their chances of making money if they could influence the very thing they were betting on.

The market-manipulation scheme started to unravel in 2008 when The Wall Street Journal published an article casting doubt on Libor's integrity. That prompted government investigations that eventually revealed what was going on.

Banks collectively paid many billions of dollars in penalties for their roles in trying to rig Libor. A few former traders have gone to prison, including Tom Hayes, a former UBS and Citigroup trader who is serving an 11-year sentence in England.

A Lifeline From Nervous Regulators

After all the fines, penalties and prison sentences had been handed out, the only reason some banks still respond to the Libor survey is that British regulators pressed them to do so. The regulators fear that banishing the rate in an abrupt, disorderly way could endanger the broader financial system.

Regulators decided they would give the industry time to prepare itself for a world without Libor. After 2021, regulators will not push banks to participate in the Libor survey. Many people expect that absent that prodding, banks will stop responding, and Libor will disappear.

For the record, the group that produces Libor -- ICE Benchmark Administration -- says it has held talks with banks about a voluntary agreement to continue submitting rates that would allow some form of Libor to be published into the middle of the next decade. No agreement has yet been struck.

"Ultimately this is up to the banks," said Timothy Bowler, the group's president. "The banks have got to decide whether they want to keep Libor or not."

The transition to a post-Libor world would not be painless. Remember those $190 trillion of Libor-linked derivatives? Hardly any of those instruments -- essentially contracts between two parties -- provide a workable option for what to do if Libor were to vanish.

In a worst-case scenario, banks and their customers would effectively have to negotiate how to end Libor-based contracts over the phone, said Darrell Duffie, a Stanford University finance professor. For a sense of what is at stake, Lehman Brothers was a party to more than 900,000 derivatives contracts when it went bankrupt in 2008, according to research published by the Federal Reserve Bank of New York.

"It'll be really nasty in terms of costly, difficult workouts," he said.

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'A Lot of Inertia,' and Perhaps a Huge Mess

The scope of the challenge is beginning to make people on Wall Street nervous. In the past few weeks, research reports have been published and conference calls with experts have been convened to consider ways to avert what could be a huge mess.

An industry group sponsored by the New York Fed has developed a new benchmark rate to replace Libor: the Secured Overnight Financing Rate, or SOFR. It began to be published in April.

Contracts must be changed. Computer systems must be updated. Customers must be communicated with. Such costly administrative work does not yield bonus-increasing fees, and it is not generally considered glamorous on Wall Street.

''There's a lot of inertia. There's a lot of reluctance to make the change,'' said Richard Berner, a former Wall Street economist and director of the Treasury's Office of Financial Research until the end of 2017. ''There's a lot of work to do.''

Andrew Bailey, of Britain's Financial Conduct Authority, said Libor-based contracts were on the rise. (PHOTOGRAPH BY HANNAH MCKAY/REUTERS) (B4)

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THE WALL STREET JOURNAL.

Markets

Investors Look to Earnings to Snap Big-Bank Share Slump; Flatter yield curve hurts sentiment, but some analysts call worries overblown

By Rachel Louise Ensign
613 words
11 July 2018
The Wall Street Journal Online
WSJO
English
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Corrections & Amplifications

A chart showing quarterly mortgage originations in an earlier version of this article didn't indicate that the data were in billions. (July 16)

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Despite such concerns, most analysts are fairly upbeat about banks' coming earnings reports. They expect firms to at least meet market expectations, which could bolster share prices that have been pricing in a more dire outlook.

Write to Rachel Louise Ensign at rachel.ensign@wsj.com

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Heard on the Street
VMware Has Good Reason to Cover Dell Technologies' Tab

By Dan Gallagher
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6 July 2018
The Wall Street Journal
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B12
English
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[Financial Analysis and Commentary]

Dell Technologies' efforts to return to the public market will come at some cost to VMware, but the end result should ultimately prove worth the bill.

The complicated deal announced this week involves Dell buying up the VMware tracking stock that was created to help fund the company's last big move -- the late-2016 acquisition of EMC. VMware is helping to finance the deal with a special dividend of $11 billion -- $9 billion of which goes to Dell to finance a portion of the tracking-stock purchase.

Dell, which owns the majority of VMware's shares, plans to list its own shares on the New York Stock Exchange once the purchases are completed later this year. Activist Carl Icahn, a frequent critic of Dell over the years, doesn't plan to oppose the latest move, The Wall Street Journal reported Tuesday.

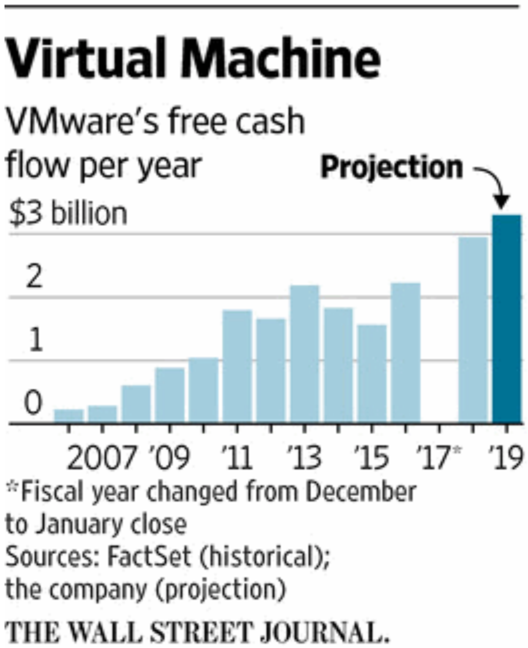
The special dividend represents about 87% of VMware's last-reported cash balance and is therefore not an insignificant sum. Additionally, VMware is a fairly acquisitive company, having wrapped up six M&A deals just since Dell's EMC takeover was completed.

VMware Chief Executive Officer Pat Gelsinger said in an earnings call last year that "prudent M&A continues to be a good way for us to grow."

Software valuations have risen notably since he said that, with the **S&P 500** Software and Services Group up 12% this year compared with the **Nasdaq**'s 8% gain. In other words, this may not be the ideal time to clean out the till.

Even so, the benefits to VMware should outweigh the costs. The deal removes the short-term cloud over the company caused by rumors that Dell was instead considering a reverse merger with the software maker. It also suggests that Dell plans to leave the business alone for the longer term. And VMware's business has been doing very well of late, with revenue growth accelerating and quarterly sales now topping the $2 billion mark for the first time. A high-profile partnership with Amazon.com's AWS public cloud service struck in late 2016 is contributing to that growth.

VMware's cash flow also is on the rise, which should help replenish its bank account more quickly. Free cash flow is projected to top $3.3 billion for the fiscal year ending in January, up 12% from the previous year. Maintaining independence from Dell won't come cheap, but freedom is usually worth the price.



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THE WALL STREET JOURNAL.

Markets

Asian Markets Lifted After Beijing Promises New Stimulus; Shanghai Composite Index rose 1.6% after China unveiled a string of measures to boost domestic consumption

By Mike Bird and Stella Yifan Xie
610 words
24 July 2018
01:34 AM
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English
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Asian equity markets picked up almost across the board Tuesday, led by a 1.6% rise in the Shanghai Composite Index.

Japan's Nikkei 225 clawed back some of Monday's fall, rising 0.6%.

Tuesday's Big Theme

China's cabinet, the State Council, unveiled a string of measures to boost domestic consumption amid economic pressure from escalating trade friction with the U.S.

What's Happening

At a weekly meeting hosted by Chinese Premier Li Keqiang, the State Council called for "more proactive" fiscal policies, with corporate tax cuts tied to research spending, and increased support for small businesses, according to a statement late Monday. It also urged local governments to invest more in infrastructure using special bonds.

Some of the morning's biggest gainers in the Shanghai Composite Index were construction and infrastructure specialists such as Sichuan Road and Bridge Co. and Chongqing Construction Engineering, which each rose by the maximum 10%.

Insurers and banks were also major beneficiaries. In Hong Kong, China Pacific Insurance Co. and Industrial and Commercial Bank of China advanced 3.9% and 3.5% respectively.

Global bond markets were rattled overnight after reports that the Bank of Japancould shift its stimulus policies. U.S. Treasury yields held at 2.951% Tuesday morning in Asia, having climbed back toward 3% Monday. Yields on Japan's 10-year bonds held around 0.081%.

Higher Treasury yields have typically been bad news for emerging markets in Asia, where countries often have large stocks of dollar-denominated debt. Rising interest rates and a stronger dollar make those debts harder to service and refinance. The prospect of higher returns in the world's largest economy can also spur U.S. investors to repatriate funds.

The U.S. dollar also continued to rise against the yuan, climbing 0.3% to 6.814. That puts the Chinese currency at its weakest level in just over a year.

Market Reaction

Despite the moves, there is little indication that China is weakening the yuan to retaliate against U.S. tariffs, according to Paul Kitney, chief equity strategist at Daiwa Capital Markets. He said local currencies in Australia, India, the Philippines and South Korea had all fallen further.

In turn, that implies Chinese companies and individuals aren't rushing to sell yuan, Mr. Kitney said. "Unlike 2016, when the Chinese authorities were fighting hard against gaps in the capital account and associated rising credit risks, the present situation does not demonstrate such capital flight," he said in a note.

Some investors see the bright side after a selloff in Asian equities, with valuations now low on some measures, according to Mark Davids, portfolio manager at J.P. Morgan Asset Management. When the MSCI Asia Pacific ex-Japan index has traded close to its current level of 1.6 times book value, average returns over the subsequent six months have been about 24%, according to Mr. Davids.

Elsewhere

Fast Retailing Co., the Japanese owner of Uniqlo, fell another 0.1%, after declining more than 3% Monday. The stock is heavily represented in the Nikkei 225 index which, like the **Dow Jones Industrial Average**, weights components according to share prices rather than market value. Speculation that the BOJ might also reduce its purchases of exchange-traded funds, many of which are linked to that index, is weighing on the stock.

Write to Mike Bird at Mike.Bird@wsj.com and Stella Yifan Xie at stella.xie@wsj.com

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The New York Times

The Upshot
There Isn't Much the Fed Can Do to Ease the Pain of a Trade War

By Neil Irwin
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5 July 2018
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When the top policymakers at the Federal Reserve met three weeks ago to set the course for monetary policy in the United States, they spent substantial time discussing the risks that a trade war posed to the economy, according to minutes of the meeting released Thursday.

Most Fed officials at the table "noted that uncertainty and risks had intensified," and that tariffs and other trade measures "could have negative effects on business sentiment and investment spending." They reported that some of their business contacts "indicated that plans for capital spending had been scaled back or postponed as a result of uncertainty over trade policy."

What they didn't discuss, at least as far as one can tell from the newly published minutes, was any strategy for the Fed to come to the rescue if trade wars began to act as a meaningful drag on the overall economy. Indeed, at that meeting, Fed officials "generally judged that, with the economy already very strong" and inflation running at about 2 percent, "it would likely be appropriate to continue gradually raising" interest rates.

There was no hint in the minutes that the Fed intended to use its power over interest rates in reaction to rising economic risks from trade wars.

That reflects a particular economic challenge as the United States imposes tariffs on major trading partners and as those partners retaliate with tariffs of their own — a cycle set to escalate with $34 billion of Chinese imports to go into effect at midnight.

It's not just that a multi-front trade war could slow economic growth. It's that it would do so in a way the Fed would not be able to easily offset. The usual economic shock absorber is particularly ill-suited to a trade-induced slump.

That's because a trade war simultaneously risks pulling growth rates down while pushing prices up. Anything the Fed seeks to do to cushion the blow on one side of that equation would tend to make things worse on the other side. So if, for example, the Fed held off on further interest rate increases to cushion a slump in investment spending, it would be doing so just as inflation was accelerating above the 2 percent the Fed aims for.

Prices for washing machines, for example, have risen in recent months amid new tariffs on washing machine imports. Tariffs on steel and aluminum have already driven up domestic prices of the materials, which could flow through in the form of higher inflation even for American-made goods that use the metals.

"I think of this as a standard supply shock," said Tim Duy, an economist at the University of Oregon. "Tariffs are going to constrict the productive capacity of the United States, which means lower growth and higher prices. The Fed operates on the demand side. They don't have the right tools for dealing with it."

For the Fed, the nearest parallel may be an **oil price** shock caused by some geopolitical event, such as those that took place in the 1970s, or a food price spike caused by a drought. What those events have in common is that they are caused not by economic fundamentals — such as when **oil prices** rise because the global economy is booming — but by some external shock. They are bad for growth, yet inflationary.

In those cases, monetary policy orthodoxy tends to emphasize looking past a one-time bump in inflation caused by the shock, while paying more attention to whether higher prices — whether for oil or corn or aluminum — are leading people to expect continually rising prices. A couple of years ago, with the Fed struggling to achieve the 2 percent inflation level it targets and with prices consistently rising more slowly, that might have been welcome.

Now, though, the Fed is pretty much achieving its inflation goal already, and with the unemployment rate at a very low level by historical standards, there's reason to think higher prices may be on the way soon even before the impact of tariffs. In projections released at the mid-June policy meeting, the median Fed official expected that inflation would be 2.1 percent this year and next.

That calculus could change if a trade war starts doing major damage to the financial system, such as by causing steep losses in stock and bond markets or by causing financial stress for banks. But while the **stock market** is down a bit in recent weeks as the war of words over trade has escalated, so far the pain from trade wars has been limited to specific companies and their workers and customers. It has not been a systemic crisis.

For the last 11 years, from the housing downturn in 2007 that turned into the global financial crisis in 2008 and a prolonged, sluggish expansion after that, the Fed's tools were reasonably well suited to the challenges that presented themselves. The central bank became even more central than usual to every economic discussion.

But this time, the economic risks are different, and if conflict over trade practices starts to cause damage to the broader economy, we shouldn't count on the Fed to bail us out.

Jerome Powell, the Fed chairman, at a news conference last month. | Yuri Gripas/Reuters

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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
Tapping Oil Reserve Is Bad Idea

By Spencer Jakab
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17 July 2018
The Wall Street Journal
J
B11
English
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[Financial Analysis and Commentary]

"Strategic" has multiple definitions, but it is important to remember which one politicians had in mind in the aftermath of the 1970s **oil-price** shocks.

America's roughly 660-million-barrel Strategic Petroleum Reserve was intended to insulate the U.S. economy from supply shocks. President Donald Trump reportedly is considering a release at time when the Organization of the Petroleum Exporting Countries, together with Russia, is increasing supply. True, fears that this may not be enough to balance the market right away had left **oil prices** near 3 1/2-year highs recently, but that still makes a release an ill-advised move.

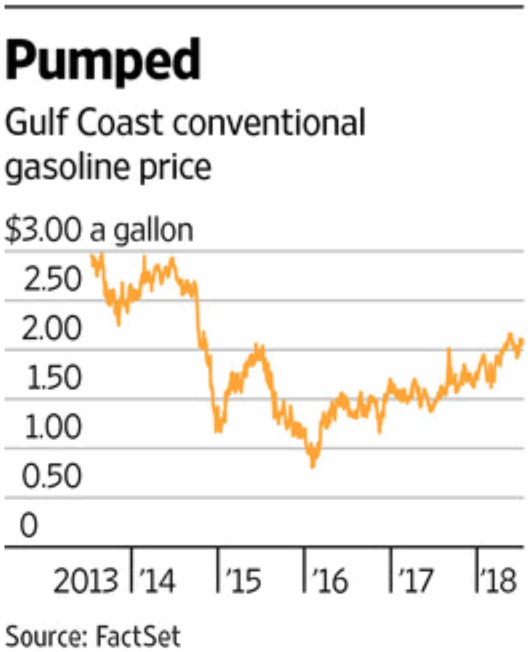
Drawdowns in 1991, 2005 and 2011 came in the wake of armed conflict in the Middle East and a devastating hurricane that knocked out one-quarter of U.S. production.

What else do 1991, 2005 and 2011 have in common? They were odd-numbered years, so there was no suggestion of an ulterior motive by a president to bring down summer gasoline prices ahead of elections. There was a swap or temporary release conducted in the fall of 2000 by the Clinton administration, though, shortly before the presidential election; the administration cited a looming heating-oil shortage. The eventual victor, George W. Bush, justifiably attacked the decision from the campaign trail.

One could argue that having a Strategic Petroleum Reserve is the proverbial "fighting the last war" given the surge in U.S. production. Back in 2005, for example, the U.S. imported about five billion barrels and produced 1.9 billion. This year those figures should be around 3.5 billion each, with many U.S. barrels of crude and refined product being exported. Mr. Trump last year even suggested selling half of the reserve to cut the deficit. Even at today's higher prices, though, that would pay for just two days of federal spending.

If tapping the reserve is a transparent attempt to affect prices, it is a blunt and expensive tool, and probably unnecessary. For some perspective, wholesale gasoline prices were about 85% and 60% higher in inflation-adjusted terms in 2005 and 2011, respectively.

The reserve was conceived at a time of gas lines and economic malaise. Yes, summer pump prices are higher than they have been since 2014. The economy also is booming, the **stock market** is near a record and consumers are confidently snapping up SUVs. Shaving a buck or two off the cost of a fill-up isn't why the reserve was established. Each barrel used for that purpose is one that won't be available in a legitimate emergency.



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THE WALL STREET JOURNAL.

Markets

European-Stock ETFs Absorb Outflows Triggered by Italy; Concern about EU economic growth and a stronger dollar also contribute to outflows

By Tanzeel Akhtar
665 words
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The Wall Street Journal Online
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English
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The recent slowdown in eurozone growth, political turmoil in Italy and a weakening euro have spurred outflows from European-stock exchange-traded funds.

Investors pulled a net $3.7 billion from European-stock ETFs in May, according to ETFGI LLP, a London-based research firm. Net outflows for the first five months of the year totaled $1.8 billion, with funds tracking German, Italian and Spanish stocks seeing significant outflows.

That is a reversal from last year, when investors piled into European-stock funds. Last year's buying spree was encouraged by the prospect of steady economic growth in the European Union, the euro's strength against the dollar, and Emmanuel Macron's defeat of Marine Le Pen for the presidency of France, which eased concerns about political upheaval as populist, anti-immigration politicians like Ms. Le Pen appeared to be gaining traction across Europe.

Now, all that has changed.

The mood among investors has soured on Europe and there is a lack of confidence in the region as the economic and political promise of last year has faded, says Adam Laird, head of ETF strategy in Northern Europe for Lyxor Asset Management. He adds that the region has suffered from comparison to the U.S. "There's been a real positive sentiment towards U.S. equity, and I think some of the outflows are simply investors looking around for cash to top up their American holdings," says Mr. Laird.

For 2018 so far, Europe-focused mutual funds and exchange-traded funds on average are showing a negative total return of 2.3%, according to Thomson Reuters Lipper data. In contrast, U.S.-stock funds are up 3.4%.

Investors have shied away from Italy in the wake of elections in March that resulted in a governing coalition including ministers who have expressed opposition to immigration and criticized the eurozone. The vote revived concerns about political instability across Europe and the possible effect on the continent's economies, which already have lost some steam. Italy is the third-largest economy in the eurozone.

The eurozone economy grew at the fastest rate in a decade last year, but economic data in the region has turned mixed in recent months. Wei Li, head of iShares investment strategy for Europe, the Middle East and Africa at BlackRock Inc., says eurozone economic growth is likely to continue to disappoint many investors. "Our in-house growth indicators continue to point to potential downside surprises," Ms. Li says. "We think that the eurozone is poised to grow close to 1.8% this year, versus consensus expectations of just below 2%."

Jeffrey Kleintop, chief global investment strategist at Charles Schwab, says the dollar's strength against the euro, a reversal from last year, may also be chasing some investors out of European stocks. The dollar has gained as Europe's economic prospects have faltered and as interest-rate trends have favored the U.S. currency. European Central Bank officials said in June that they didn't expect to raise interest rates at least through the summer of 2019, while the Federal Reserve, which already has been raising interest rates from their recent lows, has signaled a faster pace of increases this year.

"A stronger dollar weighs on the returns of international investments by translating gains back into fewer dollars for U.S.-based investors," Mr. Kleintop says. "This may be contributing to the investor moves."

Ms. Akhtar is a writer in London. She can be reached at reports@wsj.com.

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* U.S.-Stock Funds Rose 3.7% in Quarter

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THE WALL STREET JOURNAL.

Markets

Is Bitcoin Back? Cryptocurrency Crosses $8,000 for First Time in Two Months; The cryptocurrency is trading at its highest level since late May on optimism over the possible launch of a bitcoin ETF

By Steven Russolillo
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The Wall Street Journal Online
WSJO
English
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The price of bitcoin jumped above $8,000, extending a rally that has lifted the largest cryptocurrency by market value to its highest level in two months.

After a dismal first half of the year, bitcoin has shown signs of life in recent weeks. It hurdled back above $6,000 a token in late June, surpassed $7,000 last week and exceeded $8,000 on Tuesday. The 25% gain so far in July puts bitcoin on pace for its second biggest monthly gain this year.

Bitcoin recently traded at $8,200, its highest level since May, according to research site CoinDesk.

Some market watchers said the gains have been fueled by mounting optimism that the first bitcoin-based exchange-traded fund could eventually come to fruition. Asset manager Van Eck Associates Corp. and startup SolidX Management LLC applied last month to the Securities and Exchange Commission for permission to launch a regulated bitcoin ETF.

Bitwise Asset Management Inc., a San Francisco asset manager specializing in cryptocurrencies, on Tuesday filed with the SEC for permission to launch an ETF that would track an index of the top 10 cryptocurrencies such as bitcoin and Ethereum.

Such instruments could boost bitcoin's valuation by opening it up to a broader range of investors.

"There are a lot of rumors that a bitcoin ETF is finally going to be approved," said Adrian Lai, managing director at BlackHorse Group, a cryptocurrency investment firm in Hong Kong. "I'm not so sure. It's too optimistic to think it's actually going to happen but the market is reacting really well to this speculation."

The SEC has previously been resistant to approving such products. In January, Wall Street's top regulator all but shut the door to approving ETFs that hold bitcoin and other cryptocurrencies. The agency questioned whether such products could comply with rules meant to protect individual investors. Van Eck and SolidX, both based in New York, have said their proposal was designed to address the SEC's main concerns.

The recent rebound also helped lift rival digital currencies such as ether and ripple, pushing the market capitalization for the entire cryptocurrency market back above $290 billion, according to research site Coinmarketcap.com. But bitcoin has recently started to separate itself from the pack. Bitcoin's market cap has risen to 47% of the entire market, up from 33% in January.

Even after the latest surge, bitcoin is still down about 60% from its peak late last year. The selloff represents a stark turnaround from 2017, when bitcoin soared from under $1,000 to nearly $20,000, a manic run that attracted mainstream interest all over the world.

Mr. Lai at BlackHorse said the excitement over ETFs showed many in the market were latching on to any reason to be optimistic. "The **bear market** has been going on for quite a while now."

Asjylyn Loder contributed to this article.

Write to Steven Russolillo at steven.russolillo@wsj.com

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WSJ PRO CENTRAL BANKING

Economy
Timiraos's Take: Powell Is Bullish But Not Hawkish

By Nick Timiraos
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Fed Chairman Jerome Powell offered a mostly **bullish** assessment of the U.S. economy over two days of congressional hearings that ended Wednesday, but there weren't many hints of hawkishness.

Consider: Pressed over whether inflation was more likely to be stronger- or lower-than-expected, he said he was "maybe slightly more worried about lower inflation, still."

Perhaps that's not a surprise after the Fed has consistently projected inflation returning to its 2% target, only to see global events or idiosyncratic weaknesses intrude on those forecasts.

The exchange is the latest reminder that Mr. Powell wants to see inflation to stay at 2% or even rise slightly above it for a while before declaring success on hitting the target.

Later, he showed lingering doubts over whether the economy, with 4% unemployment in June, had reached a level of full employment, meaning joblessness can't go sustainably lower.

"We're close to full employment—maybe not quite there," he said.

The exchanges reveal that while some Fed officials worry they could fall behind the curve, particularly with fiscal policy likely to boost growth and further reduce the unemployment rate, Mr. Powell isn't lighting his hair on fire.

At the same time, he declined an opportunity to echo the concerns of more dovish Fed bank presidents. He didn't appear terribly worried by the recent flattening of the yield curve, even though several of officials have raised more alarm over the signal embedded in the shrinking term spread.

He also revealed greater concern than at his June press conference over the downside risks of trade tariffs and related international disruptions.

Mr. Powell offered nothing to push back against market expectations of two more rate increases this year, with the next one coming in September. But he showed how the debate over what to do after that, as the Fed gets much closer to a neutral rate setting, is far from settled.

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THE WALL STREET JOURNAL.
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USDA Takes Aim at High-Speed Trade

By Alexander Osipovich
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The U.S. government is taking steps to protect agricultural markets from high-frequency traders -- a move some say will make little difference down on the farm.

Starting on Aug. 1, the Agriculture Department will change how it releases crop and livestock reports. It is an attempt to placate critics who say fast traders are reaping profits in wheat, corn and soybean futures at the expense of slower investors.

The agency says computerized traders currently can get its data about two seconds before everyone else -- eons in today's electronic markets.

"The new procedures will level the playing field and make the issuance of the reports fair to everyone involved," Agriculture Secretary Sonny Perdue said in a press release last week.

The USDA is ending a decades-old practice in which news organizations get advance access to its reports so journalists can write articles before the data are publicly released. In "media lockups," journalists give up their mobile phones and sit in sealed rooms to review the reports to ensure they aren't leaked prematurely.

The problem is what happens at noon Eastern time, when the USDA lifts restrictions on distributing the data. A number of news organizations transmit the data over high-speed cables to their clients, including tech-savvy trading firms. Simultaneously, the USDA posts the data online, a process that takes roughly two seconds, according to the agency.

The result is that traders can get quicker access to potentially market-moving information from news organizations' data feeds. Dow Jones, The Wall Street Journal's parent company, is among the organizations that sell fast access to the USDA's data. Others include Bloomberg LP, London-based Market News International and Thomson Reuters Corp.

An electronic-trading firm could profit from the reports by scanning the data and buying futures if the report is **bullish** for prices, or selling if the report is **bearish**.

"In a world of electronic and high-frequency trading, two seconds is an eternity," said Scott Irwin, a professor at the University of Illinois at Urbana-Champaign. "It's like giving Usain Bolt a 50-meter head start in a 100-meter race," he added, referring to the Olympic sprinting champion.

Farmers, ranchers and agribusinesses often rely on futures markets to protect against swings in commodity prices. Some agriculture groups complain that high-speed trading has hurt these markets by increasing **volatility** and making it tougher for more traditional players to execute trades at good prices.

Under its new policy, the USDA will simply release the data online without sharing it with media outlets first. Among the reports affected are World Agricultural Supply and Demand Estimates, a closely watched source of monthly supply projections for wheat, rice and other crops.

Some commodity traders welcomed the USDA's move. "It will help the general public and the traders that aren't paying a lot of money for data access," said Ron Hovanec, a former Ohio dairy farmer who now trades futures and options for his own account.

Others predicted the new policy would have little impact, since speedy traders could write computer programs to grab data from the USDA's website the moment reports are released. Those with the quickest technology would still have an edge.

"I struggle to see how releasing crop and livestock reports via the USDA's website will address the fact that some participants will be able to capture, analyze and respond to that data more quickly than others," Rob Creamer, president and chief executive of Geneva Trading, a high-tech trading firm in Chicago, said in an email.

The current process "is clearly inequitable and benefits the news outlets selling the high-speed service and the customers who are able to buy it," a USDA representative said in an email.

Other government agencies also have considered eliminating media lockups. In 2014, the Labor Department's Office of Inspector General said the agency should either tighten lockup procedures for a key weekly measure of U.S. employment or get rid of lockups altogether. Some past officials at the agency have criticized the fact that news organizations make money by selling the government's economic data to high-speed traders.

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THE WALL STREET JOURNAL.

Markets

Dollar Bounces Back and Looks Poised for More Gains; Expectations that the Federal Reserve will raise rates at a faster pace this year have been driving dollar's gains

By Ira Iosebashvili
850 words
1 July 2018
10:32 AM
The Wall Street Journal Online
WSJO
English
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The dollar rally that started early in the second quarter is showing little sign of letting up, an unexpected reversal after the U.S. currency slumped for most of the past year.

The WSJ Dollar Index, which measures the currency against a basket of 16 others, rose 5.1% in the second quarter and stands near its highest level in a year. The dollar rose 5.5% against the euro and 4.2% against the yen in the second quarter.

Driving those gains are expectations that the Federal Reserve will raise rates at a faster pace this year in response to a robust U.S. economic expansion that has outpaced growth in Europe and other regions. Higher rates make the dollar more attractive to yield-seeking investors.

The dollar's surge—along with signs that the U.S. economy is strengthening while growth in other major economies is slipping—is helping draw global investors to U.S. stocks and bonds. U.S.-focused equity funds attracted $3.2 billion of inflows in the second quarter, compared with $25 billion in outflows for Europe-focused funds, according to EPFR.

But a stronger dollar can hurt economies in the developing world, making it more difficult for governments and companies to service their dollar-denominated debt. Countries with large current account deficits, such as Argentina and Turkey, have suffered particularly big currency declines in recent weeks.

A rising dollar also can weigh on the prices of raw materials, most of which are priced in dollars, which become more expensive to foreign investors when the U.S. currency rises. Copper has fallen 2.3% in the second quarter, while gold stands near its lowest level since late 2017 after a 5.4% drop.

"When it comes down to it, the world doesn't like a stronger dollar," said Kit Juckes, a strategist at Société Générale.

Several factors are behind the dollar's rally. Many investors started the year believing that a global recovery would shift growth momentum from the U.S. to the eurozone, which experienced its biggest economic expansion in a decade last year. That growth abroad punished the dollar, which fell 0.4% in the fourth quarter.

Yet eurozone data has been uneven during the last few months, and European Central Bank officials said in June they didn't expect to raise rates at least through the summer of 2019. Meanwhile, the Federal Reserve signaled a faster pace of rate increases this year, spurred by stronger growth in the U.S.

Expectations that U.S. yields will rise while borrowing costs elsewhere are making the dollar more attractive to investors seeking yield.

As U.S. borrowing costs rise, "people ask themselves if they really want to be invested in risky instruments, or in the U.S., where they can earn a decent return for much less risk," said Ben Randol, senior analyst of G-10 FX Strategy at Bank of America Merrill Lynch.

Investors have also sought refuge in the dollar amid an intensifying trade conflict between the U.S. and China. Many believe a prolonged conflict between the world's two largest economies will initially have a larger impact on growth in Europe and Asia.

An escalation of trade-war rhetoric would likely accelerate the dollar's appreciation, especially against the currencies of export-dependent countries such as Canada and Australia, analysts at Bank of America Merrill Lynch said in a note to clients.

The dollar is up 1.9% against the Canadian dollar and 3.7% against the Australian dollar in the second quarter.

BNP Paribas expects the dollar to get a lift from U.S. companies repatriating cash from abroad to take advantage of a Republican tax holiday signed into law in late 2017. The bank estimates that companies repatriated around $160 billion in the first quarter.

At the same time, the dollar could be vulnerable to easing trade tensions and the efforts by the U.S. administration to talk down the currency, they said. A stronger dollar hurts U.S. companies by making their products more expensive abroad.

Some think the dollar rally won't last much longer. Analysts at TD Securities believe growth will soon pick up in Europe and Asia, making the dollar a less attractive.

"The best days of the dollar's **bull market** lie in the past," said a TD Securities report. "If global growth resets higher in the second half," the report said, "then we think the dollar will suffer accordingly."

Analysts at Standard Bank believe the strengthening dollar will likely push the euro down to as low as $1.10 in coming months, from around $1.17. Over the next year, however, they expect the euro to rise to around $1.30 against the dollar, as fiscal and trade deficits in the U.S. undermine confidence in the country's economy.

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WSJ PRO CENTRAL BANKING

Economy
The Friendlier Fed | Weakening Yuan | RBA Signals Trade Worries | Riksbank Eyes Fourth Quarter Rise | Hannon's Take: Reassuring Jobs Numbers for the ECB; The Wall Street Journal's central banking newsletter for Tuesday, July 3, 2018

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Hannon's Take: Reassuring Jobs Numbers for the ECB

Wall Street Gets the Friendlier Fed It's Been Waiting For

China's Currency Just Hit Its Weakest Point Against the Dollar in Almost a Year

RBA Keeps Cash Rate Unchanged, Signals Concern on Trade Tensions

Riksbank Confirms It's Ready to Raise Rates in Fourth Quarter

Reassuring Jobs Numbers for the ECB

The first half of 2018 didn't turn out as the European Central Bank would have liked. But amid the disappointments with economic growth and U.S. trade policy, there has been one reassuring constant: unemployment is heading steadily lower.

After a surprisingly strong 2017, eurozone economic growth slowed significantly during the first three months of 2018, and there haven't been many signs of a second-quarter rebound.

To that disappointment can be added growing trade tensions between the U.S. and the European Union, with President Donald Trump threatening to impose new charges on U.S. imports of automobiles. That would inflict the most damage in Germany--the eurozone's manufacturing powerhouse--and the central European economies that serve its automobile industry.

There has also been some good news. Figures released Monday showed 125,000 fewer people were looking for a job in May than in April, with the unemployment rate unchanged at 8.4%.

That put the decline in jobless numbers back at its 2017 average, breaking a two-month run of worryingly weak outcomes. And the 8.4% rate was only unchanged because the statistics agency had cut its April estimate to the lowest since December 2008. At this pace, the lowest jobless rate recorded since the launch of the euro in 1999--7.3% as 2007 passed into 2008--is in sight.

As in the U.S., the long decline in unemployment hasn't translated into a pickup in wages at the speed that the historic relationship between the two would have indicated. ECB officials think that is because there is a lot of slack in the jobs market that isn't picked up by the overall jobless rate, such as people who are working but aren't putting in as many hours as they would like.

Others think the weakening of employment protections long advocated by ECB President Mario Draghi has undermined workers' bargaining power.

Whatever the reasons behind the weakening of the link between falling unemployment and wage growth, the ECB remains convinced that it exists and will eventually help keep inflation around its target. Were a trade war to derail the jobs train, that would cease to be the case, and the arguments for a rate increase in 2019 would be much weakened.

Editor's Note: The WSJ Pro Central Banking newsletter will not publish Wednesday July 4 due to the U.S. Independence Day. It will resume Thursday.

Key Developments Around the World

Wall Street Gets the Friendlier Fed It's Been Waiting For

Federal Reserve officials called executives at Goldman Sachs Group Inc. and Morgan Stanley 10 days ago with an unusual offer. The two Wall Street titans had flunked a portion of the Fed's stress test, which simulates an economic crisis. Passing would require cutting almost in half the combined $16 billion they had hoped to pay out to shareholders, according to people familiar with conversations between the Fed and both banks. But regulators in the June 21 communications gave them an unprecedented option: The banks could agree to freeze their payouts at recent levels, get a "conditional non-objection" grade and avoid failing.

China's Currency Just Hit Its Weakest Point Against the Dollar in Almost a Year

The yuan on Tuesday slumped to its weakest value against the U.S. dollar in nearly a year. The gap between the yuan's value in mainland China and trading hubs like Hong Kong has started to widen, a sign that foreign investors who can access the offshore market could be growing more **bearish** on the currency. The yuan ended June with one of its biggest monthly losses on record, tumbling 3.4% against the dollar.

RBA Keeps Cash Rate Unchanged, Signals Concern on Trade Tensions

Australia's central bank maintained its interest rate at record lows Tuesday, but signaled uncertainty regarding the global outlook amid rising trade tensions. The Reserve Bank of Australia left its cash rate target at 1.5%, where it has stood since mid-2016. "One uncertainty regarding the global outlook stems from the direction of international trade policy in the United States. There have also been strains in a few emerging market economies, largely for country-specific reasons," RBA Governor Philip Lowe said in a statement.

Riksbank Confirms It's Ready to Raise Rates in Fourth Quarter

Sweden's central bank reiterated its intention Tuesday to start raising its key policy rate in the fourth quarter, but signaled that it is in no rush to end a more-than three-year-period of negative repo rates. Keeping the repo rate at a record low of minus-0.5%, the Riksbank said "slow repo rate rises will be initiated toward the end of the year."

Quick Hits: Smaller Banks Exempt From Living Wills Under Banking Law

The Fed has exempted banks with less than $100 billion in assets from the annual living wills process, and the People's Bank of China injected $100 billion worth of liquidity via its medium-term lending facility in June. Here are quick hits on central banking and related market views from around the world.

Tuesday

9:30 p.m. EDT

Bank of Japan's Harada speaks to business leaders in Ishikawa prefecture

Wednesday

9:30 p.m. EDT

Bank of Japan's Masai speaks to business leaders in Nagano prefecture

(Don't Fear) The Yield Curve

Eric Engstrom and Steven Sharpe show in FEDS Notes that for forecasting recessions, the spreads in yields between longer maturities like the 10-year and shorter 1 or 2-year maturities are statistically dominated by a "near-term forward spread." "This spread can be interpreted as a measure of the market's expectations for the direction of conventional near-term monetary policy," the researchers note. "When negative, it indicates the market expects monetary policy to ease, reflecting market expectations that policy will respond to the likelihood or onset of a recession." Given this interpretation, the current level of the near-term spread doesn't mean there is an increased probability for a recession the year ahead.

Good Monetary Policy Obscures the Phillips Curve

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The widely shared perception that the relationship between economic slack and inflation has broken down is in fact a sign of successful monetary policies, write Michael McLeay and Silvana Tenreyro in a posting on VoxEU. Ms. Tenreyro is a member of the Bank of England's Monetary Policy Committee, and the two authors write that the Phillips curve is obscured by policy moves to reduce output when inflation threatens to rise above the target. "Our point is that a disappearing Phillips curve is also a natural consequence of good monetary policy," they write. "If the true model of the economy involves a Phillips curve relationship, monetary policymakers aware of its existence should ensure it remains elusive in the data."

Halfway Through a Troubling Year

U.S. stocks are up, but there are reasons for investors to be wary, writes James Mackintosh for The Wall Street Journal. "The first is the Federal Reserve. Investors think it has become more hawkish, with the probability priced into federal-funds futures of a total of four rate rises this year up from 9% in January to 41% on Monday, according to CME Group. Treasury yields have risen too, and even worse is that the link between stocks and bonds seems to be breaking down."

American factory activity accelerated for the second straight month this summer, in part because manufacturers were scrambling to move goods ahead of threatened tariffs.

Turkish inflation in June accelerated more than expected, driven by rising transport and food prices, Turkey's state statistics agency said Tuesday.

Send us your tips, suggestions and feedback. Write to:

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THE WALL STREET JOURNAL.

Markets

MiMedx Gets Delisting Notice From Nasdaq; The tissue graft developer said it had notified Nasdaq on July 10 that it would be unable to bring its SEC filings into compliance

By Charley Grant
359 words
26 July 2018
07:20 PM
The Wall Street Journal Online
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English
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MiMedx Group Inc. said Thursday that the **Nasdaq Stock Market** has notified the company that it faces a possible delisting of its shares.

That notification came after MiMedx informed the stock exchange that it will not be able to file audited financial statements with the Securities and Exchange Commission by a required deadline next month.

The tissue graft developer said in a press release that it notified **Nasdaq** on July 10 that it would be unable to bring its SEC filings into compliance.

MiMedx said it plans to request a hearing to appeal the decision. That request will stay any possible delisting by 15 days. The company said, citing a letter it received from **Nasdaq**, that any hearing would likely take place 30 to 45 days after the hearing request.

The company said in June it would need to restate financial statements back to 2012 as a result of an internal audit committee investigation into certain sales and distribution practices and "other matters."

On Thursday the company said its audit committee and advisers are "are continuing to work diligently to complete its independent investigation to bring its SEC filings up to date." However, it added "there can be no assurance regarding the ability of the Company to successfully maintain its **Nasdaq** listing."

MiMedx didn't immediately respond to a request for comment.

A Wall Street Journal investigation found that MiMedx, once a health-care star, had fueled its growth with aggressive sales tactics. MiMedx has said in a statement that it is cooperating fully with regulatory agencies. The company has also said it "is not going to comment on allegations raised by former employees, which are being looked into" by the audit committee.

MiMedx shares were up nearly 11% to $4.80 in regular trading Thursday, but fell more than 9% after hours.

Write to Charley Grant at charles.grant@wsj.com

Related

* Highflying Medical Firm, a Help to Wounded Veterans, Falls to Earth (July 23)

Document WSJO000020180726ee7q0096l

THE WALL STREET JOURNAL.
U.S. EDITION

EXCHANGE --- On Business -- How Stock Creates Bonds: The Starbucks Job Incentive

By John D. Stoll
755 words
21 July 2018
The Wall Street Journal
J
B1
English
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U.S. companies are collecting record amounts of cash in their coffers, and many can't think of anything better to do with it than buy back their stock. Here's a better idea: Hand out some of those shares to rank-and-file employees.

Starbucks Corp. has been awarding shares to baristas since the 1990s. The company says it has granted more than $1 billion in equity under its "Bean Stock" program. It currently offers restricted stock vesting over two years to nearly all employees.

Apple Inc. in 2015 initiated a restricted-stock program that includes grants to retail employees. A worker getting $1,000 in Apple stock at that time would have seen the investment grow to more than $1,800 as of this past week, including dividends.

But Apple and Starbucks are exceptions in a corporate environment where most of the equity compensation is reserved for white-collar professionals, executives or higher-level managers. Companies, however, have plenty of cushion to reconsider this equation.

Nonfinancial businesses had amassed $2.1 trillion in cash and liquid investments by the end of last year, according to S&P Global Ratings. **S&P 500** companies are on track to buy back $800 billion in shares this year, a move designed to make the remaining shares -- the ones that aren't repurchased -- more valuable, since each share now represents a larger piece of the company.

In practice, though, a sizable portion of the repurchased shares are reissued in the form of equity-based compensation, said Jesse Fried, a Harvard Law School professor who studies compensation and buybacks.

Mr. Fried said shareholders may see aligning executive pay with stock performance as logical because senior leaders can do disproportionately more to affect a company's performance. But giving out shares at the entry level could be considered a handout.

Still, there is evidence that offering lower-level workers a modest amount of restricted stock is good for the bottom line because it generates loyalty. With the U.S. unemployment rate hitting a five-decade low this year, attracting and retaining workers has become a major challenge for companies.

Consider Shannon Rainey's story. The 34-year-old has worked his way up at Starbucks since joining as a part-timer in the summer of 2003. He's been collecting company shares under the Bean Stock plan and cashed in at various times. He used some of the proceeds to remodel a house, and is now selling stock to construct a nursery in his home as his family grows.

Now a store manager in Seattle, he tells potential employees about the stock program as a way to get them to hire on. (His contact information was provided by a company spokesman.)

Many companies take a different route, offering a cash bonus or profit-sharing. And some suggest the workaday crowd doesn't want stock compensation.

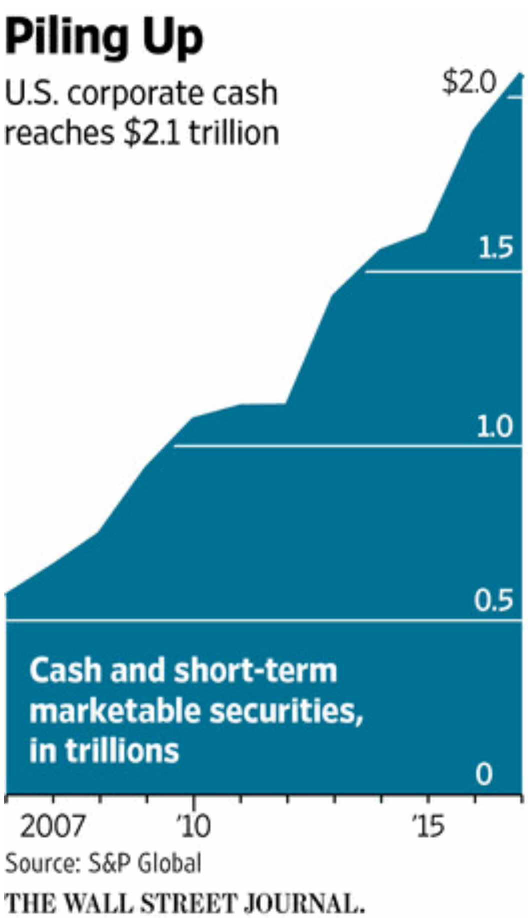
"Cash is king for rank-and-file or hourly folks," Stephanie Penner, a senior partner with human-resources consulting firm Mercer LLC, said. Still, she said, there is an appetite among all employees to get equal treatment as top executives even if they aren't getting wealthy. "It isn't the actual value of the stock that matters," Ms. Penner said. "This is a powerful recipe for an engaged workplace."

Apple earlier this year awarded $2,500 restricted-stock grants to employees following the passage of the Trump administration's tax cuts. It has also repurchased $200 billion of its stock since 2012, and its board authorized a new $100 billion buyback program this year. Meanwhile, Apple's market capitalization is approaching $1 trillion, a milestone that no U.S. company has ever reached.

The National Center for Employee Ownership, a nonprofit based in Oakland, Calif., estimates workers who make less than $30,000 a year and get equity in their company have 11% longer median job tenures than those without.

Ms. Penner said stock grants are part of a broader move by companies to improve benefits to help with retention. Longer parental leaves and education reimbursement are also becoming more widely available.

These perks are to human-resources departments what the spice rack is to a chef: "If you go to cook a chicken and you cook the chicken without spices it's going to be kind of bland," she said. "Add the right ingredients and you'll get better results."



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WSJ PRO CENTRAL BANKING

Markets

Fannie Mae Debt Sale Sets Milestone For New Borrowing Benchmark; New index taking aim at scandal-ridden Libor passes $6 billion test.

By Vipal Monga and Daniel Kruger
690 words
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A benchmark lending rate that regulators and investors hope can replace the scandal-plagued Libor as the foundation for trillions of dollars of debt from credit cards to business loans easily passed a key test.

Mortgage finance giant Fannie Mae sold $6 billion of adjustable-rate securities in the first major trial run of the new index Thursday. The sale marked a milestone for borrowers, investors and bankers as Libor, the London interbank offered rate, begins its planned wind-down from ubiquitous metric to expiration at the end of 2021.

Once obscure, Libor eventually became the foundation for trillions of dollars of derivatives and other financial contracts. More recently, it was discredited after evidence emerged that bank traders were manipulating it to boost trading profits. Banks were fined billions of dollars, and several traders were sent to prison. Since 2012, Libor has been under the supervision of U.K. regulators.

On Thursday, investor demand for the Libor-replacement proved strong enough that it could inspire other borrowers to use the new benchmark, analysts said. Known as the secured overnight financing rate, or SOFR, the new index was developed by a panel of banks and investors overseen by the Federal Reserve, as part of an effort to move contracts away from Libor.

The new product is one of several that aims to address a major challenge for the **financial markets**. Libor-based contracts cover many borrowings including floating-rate home mortgages, business loans and complex financial instruments.

"There is a massive amount of work to do to move all that risk from Libor to another index," said Michael Cloherty, head of interest-rate strategy at RBC Capital Markets. "It's a long, long path."

Fannie Mae is part of a group of financial industry associations and banks convened by the Fed in 2014 to address replacing Libor. Last year, the group approved the new rate as an alternative to U.S.-dollar-based Libor.

Libor has been calculated by asking banks how much it theoretically would cost them to borrow money from other banks, making it possible to manipulate. The new SOFR rate is averaged from more than $750 billion of short-term loans made every day, known as repurchase agreements or "repo" trades, backed by Treasury securities as collateral. Analysts expect it to be resistant to attempts at manipulation.

As of Wednesday, the SOFR rate was 1.87%, based on $753 billion worth of transactions, according the Federal Reserve Bank of New York. Fannie Mae's bonds were priced in three segments, maturing in six, 12 and 18 months, carrying rates that exceeded SOFR by 0.08, 0.12 and 0.16 percentage points, respectively.

The rate is "more robust" than Libor because it's based on actual market trades that reflect the price at which banks and other financial institutions can borrow, said Greg Moore, head of U.S. fixed income currencies and commodities at TD Securities USA, which was one of the lead managers on Fannie Mae's offering, along with Barclays Capital Inc. and Nomura Securities International Inc.

Supporting the Libor replacement has been a pressing priority for regulators and market participants as the old benchmark moves closer to disappearing. Fed Vice Chairman for Supervision Randal Quarles last week revealed data showing the dearth of transactions that reference Libor each day, and said banks are "justifiably uncomfortable" with how thin the underlying markets for Libor have become.

Still, Mr. Quarles said the transition toward the replacement rate was proceeding "ahead of schedule."

While Libor's history has been troubled, the rate will likely continue to be widely used for some time to come, said Moti Jungreis, head of global markets at TD. In part, that is because the rate is still used in trillions of dollars worth of contracts that were signed before the index fell out of favor.

Write to Vipal Monga at vipal.monga@wsj.com and Daniel Kruger at Daniel.Kruger@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

RBA Keeps Cash Rate Unchanged, Signals Concern on Trade Tensions; Caution at the RBA comes as a slew of global growth indicators point to a slowdown amid fears of an escalating trade war between China and the U.S.

By James Glynn
414 words
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SYDNEY—Australia's central bank maintained its interest rate at record lows Tuesday, but signaled uncertainty regarding the global outlook amid rising trade tensions.

The Reserve Bank of Australia left its cash rate target at 1.5%, where it has stood since mid-2016.

"One uncertainty regarding the global outlook stems from the direction of international trade policy in the United States. There have also been strains in a few emerging market economies, largely for country-specific reasons," RBA Governor Philip Lowe said in a statement.

The RBA expects an acceleration in wages growth and inflation over time, but the process will be slow.

"The low level of interest rates is continuing to support the Australian economy. Further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual," Gov. Lowe said.

Caution at the RBA comes as a slew of global growth indicators point to a slowdown amid mounting fears of an escalating trade war between China and the U.S.

Financial markets have priced in an interest rates increase for mid-2019, but some economists warn that the RBA could remain dormant much longer due to a soft housing market, and cooling in global growth.

Locally, house prices are falling, led by the major capitals of Sydney and Melbourne, feeding fears that this could slow the economy and curb consumer spending.

House price nationally have been falling for nine months in a row. Dwelling values fell 0.2% in June from May, to be 1.3% below their September 2017 peak, according to data released Monday by Corelogic.

Lending to housing investors has slumped to a 5-year low and pressure is mounting on banks to lift mortgage interest rates as money market interest rates have risen in recent weeks, eating into the profit margins of banks.

But low interest rates are supporting solid business conditions and hiring by firms continues. Participation in the labor market, especially among women, is rising, helping to ease concerns around household debt, which is among the highest in the world.

The RBA has forecast on-year GDP growth of more than 3% in 2018.

Write to James Glynn at james.glynn@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Exchange-Rate Uncertainty Was Behind Bank of Mexico's Rate Increase; Central bank had seen Nafta negotiations, higher U.S. interest rates and Mexico's recent presidential election as the main risks to the peso

By Anthony Harrup
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WSJ Pro Central Banking
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MEXICO CITY—Risks to the Mexican peso that could delay the return of inflation to the Bank of Mexico's 3% target were a major consideration when the bank raised interest rates earlier this month, minutes to the meeting showed Thursday.

The central bank's five board members all voted in favor of raising the overnight interest rate target to 7.75% from 7.5% at the June 21 meeting, although inflation had slowed to 4.5% in May from 6.8% in December.

Uncertainty over negotiations to redraw the North American Free Trade Agreement, higher U.S. interest rates and Mexico's July 1 presidential election were seen as the main risks for further peso losses, which could have an effect on consumer prices and compromise the bank's efforts to get inflation back to 3%.

"Some members pointed out that inflation may not attain the 3% target during 2019," the central bank said.

Members considered that monetary policy would play a significant role in making sure that adjustments in **financial markets**, including the foreign exchange market, remained orderly.

Since the central bank's meeting, leftist Andrés Manuel López Obrador won the presidential election by a landslide and has pledged to maintain central bank autonomy and fiscal discipline, contributing to a rally this week in the peso against the U.S. dollar.

The flare-up in Mexico-U.S. trade relations in June, when Mexico retaliated against U.S. tariffs on its steel exports with duties on a number of U.S. agricultural products, was seen having a limited and short-lived impact on inflation.

The central bank's rate move was the first in three meetings, and several members said that further increases shouldn't be ruled out.

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THE WALL STREET JOURNAL.

Business

BP Earnings Boosted by Higher Oil Prices; Recent shale deal signals renewed confidence at oil major

By Sarah Kent
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The Wall Street Journal Online
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English
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LONDON—BP PLC on Tuesday said second-quarter profit jumped, as higher **oil prices** helped the company push its ambitious growth plans.

The London-based energy producer said its replacement cost profit—a metric analogous to the net income that U.S. oil companies report—tripled from last year's second quarter to $1.8 billion.

After years of cost-cutting and financial restructuring when crude prices slumped, BP and other big oil companies are benefiting from a recovery in the market. **Oil prices** are up more than 10% since the start of the year, leading to higher profit and cash flow for producers.

Brent crude prices averaged nearly $75 a barrel from April to June, compared with an average of roughly $50 a barrel in the same three months last year.

BP's production in the first half rose 3% from a year earlier, delivering on a strategy to return to its former size by the early 2020s.

"I can't remember when it has looked this good," BP Chief Executive Bob Dudley said.

Last week, the company announced a $10.5 billion deal to acquire some of the hottest assets in U.S. shale country. The acquisition marked BP's biggest in nearly 20 years and signaled the company's growing confidence. At the same time, it said it would increase its dividend for the second quarter by 2.5%.

BP is on track with its plan to restore growth following years of retrenchment in the wake of the Deepwater Horizon blowout in the Gulf of Mexico eight years ago.

Still, penalties related to the 2010 disaster remain a financial drag. BP's landmark $20 billion settlement with the U.S. government in 2015 requires the company to make annual payments of around $1 billion through the end of the next decade. Payments in 2018 are expected to total just over $3 billion after tax.

BP caps off a mixed earnings season for the world's biggest oil companies. The likes of Exxon Mobil Corp., Chevron Corp. and Royal Dutch Shell PLC all posted sharply higher profit, but for the most part failed to impress investors who had expected even bigger windfalls.

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WSJ PRO CENTRAL BANKING

Economy

ECB Leaves Rates on Hold | Trump Discusses GDP Numbers | CFPB Enforcement Is Back | Derby's Take: No Signs Yet Fed Will Use Balance Sheet to Avert Curve Inversion; The Wall Street Journal's central banking newsletter for Friday, July 27, 2018.

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ECB Leaves Rates on Hold as It Affirms Bond Taper Plan

ECB Takeaways: Draghi Sticks to Script on Rates Guidance, Economic Outlook

Trump Discusses GDP Figures Ahead of Friday Release

Financial Regulation Roundup: CFPB Enforcement Is Back—With a Softer Touch

Derby's Take: So Far, No Signs Fed Will Use Balance Sheet to Avert Curve Inversion

So Far, No Signs Fed Will Use Balance Sheet to Avert Curve Inversion

There's a strategy the Federal Reserve could employ to ward off a potential bond market development that would strongly suggests a recession lies ahead, but Chairman Jerome Powell doesn't appear to want to use it.

At a recent congressional hearing, Rep. Andy Barr (R., Ky.) asked Mr. Powell if he had considered altering the pace of the Fed's balance sheet drawdown in to keep the bond market yield curve from inverting. Mr. Powell said no.

The curve is a graph depicting the yields on Treasurys of different maturities, normally showing long-term yields exceeding short-term yields. The difference between the two has been narrowing for some time. The gap between the yields on the two-year and 10-year notes is now so small that some observers worry it could turn negative—a so-called inversion of the yield curve. Inversions frequently precede recessions.

Some Fed officials are wary of raising short-term interest rates further if that might cause an inversion, but others aren't.

Most of them agree short-term bond yields are rising because the Fed has raised short-term rates and plans more increases. They say long-term yields are held low by a number of factors, including the central bank's large holdings of long-term bonds, a big component of its so-called balance sheet. This suggests the more the Fed raises rates, the greater the risk the curve will invert.

The Fed could relieve some of the downward pressure on long-term yields by allowing its balance sheet to shrink more rapidly. But Mr. Powell is not ready to go there. For one thing, he is among those officials who appear less worried about a yield curve inversion. But more important for him is policy continuity.

Mr. Powell said in reply to Mr. Barr the process of shrinking the balance sheet is "working smoothly" and there are no plans to alter it absent real trouble.

Mr. Powell's reticence is understandable. It was far from clear that shrinking the Fed's holdings would go so smoothly. But allowing the yield curve to invert would be a leap into some potentially dark waters, and the Fed might have to think very hard how comfortable it would be going down that road.

Key Developments Around the World

ECB Leaves Rates on Hold as It Affirms Bond Taper Plan

The European Central Bankconfirmed plans to gradually phase out easy money on Thursday but said it would probably keep interest rates steady through next summer, underscoring a growing policy divergence with the U.S. Federal Reserve. In a policy statement Thursday, the ECB said it expects to phase out its €30 billion ($35 billion) a month bond-buying program by December and switch its focus to rates. Its deposit rate was held Thursday at minus 0.4%, where it has been since March 2016. In contrast, the Fed has been gradually raising borrowing costs since late 2015 including twice this year, lifting its benchmark rate to a range between 1.75% and 2%. Fed officials have penciled in two more increases this year.

ECB Takeaways: Draghi Sticks to Script on Rates Guidance, Economic Outlook

The ECB played it safe Thursday, sticking to its plan to end bond purchases at the end of this year and repeating that interest rates will stay where they are through summer 2019. Still, ECB President Mario Draghi in his press conference touched on several topics including trade, currencies and the widening economic gap between the U.S. and Europe. Here are five takeaways.

Trump Discusses GDP Figures Ahead of Friday Release

President Trump on Thursday outlined his expectations for Friday's economic growth report, breaking from a tradition of presidents refraining from commenting on the figure ahead of its release, and predicted the numbers would be strong. "Somebody actually predicted today 5.3 [percent growth]" he said during a rally at a steel plant here. "I don't think that's going to happen." But, he continued, "if it has a 4 in front of it, we're happy. If it has like a 3, but it's a 3.8, 3.9, 3.7, we're OK."

Brazil's Current-Account Surplus Fell in June From May After Truckers Strike

Brazil recorded a $435 million current-account surplus in June, down from a $729 surplus in May, the central bank said Thursday, as the nation struggled to recover from a disrupting truckers strike. The outcome compares with a $1.3 billion surplus recorded a year earlier, bringing the 12-month result to a $13.9 billion deficit in June, wider than the $13 billion deficit recorded as of May, the bank said. June's result increased Brazil's current-account shortfall to 0.7% of gross domestic product.

Financial Regulation Roundup

CFPB Enforcement Is Back—With a Softer Touch

The Consumer Finance Protection Bureau, after pausing the policing of financial firms under Trump-appointed leadership, has restarted enforcement using a more collaborative approach than in the Obama era. Mick Mulvaney, the CFPB's acting director who has introduced pro-business changes at the bureau, said in an interview the bureau's enforcement strategy now emphasizes negotiating with target companies to settle disputes, rather than moving as quickly as Obama administration officials did to file civil lawsuits.

SEC Rejects Winklevoss Bitcoin ETF Proposal

The Securities and Exchange Commission on Thursday rejected a proposal to package bitcoin into an exchange-traded fund, the latest indication that regulators are still uneasy with the **volatile** and largely unpoliced cryptocurrency market.

Fannie Mae Debt Sale Sets Milestone For New Borrowing Benchmark

A benchmark lending rate that regulators and investors hope can replace the scandal-plagued Libor as the foundation for trillions of dollars of debt from credit cards to business loans easily passed a key test. Mortgage finance giant Fannie Mae sold $6 billion of adjustable-rate securities in the first major trial run of the new index Thursday. The sale marked a milestone for borrowers, investors and bankers as Libor, the London interbank offered rate, begins its planned wind-down from ubiquitous metric to expiration at the end of 2021.

GAO Seeks Better Promotion of Loan Program for Black Colleges

Nearly 30% of payments toward a loan program for historically black colleges and universities were delinquent last year, and three of the 46 schools have outright defaulted, according to a government watchdog report being released Thursday. The HBCU Capital Financing Program, created in 1992 to provide low-cost loans to the cash-strapped schools, had made more than $2 billion in loans as of last November, with $1.8 billion outstanding.

FRIDAY

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8:30 a.m. EDT

U.S. Commerce Department releases first estimate of second-quarter GDP

The Impact of Government Debt Supply on Bond Market Liquidity

Jeffrey Gao, Jianjian Jin and Jacob Thompson explore the relationship between government debt and bond-market liquidity in a Bank of Canada paper. Their research findings indicate "that Government of Canada benchmark bonds tend to be more illiquid over the subsequent month when there is a large increase in government debt supply." This result is stronger for the long-term than the short-term sector and "consistent with the interpretation that risk-averse dealers tend to provide less liquidity to the market when facing increased duration risks brought by large debt issuance."

Trump's Trade War Is Uniting ECB Hawks and Doves

German monetary hawks finally have something bigger than inflation to worry about, writes Melvyn Krauss for Bloomberg View. "In the current international environment, the Bundesbank would be right to go along with a policy of stretching out the withdrawal from QE. It should be open to the possibility of bringing back QE policies should the euro-zone economy falter -- or even to go for a further postponement of interest rate increases into 2020, if the need arises. The need to worry about inflation risks is much less urgent for Germany now that it is facing a hostile presence in the White House."

The Fed More Worried About Congress Than Trump

Adam Posen, Peterson Institute for International Economics president, said on CNBC, "It is Congress that the Fed fears, not the president and certainly not the president's rhetoric." He adds: "If at some point the right wing in Congress -- some Tea Party people who already were suspicious of the Fed -- you remember the Audit the Fed movement -- decides to pick up on the president's remarks and hold hearings, then the Fed has to take notice."

Several forecasters tempered their high expectations for U.S. economic growth in the second quarter based on last-minute data about factory orders, international trade and business inventories.

The number of Americans claiming new unemployment benefits rose last week from the lowest level since 1969 but remained near multidecade lows, offering evidence of the labor market's strength.

The U.S. homeownership rate continues to climb, but the rate remains historically low.

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Jon Hilsenrath; Michael Derby; Nell Henderson; Jason Douglas; Paul Hannon; Harriet Torry; Kate Davidson; David Harrison; Kim Mackrael; Tom Fairless; Michael Maloney.

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THE WALL STREET JOURNAL.

Economy
Beneath the Surface, a Solid Economy With Room to Run; The quarter's 4.1% growth points to vigorous economic expansion. Whether President Trump's policies can take credit is hard to answer

By Greg Ip
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President Donald Trump is justifiably delighted with how the economy is performing. Though the second quarter's 4.1% annualized growth is unlikely to be repeated, the underlying picture looks impressive.

Less clear is how much credit he deserves for this. President Trump has promised to elevate annual growth to 3% from 2% through deregulation, tax cuts and tougher trade policies. He'll get to 3% in the short term, most economists agree. Yet evidence that his tax cut has revived investment—key to long-term growth—remains elusive. And trade, at least using Mr. Trump's preferred yard stick of deficits, is still a drag.

To get a clear picture of the second quarter, exclude the **volatile** categories of net exports, which were boosted by soybean shipments ahead of tariffs, inventories and government. The result: 4.3% growth, even faster than the headline rate. Over the past year, it's up 3.2%, a decent proxy for underlying growth. Indeed, forecasters Macroeconomic Advisers see still-solid 3.1% growth in the current quarter.

Consumers were the standout contributor, and the tax cut helped by boosting after-tax income and wealth via last year's **stock market** jump. Still, it would take repeated tax cuts, and ever wider budget deficits, to maintain that performance—the sort of "sugar high" demand stimulus Republicans once derided. President George W. Bush's 2003 tax cut provides a cautionary tale: In the two quarters after it was implemented, growth leapt to 6%, annualized. It averaged less than 2% for the remainder of his presidency.

Yet even without the tax cut, the consumer would be in great shape. Wage growth remains subdued, but so many people are finding jobs that incomes are rising briskly. And Friday's report disclosed that wages and self-employed income were much higher in recent years than previously thought. Consumers sustained their spending without running down savings, so the saving rate, instead of sliding to around 3%, stands at 6.8%, in line with its average since 2012.

The expansion now looks to be in its late middle age, not old age. This benefits Mr. Trump, since it makes a recession less likely before he faces voters again in 2020.

The lower corporate rate cut and the ability to immediately write off capital spending for the next five years were supposed to spark business investment, and with it, worker productivity and wages. Investment certainly has boomed this year, especially for structures such as stores, factories, offices and drilling rigs—precisely the sort of long-lived investment that should respond most strongly to lower taxes.

But look closer. Oil and gas accounts for the vast majority of that, thanks to a rebound in **oil prices** and drilling from 2016 lows. Excluding that, structures investment had a strong first quarter then contracted in the second. Spending on equipment is growing briskly but no faster than before the tax cut. In fact, recent data on equipment orders point to a modest tapering.

Jason Cummins, an economist at hedge fund Brevan Howard, says the evidence suggests the tax cut has worked in the predicted direction. "We've seen some action, especially in structures, but this stuff takes time and the data is noisy," he says. "I give it a grade of 'positive signs but incomplete/too early to tell' so far."

As for trade, arithmetically, exports are added to gross domestic product and imports subtracted, which implies, wrongly, that widening trade deficits are bad for growth. (It may simply mean that consumers are in a better mood in the U.S. than elsewhere.) By that metric, trade subtracted from growth in the six months before that second-quarter soybean bump.

To be sure, Mr. Trump's tariffs didn't take effect until the past few months, and he hasn't reached any new trade deals except with South Korea. But a better bet is that trade will be driven mostly by countries' differing growth, exchange rates and commodity prices, not trade war.

Growth has clearly picked up since Mr. Trump became president even if his policies aren't the main reason why. Is it sustainable? The economy last hit this pace in 2014 and 2015, before slipping back. Sustained growth requires both faster growth in the pool of workers and in their productivity. For now, the former is happening. Employer demand is pulling in both the unemployed and workers who were never recorded as unemployed. But eventually the U.S. will run out of workers, especially if immigration shrinks, as Mr. Trump intends.

That leaves productivity. I estimate it grew 1.3% in the past year—still historically slow, though an encouraging pickup. It will take a few more years to determine if it returns to an old normal or a new one.

Write to Greg Ip at greg.ip@wsj.com

More

* Consumers, Business and Exports Power Strong GDP Growth

* What Fueled Second-Quarter U.S. Growth

* Analysis: Flawed Report, but Solid Outlook

* Fourth Quarters Are New Growth Laggards

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WSJ PRO CENTRAL BANKING

Economy
Fed Chair Jerome Powell Says Trade Policies Complicate Economic Outlook; Bank official speaks in interview with Marketplace radio program to air later Thursday

By Nick Timiraos
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Federal Reserve Chairman Jerome Powell said a strong economy should allow the central bank to keep raising interest rates gradually and it was premature to judge how recent trade policy actions could alter those plans.

Mr. Powell spoke in an interview on the Marketplace radio program set to air Thursday evening. He is scheduled to testify on Capitol Hill next week in semiannual congressional hearings.

"I sleep pretty well on the economy right now," Mr. Powell said in the interview, according to a transcript posted online Thursday afternoon.

Mr. Powell pointed to considerable uncertainty around the range of possible economic effects of recent trade measures and how they might influence the Fed's plans for raising short-term interest rates.

"We don't know. It's very hard to sit here today and say which way that's going," he said.

If the Trump administration is successful over time in lowering trade tariffs, "then that'll be a good thing for our economy," Mr. Powell said. "If it works out other ways, so that we wind up having high tariffs on a lot of products ... and that they become sustained for a long period of time, then yes, that could be a negative for our economy."

In his most direct comments on the issue to date, Mr. Powell highlighted a worse-case scenario, of sorts, for the Fed. "You can imagine situations which would be very challenging, where inflation is going up and the economy is weakening," he said.

The Trump administration on Tuesday announced a third round of tariffs on $200 billion of Chinese products, which could provoke new retaliation from Beijing. The administration has also imposed tariffs on imported steel and aluminum from the European Union, Canada and Mexico, leading those countries to set their own tariffs on U.S. exports.

Mr. Powell has largely refrained from commenting on trade policy because he has said it isn't part of the Fed's responsibilities. "When we don't make policy, we don't praise it; we don't criticize it," he said Thursday, explaining his hands-off approach.

Strong economic growth, low unemployment and stable price pressures have made it easier for Fed officials to agree on a policy of gradually lifting rates to a level they consider neutral, meaning they will seek to neither spur nor slow growth.

The Fed has raised its benchmark federal-funds rate twice this year, most recently in June to a range between 1.75% and 2%, and officials last month penciled in two more rate increases this year and three more next year.

While estimates of the so-called neutral level vary, most officials believe it is around 2.75% or 3%. If the Fed sticks to its anticipated policy path, the rate could reach its estimated neutral level by next spring or summer.

The Fed's mandate from Congress is to maximize sustainable employment and ensure prices are stable, which the central bank defines as meeting a 2% inflation target.

The Fed is closer to meeting those goals than at any point in the past decade. Consumer prices in May rose 2.3% from a year earlier. Excluding **volatile** food and energy categories, they rose 2%, according to the Fed's preferred inflation gauge.

"We're really close to our target. I wouldn't say we've fully achieved it yet," Mr. Powell said.

Fed chairs have traditionally done such on-the-record interviews only sparingly, and Thursday's appearance offers the latest example of Mr. Powell's desire to demystify what the central bank is doing and why.

Alan Greenspan, for example, did just one television interview, on NBC's "Meet the Press" in 1987, a few months into his 19-year term as chairman. He never did another such appearance as Fed chairman. His successor, Ben Bernanke, spoke to CBS's 60 Minutes in 2009 and 2010 and to ABC News in 2012.

Mr. Powell, who began a four-year term as chairman in February, said last month he would double the frequency of his regular news conferences next year. He will take questions from the media after every meeting of the Fed's rate-setting committee, rather than at every other meeting.

Mr. Powell also has expressed a desire to speak more casually about the economy, which reflects his nonacademic background. "It would be harder" to explain things more clearly to the public, he said Thursday, if he had spent "30 years, for example, teaching economics to graduate students."

He described the latest communication changes as part of a long-running push toward transparency at the central bank that began under Mr. Greenspan. "I'm just carrying that forward in my own particular way," he said.

Later, when Mr. Powell said he couldn't easily explain why wages haven't been rising more given complaints from employers about labor shortages, he brushed aside concern that he might not know the answer, revealing uneasiness with the perception of an omniscient central bank chief.

Radio host Kai Ryssdal said the response was "a little troubling, if you're the guy running the economy."

Mr. Powell responded, "I don't think of myself as the guy running the economy."

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International New York Times

business
Saudi Arabia Promised More Oil. So Why Are Prices Rising?

By STANLEY REED
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LONDON — When major oil producers last met in Vienna, they said they would curb rising prices by ramping up production. Why, then, are **oil prices** still going up?

Officials from the Organization of the Petroleum Exporting Countries, and other major oil producers like Russia pledged last month to increase total output by around 1 percent of the global oil supply. President Trump has pressed the issue further, repeatedly calling for lower **oil prices**.

Yet prices have remained stubbornly high. The price of Brent crude, the international benchmark, has risen more than 20 percent so far this year, to around $78 a barrel.

Here are some of the factors pushing prices higher.

Risky Producers

Saudi Arabia is under pressure to quickly increase its production of oil, but those increases may not be enough to offset declines in three countries grappling with crises: Iran, Libya and Venezuela.

The Trump administration has softened demands that countries like China and India end all imports of oil from Iran. But Mr. Trump has nevertheless sought to line up support against Tehran as the United States prepares to reimpose sanctions on its energy sector.

At present, Iran exports around two million barrels of oil a day, equivalent to about 2 percent of global supply. But the United States wants to drastically curb Tehran's ability to sell its natural resources, eating into any additional supply from Saudi Arabia, Russia or elsewhere.

"The administration is posturing, to a certain extent, with this hard-line position," said Andrew Keller, a former state department sanctions expert who is now a partner at the law firm Hogan Lovells.

Still, analysts have been increasing their estimates of how far Iranian crude exports are likely to fall, from a few hundred thousand barrels a day to around a million. A loss in the upper end of that range would wipe out much of the added supply that oil producers had promised in Vienna.

That looming outage is far from the only potential disruption weighing on the oil markets.

Venezuela, once a major producer, has nearly halved output, to less than 1.4 million barrels a day, as its economy has cratered and international sanctions have been imposed on the country. Further declines seem almost certain.

Fighting among various armed factions in Libya, meanwhile, has meant that the North African country will not be able to supply around 850,000 barrels a day, most of its output.

"It is almost turning into a geopolitical perfect storm for the oil markets," said Helima Croft, an analyst at RBC Capital Markets, an investment bank. It will be tough for Saudi Arabia, she added, "to bridge the gap caused by Venezuela, Iran and now Libya."

Supply and Demand

Oil is not in short supply — for now.

Long-running production cuts by OPEC and Russia have drained once-brimming storage tanks to more normal levels. That means that any threats to output have a bigger effect on **oil prices**.

With the world economy growing and demand for energy on the rise, “prices can skyrocket well past $100 a barrel,” unless supplies are quickly found to meet any potential outages, analysts at the oil and gas consultancy FGE wrote in a note to clients.

Saudi Arabia is already preparing to replace the falling supplies from Iran and elsewhere — Saudi exports increased substantially in June, while storage levels also rose, according to analysts at Kayrros, a Paris-based firm that monitors oil industry activity using satellite data. Russia is increasing its own exports.

But there is skepticism as to how much either country can do, and for how long. Riyadh claims to have two million barrels a day of spare production capacity, but analysts say the kingdom can realistically add only about one million barrels to its daily output without additional drilling.

Most forecasters agree that a substantial global buffer now exists, but that it could be stretched in the future. Wood Mackenzie, an energy consultancy, estimates global spare capacity to be 2.5 million barrels a day of additional production, most of it in OPEC.

Threats to production in Iran, Libya and Venezuela eat into that potential, and Nigeria’s supplies are also vulnerable to strikes by workers and other issues. The oil market’s increased dependency on crude exports from the United States poses its own risks, because Gulf Coast ports can be shut down by hurricanes in the summer and the fall.

Politicized Markets

On top of all these factors, oil markets are also becoming increasingly politicized, potentially adding to **volatility**.

Mr. Trump has, for example, been unusually vocal for an American president in trying to push gasoline prices down by asking King Salman of Saudi Arabia to increase production.

But analysts say Iran’s reaction to renewed United States sanctions could affect the market’s dynamics even more. If the country’s oil exports sink below one million barrels a day, the situation could “get really dangerous,” said Homayoun Falakshahi, an Iran energy analyst at Wood Mackenzie.

Iranian officials have been vocal about the dangers. In a telephone interview from Tehran, Hossein Kazempour Ardebili, a high-ranking Iranian oil official, warned that prices could rise to $100 a barrel, or even $140 a barrel, unless tensions were cooled down. “You better keep the market away from politics,” he said.

Follow Stanley Reed on Twitter: @stanleyreed12.

PHOTO: An oil tank farm in Ras Tanura, Saudi Arabia. More Saudi output may not be enough to offset declines in Iran, Libya and Venezuela. (PHOTOGRAPH BY CHRISTOPHE VISEUX FOR THE NEW YORK TIMES)

* Trump Pressures Saudi Arabia to Increase Oil Production

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THE WALL STREET JOURNAL.

Markets

The Pension Hole for U.S. Cities and States Is the Size of Germany's Economy; Many retirement funds could face insolvency unless governments increase taxes, divert funds or persuade workers to relinquish money they are owed

By Sarah Krouse
2,047 words
30 July 2018
The Wall Street Journal Online
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English
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Corrections & Amplifications

Moody's Investors Service estimates state and local pensions have unfunded liabilities of about $4 trillion, roughly equal to the economy of Germany, the world's fourth-largest economy. An earlier version of this article and its headline incorrectly said $5 trillion, roughly equal to the output of the world's third-largest economy, Japan, based on incorrect data provided by Moody's. (August 1, 2018)

For the past century, a public pension was an ironclad promise. Whatever else happened, retired policemen and firefighters and teachers would be paid.

That is no longer the case.

Many cities and states can no longer afford the unsustainable retirement promises made to millions of public workers over many years. By one estimate they are short $4 trillion, an amount that is roughly equal to the output of the world's fourth-largest economy.

Certain pension funds face the prospect of insolvency unless governments increase taxes, divert funds or persuade workers to relinquish money they are owed. It is increasingly likely that retirees, as well as new workers, will be forced to take deeper benefit cuts.

In Kentucky, a major pension plan covering state employees had about 16% of what it needs to fulfill earlier promises, according to the Public Plans Database, which tracks state and local pension funds, based on 2017 fiscal year figures. A fund covering Chicago municipal employees had less than 30% of what it needed in that fiscal year, according to the same database. New Jersey's pension system for state workers is so underfunded it could run out of money in 12 years, according to a Pew Charitable Trusts study.

When the math no longer works the result is Central Falls, R.I., a city of 19,359. Today, retired police and firefighters are wrestling with the consequences of agreeing to cut their monthly pension checks by as much as 55% when the town was working to escape insolvency. The fiscal situation of the city, which filed for bankruptcy in 2011, has improved, but the retirees aren't getting their full pensions back.

"It's not only a financial thing," said 73-year-old former Central Falls firefighter Paul Grenon, who retired from the department after a falling wall punctured his lung, broke his back and five ribs, and left him unable to climb ladders. "It really gets you sick mentally and physically to go through something like this. It's a betrayal, as far as I'm concerned."

Uncertainty over public pensions is one reason some Americans are reaching retirement age on shaky financial ground. For this group, median incomes, including Social Security and retirement fund receipts, haven't risen in years. They have high average debt, and are often using savings for their children's educations and to care for their elderly parents.

The public pension arose from the aftermath of the U.S. Civil War. New York was the first city in the U.S. with a pension fund for injured police officers in 1857 and then for firefighters in 1866. The concept of a public pension plan for government workers became widespread in the early decades of the 20th century. The understanding was employees would accept relatively lower pay in exchange for richer, guaranteed benefits once they retired.

Expanded lifespans

When times were flush, politicians made overly generous promises. Public-employee unions made unrealistic demands. High-profile municipal employees, such as coaches at public universities, have drawn fire for what some consider too-rich retirement benefits, while some first responders scored rich early retirement and disability arrangements.

Extended lifespans caused costs to soar, as did increasingly expensive medical care, which unions put at the center of contract negotiations, among other benefits.

A technology-led **stock market** boom in the late 1990s produced a brief period of surpluses in pensions, according to figures from Pew, before deficits began to creep higher in the mid 2000s. Deficits accelerated following the 2008 financial crisis, which caused steep losses for many funds just as large numbers of baby boomers began to retire.

State and local pensions lost roughly $35 billion in assets between 2008 and 2009, according to Pew. Liabilities, meanwhile, ballooned by more than $100 billion a year, widening the difference between the amount owed to retirees and assets on hand. Not even a nine-year **bull market** in stocks could close that gap.

Officials, taxpayers and public-sector employees are increasingly at odds as they figure out what comes next. The board overseeing Puerto Rico, which filed for the largest-ever U.S. municipal bankruptcy in 2017, this year certified an average 10% cut in certain retiree pensions as part of a plan to restore the island to solvency. The governor has vowed not to implement it, a face-off that will likely end in court.

In the Bluegrass State, a judge in June ruled that a reduction in new worker benefits championed by Kentucky's governor was unconstitutional because of the way lawmakers passed it. The state's attorney general opposed the cuts. The case could end up at the state Supreme Court.

In California, several cases before the state's Supreme Court are testing an influential 1955 rule that stipulates benefits for public employees can't be cut. Gov. Jerry Brown is predicting pension reductions in the next recession if that rule is loosened. A change in that law might persuade other states to reach for deeper benefit reductions.

State and local pension plans in the U.S. now have less than three quarters of the money they need to meet their promised payouts, their lowest level since at least 2001, according to Public Plans Database figures weighted by plan size. In dollar terms the hole for state and local pensions is now $4 trillion, according to Moody's Investors Service. Another estimate of unfunded state pension liabilities, from Pew, is $1.4 trillion.

The prospect of lower benefits is particularly daunting for pensioners in their 60s. Those older are likely to die before a large reckoning, while those younger have years left in their careers to make new plans. But many in their 60s have spent four decades assuming a financial promise that is no longer guaranteed.

There are few easy solutions. Cities and states can either raise taxes, cut services or become more aggressive about reducing benefits to retirees. For many years governments were unwilling to take these steps because they weren't politically palatable, although public appetite to cut public-employee benefits is emerging, in states including Wisconsin. Many governments opted to change benefits for new employees, which in some cases didn't fully alleviate funding woes.

In San Jose, Calif., voters approved cuts to police pensions in 2012 only to roll back those changes after hundreds of officers quit and the crime rate increased. The measures were revised, with savings coming in part through changes to retiree health care.

San Jose Mayor Sam Liccardo said the bulk of the police departures took place before the pension revamp as a result of earlier hiring freezes, layoffs and pay cuts. He doesn't see the pension changes as a factor in the crime rate.

'Our medicine'

San Jose has taken "our medicine perhaps earlier than others have," said Mr. Liccardo. "This is medicine that hundreds of cities and many states are going to have to take," he added.

Retirees in other cash-strapped states said they expect to lose some of what they have been promised. "It may sustain itself before I die," Len Shepard, 68, a retired teacher in Pennsylvania said of the pension system in his state. "But I don't see how it can continue to do so."

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Central Falls, which sits 7 miles north of Rhode Island's capital, is one of several former industrial towns that speckle the Blackstone River Valley.

It provided for public workers under a number of pension plans. Under one, firefighters hired after July 1972 could retire after 20 years of service, essentially in early middle age, receiving half of their final base salary. They could earn another 2% a year for up to five additional years of work and 1% a year after that, up to 65% of their end salary if they retired after 30 years.

The city's required contribution to its police and fire pensions was about $4 million in fiscal year 2011, the last fiscal year before its bankruptcy, or 20% of the total, said Finance Director Leonard Morganis.

Central Falls didn't pay that year, or in either of the previous two, given the severity of the city's economic woes. Rhode Island officials then took the rare step of passing legislation that put bondholders ahead of other creditors and pensioners in the event of a municipal bankruptcy.

After the 2011 bankruptcy, an event that received national attention amid predictions of widespread municipal failures, retirees agreed to 55% cuts because they feared facing even deeper cuts later.

The concessions helped Central Falls emerge from bankruptcy in 2012 and create a "rainy day fund" that now holds $2 million. The town hired a grant writer to help secure money for a new firetruck with smaller wheels custom-made for the town's narrow streets. The truck is emblazoned with an image of Yosemite Sam dressed as a firefighter that reads "The Wild Mile," the city's nickname.

Even though the town is on a better fiscal footing, and state contributions blunted the full impact of the cuts, retired workers are still grappling with how their lives were altered in matters big and small. Two men lost their homes to foreclosure after falling behind on their mortgages. Others had problems paying medical bills as they fought terminal illnesses.

Mr. Grenon, the firefighter who retired after he was injured, says the pension reduction left him without enough money each month to cover a $300 prescription lung medication. He has medical coverage but said the medication is beyond what is covered.

George Aissis, a retired Central Falls firefighter, says he has so little left in his checking account he has to buy groceries when they are on sale and use as little power or gas as possible.

The pension settlement cut his income by $1,200 a month to about $2,600, including an additional state contribution. On one recent Wednesday, he said there was $6.01 in his checking account.

"I never used coupons before, but I know about coupons now," Mr. Aissis said. "You gotta cut back on things when the money is not there."

Central Falls Mayor James Diossa, in an interview, called the 2011 pension cuts "unfortunate" but said they did alleviate long-term budget pressures for the city. "These aren't big pensions, but a lot of these folks built their lives around it," he said. "To see them get cut was devastating."

Working longer

Under the changes, many current workers have to work longer than they thought when they signed up and some will get a lower percentage of their final salary than they would have under the old plan. Some retirees whose income was cut are now arguing their benefits should be restored to prebankruptcy levels.

The person in charge of that effort, 52-year-old former firefighter Don Cardin, acknowledged he and his colleagues have no legal recourse to restore lost benefits since they signed them away in the settlement.

One of his bleaker arguments contends that firefighters tend to have shorter lifespans because of smoke inhalation and other workplace hazards. That means the town, which also covers some health benefits, is unlikely to have to pay the added benefits for more than a decade.

Despite the city's surplus, the mayor said Central Falls is unlikely to restore the pensions.

What happened in Central Falls is "certainly not going to be a one-off," said Robert Flanders, who acted as the city's state-appointed receiver. "Because other cities and towns, not just in Rhode Island but across the country, are still in bad shape."

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THE WALL STREET JOURNAL.

Markets
Behind the Flattening Yield Curve: Fed Rate Increases and Tariff Fights; The yield gap between short- and long-term Treasurys is its narrowest in nearly 11 years

By Daniel Kruger
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The gap between yields on short- and longer-term Treasurys has narrowed to nearly 11-year lows, a sign investors remain cautious about the outlook for economic growth even as they expect the Federal Reserve to continue raising interest rates.

The difference between the yields on two- and 10-year U.S. government notes on Thursday settled at 0.279, its narrowest since August 2007, according to data from Ryan ALM. Two-year yields typically climb along with investor expectations for tighter Fed interest-rate policy, while longer-term yields are more responsive to sentiment about the outlook for growth and inflation.

The dispersion between shorter-term and longer-term rates, known as the yield curve, is a crucial indicator of sentiment about the prospects for economic growth. Investors monitor the curve closely because short-term rates have exceeded longer-term ones before each recession since at least 1975—a phenomenon known as an inverted yield curve.

The flattening has occurred as U.S. economic growth remains steady and few analysts see signs of an imminent slowdown. That leaves many split on what the signal shows now.

Investors will be watching Friday's June jobs report from the Labor Department for signs a tight labor market is producing wage inflation, which could push long-term yields higher and steepen the curve. Low wage growth, in contrast, could drag longer-term yields down, flattening the curve further. Inflation poses a threat to the value of government debt, especially longer-dated bonds, because it erodes the purchasing power of their fixed payments.

For now, many analysts remain sanguine about the recent curve flattening. Two-year yields have climbed as policy makers have raised rates to normalize monetary policy following extraordinary stimulus undertaken in the wake of the financial crisis. They have signaled the possibility of two more rate increases this year.

That has kept upward pressure on short-term rates as the Treasury also is selling more short-term debt to fund tax cuts and government spending.

At the same time, the 10-year yield has retreated from a nearly seven-year high reached in May, weighed down by trade-war fears. The concern is that trade tensions will disrupt global growth, tempering expectations for an economic surge spurred by recent tax cuts. Investors also have bought Treasurys, a haven asset as tariff fears have rattled markets around the world.

Some observers contend those circumstances negate the traditional signal sent by a flattening yield curve. Following five of the past six periods in which the yield curve inverted, the economy tipped into recession within a year, according to data from the St. Louis Fed.

"It's a red flag, and you need to be cognizant of what's driving it," said Sean Simko, head of global fixed-income management at SEI Investments. Mr. Simko said his firm has placed trades that benefit from a flatter curve, and that he expects it to invert by year-end as trade restrictions slow growth and the Fed continues to raise interest rates.

The 10-year yield reached 3.109% in May, propelled from 2.409% at the end of 2017 by a burst of investor optimism that tax cuts would lead to an acceleration of growth, wages and inflation. With trade tensions dimming those prospects, the 10-year yield probably has peaked for the year, Mr. Simko said.

One reason the curve has flattened is that long-term yields have been held down because capital spending hasn't picked up the way some forecasters expected after the 2017 tax cuts, said Krishna Memani, chief investment officer at OppenheimerFunds Inc.

"A couple more Fed tightenings and we're pretty much there" at a flat yield curve, Mr. Memani said.

Signs of inflation persist, however: The personal-consumption expenditures price index, the Fed's preferred inflation yardstick, rose 2.3% in May from a year earlier, its biggest annual rise since March 2012, the Commerce Department said Friday. That beats the Fed's 2% target.

Additionally, few observers see a recession on the horizon. The economic expansion likely will end in 2020 as Fed interest-rate increases cool off an overheating economy, according to forecasters surveyed by The Wall Street Journal. The survey was completed in May, before the Trump administration stepped up its tariff campaign.

Yet recent escalations in trade tensions have spurred increased **volatility** in **financial markets**, making some investors more anxious. Doug Peebles, chief investment officer at Alliance Bernstein Fixed Income, said that has made risky assets including stocks and emerging-market bonds less attractive, and he recommends investors reallocate more funds to the safer assets such as Treasurys, he said.

Rather than serving as a gauge of future economic performance, the yield curve is "probably the most important tool we have in explaining the backdrop for risk-taking" in **financial markets**, he said.

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The New York Times

Business Day
Fed Plays Down Trade Woes and Suggests Rosy Economic Outlook

By Jim Tankersley
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WASHINGTON — Federal Reserve officials presented a rosy economic report card to Congress on Friday, playing down risks to growth from trade tensions and declaring that the financial system is "substantially more resilient than during the decade before the financial crisis."

The Fed released its semiannual Monetary Policy Report just ahead of scheduled testimony before the House and Senate next week by Jerome H. Powell, the Fed chairman.

The Fed's report suggests officials are likely to stay on their telegraphed path of gradually raising interest rates to bring them back to historically normal levels. Officials raised rates at their June meeting, to a range of 1.75 to 2 percent, and signaled that they could raise rates twice more for a total of four rate increases this year.

At times, the report reads like a bit of self-congratulation among Fed officials for their performance in recent years, including steering inflation close to the Fed's 2 percent annual target, supporting strong economic growth and a low unemployment rate, and pushing Wall Street firms to strengthen their defenses against a potential financial shock.

It drops language from previous reports that stressed worry that inflation would continue to run below the target. It also reaffirms that economic activity "increased at a solid pace" for the first half of the year and that "the labor market has continued to strengthen."

The report highlights some lingering concerns in the economy, most notably slow wage growth. Adjusted for inflation, earnings for most American workers have not risen in the past year. Other measures, which include employer-provided benefits such as health care, have increased after inflation is factored in, but not by as much as could be expected when the unemployment rate is about 4 percent.

Officials blamed that sluggishness on persistent weakness in labor productivity.

"Those moderate rates of compensation gains likely reflect the offsetting influences of a strong labor market and persistently weak productivity growth," officials wrote.

The economic development that has most concerned stock markets and economists in recent months — the Trump administration's escalating trade war with China and allies like Canada, Mexico and the European Union — barely registers in the report as a threat to the recovery.

While noting that trade concerns have rattled stock traders, bond buyers and currency markets, officials said they were confident that the Fed's current policy path was the right one to handle those concerns.

"Many participants continued to express the view that the appropriate trajectory of the federal funds rate over the next few years would likely involve gradual increases," officials wrote. "This view was predicated on several factors, including a judgment that a gradual path of policy firming likely would appropriately balance the risks associated with, among other considerations, the possibilities that U.S. fiscal policy could have larger or more persistent positive effects on real activity and that shifts in trade policy or developments abroad could weigh on the expansion."

The report includes several observations about the evolving structure of the United States economy that carry implications for policymakers, particularly members of Congress and the administration as they seek to get able-bodied individuals back to work. The Fed attributes a decline in work force participation among less-educated Americans in part to technological advancements that have automated jobs.

And it says a decline in participation among women, as compared with other industrial nations, is being driven by family policies in the workplace that do not support working parents.

“Caregiving responsibilities play an important role” in explaining why prime-age women participate less in the work force than men, the report says. “This decision may reflect a lack of affordable child care.”

The report notes that rising **oil prices** have cost American families, on average, $300 a year more in gasoline. But it makes the case that **oil price** increases are far less damaging to the economy over all than they used to be, because of a surge in domestic oil production over the last decade.

That surge means that more of the money Americans spend on gasoline now stays in the country, the report says: “On net, the drag on G.D.P. from higher **oil prices** is likely a small fraction of what it was a decade ago and should get smaller still if U.S. oil production continues to grow as expected.”

* Trump’s Ace in the Hole in Trade War: A Strong Economy

* Fed Raises Interest Rates and Signals 2 More Increases Are Coming

The Federal Reserve chairman, Jerome H. Powell, will appear before lawmakers next week to discuss the Fed’s view of the economy. | Jacquelyn Martin/Associated Press

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THE WALL STREET JOURNAL.

Business
Drugmakers Call Experimental Alzheimer's Drug Study Positive; Biogen, Eisai shares jump on study news; too soon to say drug marks real advance, experts say

By Daniela Hernandez and Peter Loftus
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An experimental Alzheimer's drug showed positive results and raised hopes anew that pharmaceutical companies were moving closer to a medicine that could finally disrupt the disease's memory-robbing course, though a string of failures shadow the efforts.

Alzheimer's has proved an especially tough drug target. Approved therapies only relieve symptoms temporarily, and one experimental treatment after another promising to stymie the neurodegeneration has ultimately failed to work. Some pharmaceutical companies, after costly failures, pulled out.

Which is why Friday's news from Boston biotech Biogen Inc. and Japan's Eisai Co. that their experimental drug showed positive signs was cheered by caregivers and doctors, and drove shares in the companies up by double-digit percentages.

The data are preliminary—the companies released topline results from a mid-stage study looking for the right dose—and researchers warned other, similar medicines also showed promise early, only to fail during subsequent and more extensive testing.

Yet even skeptics looked forward to reviewing the findings in more detail, and to learning through further studies whether the drug might actually work.

The study results "definitely merit a further look and a broader trial, given the fitful efforts to find effective treatments for Alzheimer's disease that have been ongoing for decades," said Mark Ginestro, a principal for health-care and life-sciences strategy at KPMG in San Francisco. "The stage is set now for a larger study of the drug."

Biogen and Eisai said their drug, code-named BAN2401, slowed the progression of Alzheimer's disease compared with a placebo in study subjects taking the highest dose. The companies also said the drug reduced the amount of clumps of a protein called beta amyloid that build up in the brains of patients.

Many researchers believe the beta-amyloid clumps play a key role in Alzheimer's. Biogen and Eisai said in a news release issued Thursday evening that the "positive topline results" from their phase 2 trial bolster the idea that targeting the beta-amyloid clumps could help patients.

"Neurodegenerative diseases may not be as intractable as they once seemed," Biogen Chief Medical Officer Alfred Sandrock said in a statement.

An estimated 5.7 million Americans live with Alzheimer's, a figure expected to rise as the population ages, the Alzheimer's Association says.

Families and doctors have long sought a drug that actually disrupts Alzheimer's course. Analysts estimate the market for such disease-modifying drugs could be worth more than $10 billion in yearly sales. But several compounds that showed promise ultimately failed.

Axovant Sciences Ltd. shut down development for a once-highly anticipated treatment in January, days after Pfizer Inc. pulled out of the space. Last month, Eli Lilly & Co. and AstraZeneca PLCscrapped two trials of an experimental drug after concluding it wasn't likely to hit its efficacy goal.

The promise and peril of Alzheimer's research have caused wild swings among the stocks of drug companies.

Eisai shares jumped nearly 20% Friday in Tokyo. The surge in Biogen's **stock price**, also nearly 20% on the **Nasdaq Stock Market**, added more than $12 billion to the company's market value, raising it to more than $75 billion. Yet companies have also lost billions of dollars in valuation when their drugs didn't work.

Some of the companies that dropped their programs decided to use their venture arms to invest in early-stage start-ups.

For researchers, the setbacks have generated concerns that not enough is known about the brain and Alzheimer's to develop effective medicines. The setbacks have raised doubts about whether attacking the beta-amyloid clumps is the right strategy.

Some scientists have said it is too early to pull the plug, while others say the field needs more innovative approaches to treatment.

The Alzheimer's Drug Discovery Foundation, which funds trials of therapies, counted 126 of them in clinical development. Beta amyloid is the most common drug target being tested in human trials, a 2017 foundation report said.

Lon S. Schneider, an Alzheimer's researcher at the University of Southern California's Keck School of Medicine, warned against reading too much into the Biogen and Eisai news release. The study was designed to find the right dosage for a late-stage trial, he said. At this point, it would be "complicated" to assess the drug's benefits, he added, because the trial allowed a patient who started on a lower dose to be reassigned later to a higher dose.

"It remains to be seen" whether the therapy will have "meaningful" clinical effects in a later-stage study, Dr. Schneider said.

Analysts said questions remain about the results of the BAN2401 study. For one thing, researchers used a novel measure of efficacy that was developed by Eisai's in-house researchers, rather than standard measures in the field.

"More independent assessment of the clinical effects, such as they are, will be required before the value of BAN2401, or its contribution to the validation of beta amyloid as a therapeutic target, can be assessed," Leerink Partners analyst Geoffrey Porges said in a research note.

One unresolved question is what changed since the companies reported in December that BAN2401 didn't show clinical benefits in subjects at 12 months of treatment. In their latest announcement, the companies said they analyzed the trial's data using different, more conventional methods than in December. Using such statistical methods, the companies said they found a benefit at both 12 and 18 months of treatment in subjects given the highest dose.

The study involved 856 subjects in the early stage of the disease. Among the side effects that the companies reported were reactions at the sites of the infusion and swelling around blood vessels observed with brain imaging.

The companies said they plan to present the results in detail at academic conferences.

Biogen and Eisai also are developing another Alzheimer's drug, known as aducanumab, which is in late-stage studies. Like BAN2401, aducanumab clears the brain of beta-amyloid plaques, and some analysts said Biogen's latest results augur well for aducanumab. Yet, Raymond James analysts say there are differences between the drugs and the designs of their respective clinical trials.

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WSJ PRO CENTRAL BANKING

Markets

Chinese Yuan Rebounds; China's central bank earlier guided the currency to its largest one-day drop against the dollar in 18 months

By Saumya Vaishampayan and Chelsey Dulaney
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The Chinese yuan rallied against the dollar Thursday, but investors remain on edge over recent moves by the country's central bank to guide the yuan lower amid an intensifying trade fight with the U.S.

The Chinese currency rose 0.5% against the dollar in offshore markets during Thursday's U.S. trading session, extending a rebound that began in Asian trading. That came after the People's Bank of China guided the yuan down by 0.7% at its daily fixing, the largest-one-day decline in 18 months.

Onshore, where the currency is allowed to trade as much as 2% above or below the daily fixing, the yuan in late trading was little changed against the dollar.

The yuan has declined more than 2% against the dollar in 2018, retracing gains made early in the year. It has also reversed its annual advance against a basket of currencies weighted by trade volumes, according to a gauge published by Wind Info.

A weaker currency would make China's exports cheaper and could help cushion the impact of U.S. tariffs on China's economy, which has already been slowing. On Tuesday, the U.S. said it would impose 10% tariffs on $200 billion in Chinese products, less than a week after the countries placed tariffs on $34 billion of each other's goods.

Still, a currency depreciation would be risky for China. In 2015, an unexpected devaluation in China's yuan sparked capital flight as Chinese companies, citizens and investors sought to escape further declines. Allowing the yuan to weaken too fast could revive those outflows, adding further downward pressure on the currency that economists warn could become difficult for Beijing to manage.

Volatility in China's markets has also proved destabilizing to global markets in recent years because of the country's outsize role in the global economy. Many U.S. companies have large businesses in China, and weakening growth there has sometimes weighed on revenue of companies such as Caterpillar Inc.

China also is one of the largest users of commodities such as coal and iron ore; softer demand for those products has rattled those markets and the economies of the countries that export them.

So far, analysts see few signs that China is aiming for a currency devaluation.

In addition to the trade-related worries that have driven investors to dump the yuan, monetary policy is also weighing the currency down. While China's central bank could cut interest rates or free up banks to lend more in coming months, the U.S. is expected to keep raising interest rates.

"This is very different from 2015, when it was the PBOC who initiated the move," said Eddie Cheung, Asia currency strategist at Standard Chartered Bank, referring to a previous devaluation. "This time around, it's driven by the market," Mr. Cheung said. "The PBOC has been leaning against all of this."

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WSJ PRO CENTRAL BANKING

Economy

Global Week Ahead: U.S., Japan and Brazil Policy Meetings; U.S. to receive figures on personal income and jobs

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In the week ahead, central banks including the U.S. Federal Reserve, Bank of Japan and Brazil's central bank will hold policy meetings. On the data front, the eurozone will see second-quarter gross-domestic product figures, while the U.S. will receive figures on personal income and jobs.

TUESDAY: The Bank of Japan concludes its regular policy meeting. Policy-board members may consider ways of giving more flexibility to the BOJ's policy of fixing the yield on the 10-year government bond at zero. After nearly two years of stasis, market watchers are watching whether the BOJ backs away from its monetary-easing policy.

The eurozone economy slowed at the start of 2018, and gross domestic product figures for the second quarter aren't expected to record a rebound. At around 1.6%, growth is expected to be well below the 4.1% recorded by the U.S. during the three months through June, ending a period in which the two or growing at similar speeds.

The U.S. Federal Reserve begins a two-day policy meeting in Washington. The Fed is widely expected to leave its benchmark rate unchanged at its policy meeting and then increase it in September by a quarter-percentage-point to a range between 2% and 2.25%. Central bank officials have raised rates twice this year, and penciled in two further increases this year and three in 2019.

The U.S. Commerce Department releases the June report on personal income and spending. In May, personal-consumption expenditures increased a seasonally adjusted 0.2% from the prior month, while personal income rose 0.4% in May. Economists will also parse the report for signs of continued strengthening in inflation. May's data shows the price index for personal-consumption expenditures, the Federal Reserve's preferred inflation measure, was up 2.3% from a year earlier, exceeding the central bank's 2% target. Economists surveyed by The Wall Street Journal expect personal income rose 0.3% in June, while consumer spending was up 0.4%.

WEDNESDAY: Brazil's central bank is widely expected to keep rates steady at a historic low of 6.5% on Wednesday. Currency-market **volatility** and domestic political turmoil raised speculation that a rate increase was coming, but those fears abated recently as inflation remained within target. The bank also will release June's budget data on Monday.

FRIDAY: The U.S. Labor Department releases the July jobs report. In June, the economy added 213,000 jobs, while hundreds of thousands of Americans started looking for jobs, helping push the unemployment rate up to 4.0%. Economists will watch to see whether average monthly job gains this year continue to outpace the last two years. Economists surveyed by The Wall Street Journal forecast employers added 188,000 to nonfarm payrolls in July, while the unemployment rate ticked down to 3.9%.

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THE WALL STREET JOURNAL.

Markets

Real-Estate IPO to Test Investor Faith in Economic Expansion; Cushman & Wakefield is going public, but rising interest rates and fears the expansion is late in the cycle could frighten off some investors

By Peter Grant and Maureen Farrell
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Stock market investors are awaiting one of the real-estate industry's most closely watched initial public offerings in years, setting up what could be a Wall Street referendum on the current economic expansion.

Cushman & Wakefield, a global brokerage and real-estate-services firm that reported $6.92 billion in 2017 revenue, is hoping to sell $719 million to $931 million in shares in an IPO that would value the firm at roughly $6 billion including debt, according to pricing documents announced Monday.

Trading is expected to begin in early August on the New York Stock Exchange after a roadshow in which backers of the offering will discuss Cushman with potential investors, the firm said.

The real-estate business is closely aligned with the health of the broader economy, and the success or failure of Cushman's IPO will reflect in part whether investors believe economic growth in many parts of the world will continue.

Like CBRE Group Inc., JLL, and other publicly traded real-estate firms, Cushman is highly dependent on sales and leasing brokerage commissions. These balloon when companies are expanding and real-estate investors are gobbling up office buildings, hotels, apartment buildings and other commercial property.

But these revenues crater when economies contract. For example, CBRE reported $4.2 billion in 2009, the year after the **stock market** crash, down from $5.1 billion in 2008 and $6 billion in 2007.

Global brokerage firms have been trying to insulate themselves from this **volatility** by building up businesses with steadier revenue like property management. Such "recurring" revenue represented 47% of Cushman's total in 2017, according to papers the firm filed with the Securities Exchange Commission.

Still, the brokerage business draws the biggest profits from its more economically sensitive businesses, rather than those generating steady recurring revenue.

"Commercial real estate will continue to be a cyclical industry," said Louise Keeling, portfolio manager at RWC Partners Ltd., in an email. The London- based asset manager with about $15.5 billion in assets under management owns shares in CBRE and Savills PLC, a London-based real-estate services firm.

Real-estate bulls believe the current economic expansion may have years to run. They point out that shares of CBRE and JLL, the world's largest and second-largest commercial real-estate firms respectively, are trading near record highs.

"I think we're in for an extended cycle," said Ross Smotrich, an analyst with Barclays who follows CBRE and JLL.

But Wall Street bears point to signs that the strong rebound of commercial real-estate values that began shortly after the last recession ended is running out of steam. Values of properties owned by U.S. real-estate investment trusts have plateaued over the past 18 months, although some sectors, like industrial property, are doing better than others.

Meanwhile, rising interest rates have increased the likelihood that capital will increasingly shift from commercial real estate to the bond market, driving down property values. These concerns already have sent tremors through the real-estate investment trust sector causing it to underperform the broader **stock market** since the beginning of 2016.

Indeed, many thought the investment group led by private-equity firm TPG that acquired Cushman in 2015 made its bet on commercial real estate too late in the cycle. Their fears seemed to be borne out in 2016, when rising interest rates and other economic concerns caused shares of CBRE and JLL to fall.

Some of those worries eased last year. Property values in most markets didn't suffer the decline many feared, and the brokerage business strengthened as companies in Europe and the U.S. expanded. CBRE's revenue in 2017 was $14.2 billion, up from $13.1 billion in 2016.

Last year's tax overhaul, which many analysts believe will help extend the U.S. expansion, also boosted the commercial real-estate business. Continued appetite for commercial property by cross-border investors has also helped make up for concern about interest rate increases. Sales globally increased 15% in the first quarter of 2018, compared with the first quarter of 2017, according to Real Capital Analytics.

"The commercial real-estate market is proving more resilient than investors had been expecting," said Jade Rahmani, an analyst with Keefe, Bruyette & Woods. "If you would have told me the Fed is on track to raise rates four times this year on top of the rate rises we had last year and it's not going to impact the transaction market, I would have said, 'you're kidding me.'"

The macroeconomic outlook isn't the only possible concern that could cause the Cushman IPO to be a dud. The firm also has more and lower profit margins debt than many of its peers. The firm recorded net losses of $221 million and $92 million in 2017 and the first quarter of 2018 respectively partly because of spending on integrating the three firms.

But if investor appetite is strong, it wouldbe a good outcome for the TPG group, which wrote an equity check for Cushman and the two other firms of about $500 million, according to a person familiar with the deal. With a $6 billion valuation, TPG is poised to double its equity investment as that stake would be would with just over $1 billion, at least on paper, the person said.

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THE WALL STREET JOURNAL.
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EXCHANGE --- Markets Hit a Rut In China --- Investors predict trouble ahead for the economy

By Shen Hong
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SHANGHAI -- This year's selloff in China's stocks and currency is reviving painful memories of the country's last market rout, in the summer of 2015. If anything, things look more worrying this time around.

Shares in Shanghai are the world's worst performing among major markets this year, tumbling 17%. The yuan has slumped 3.6% against the dollar since the start of June, pushed down by a combination of selling by nervous investors and the Chinese central bank's efforts to guide the currency lower as a trade conflict with the U.S. escalates.

On paper, even those big market moves pale in comparison with 2015. Three years ago the Shanghai Composite Index lost nearly half its value in the two months starting in June, bottoming out only in early 2016: They have never since regained their mid-2015 highs. The central bank also shocked markets with an abrupt 2% devaluation of the yuan in August that year.

More concerning this time is that several factors, including Beijing's campaign against high debt levels and its trade war with the U.S., suggest that investors are responding rationally to signs of fundamental problems for China's economy.

The U.S. placed tariffs on $34 billion worth of Chinese goods at midnight Eastern time on Friday. And while Shanghai stocks rose 0.5% on Friday, their fall this year has accelerated since trade tensions ramped up in the spring.

By contrast, in 2015 the market boom and bust was driven by retail investors who had taken on piles of debt to bet on stocks, then rushed to sell when the market cooled.

"The 2015 market crash was like unexpectedly catching a fever that came fast but also went fast. What we are witnessing this time is a likely protracted decline," said Landing Zhang, chief executive of Shanghai asset-management firm CYAMLAN Investment.

One big difference between this year and 2015 is that institutional investors, who typically take a longer-term view of markets, appear to be driving the **equity-market** selloff.

No breakdown of market trading by investor class is available, but a couple of factors indicate professionals are in the lead. First, much of this year's Shanghai market slump is due to falling share prices of major state-owned Chinese companies such as Citic Securities and Baoshan Iron & Steel. Such blue-chip stocks are normally favored by big institutional investors.

"The latest selloff was definitely led by institutions, because in the past when the market fell, blue chips often bucked the trend. This time around, blue chips are falling, too, and it has been like a stampede," said Amy Lin, a senior analyst at brokerage Capital Securities.

A sharp fall in the use of margin finance, which enables investors to bet on stocks with borrowed money, is a sign that China's 90 million retail investors have had relatively less influence over this year's market slump. The value of margin loans outstanding is down to 908.9 billion yuan ($137 billion) as of Thursday, less than half the record 2.1 trillion yuan right before the 2015 summer rout.

"Nobody, including myself and many of my friends, wants to invest in anything. There's no confidence, and we are in no mood," said Wu Yunfeng, a retail investor from Shanghai who said he hasn't invested in stocks since last year.

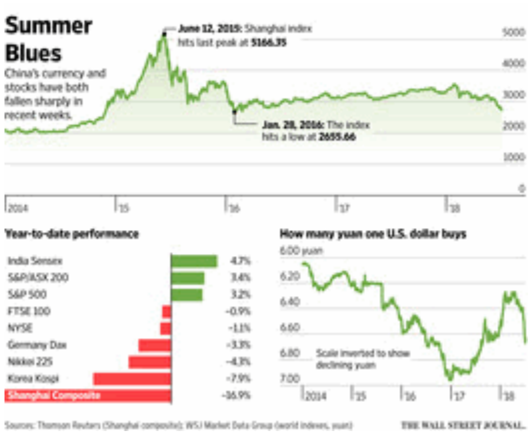
Institutional investors' increasingly pessimistic view of China's outlook has started to be borne out by economic data. Despite solid growth in the first quarter, figures for May showed a slowdown in areas including investment and retail sales. Beijing's campaign against shadow-banking activity more than halved China's overall credit supply in May.

"The economy was in better shape in 2015, and the **stock market** had rallied for a long time before the crash. There was also no trade war at that time," Ms. Lin said.

For some, the market gloom is an overdue reflection of the difficult task policy makers in Beijing face in trying to juggle a financial-system housecleaning while protecting economic growth -- all against the backdrop of a trade war.

China's central bank has faced a dilemma when it comes to managing the yuan's level against the dollar, too. Rising U.S. interest rates and slowing Chinese growth have created market pressure for the yuan to fall. Beijing may be happy to see the yuan slide, in part to offset any impact on its exports as trade tensions rise.

Still, policy makers are eager not to let the yuan drop too far, too fast, in case that encourages heavy capital outflows that could cause a liquidity shortage in China's financial system.



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WSJ PRO CENTRAL BANKING

Economy

As the Fed Moves Rates Higher, the ECB Charts Its Own Course; While the Fed prepares further interest rate moves, the ECB has signaled that it won't raise rates at least through next summer

By Tom Fairless
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FRANKFURT—The European Central Bank is expected to signal its intention to keep its key interest rate below zero for at least another year on Thursday, underscoring a widening gap with the Federal Reserve which is moving steadily toward higher interest rates.

The divergence between the world's top two central banks, reflecting a division in economic fortunes, received renewed attention last week after President Donald Trump said on CNBC that he wasn't happy with the Fed's recent decisions because every time the economy strengthens "they want to raise rates again." He also chided officials in China and Europe for weakening their currencies.

The euro has fallen to $1.17 from as high as $1.25 earlier this year after the ECB signaled increases from the current minus 0.4% policy rate were off the table for now, helping to support the region's export-focused companies. In contrast, the Fed's key rate is at a 1.75% to 2% range and is expected to rise further this year.

Still, even if Mr. Trump's comments have some rooting in recent market trends, many central bankers see such political interventions as a dangerous encroachment on their independence.

Jean-Claude Trichet, the former president of the ECB, rebuked Mr. Trump in an interview for his Fed critique.

"I strongly hope that all executive branches will respect this independence, including in the U.S., where putting into question the remarkable credibility of the Federal Reserve could be devastating," said Mr. Trichet, a 75-year-old Frenchman sometimes known as "Mr. Euro" for devoting much of his career to building the common currency.

Central bankers argue that their independence from politicians, secured in recent decades, gives investors greater confidence that officials will make unpopular decisions in the best interest of the economy, such as raising rates to keep inflation in check.

Foreign-exchange and bond markets swooned last week following Mr. Trump's comments, which marked a departure from a convention under which governments have refrained from speaking about monetary policy.

While the Fed has signaled it will raise interest rates four times this year to keep pace with a U.S. economy currently growing at an annualized pace of 4.5%, the ECB signaled last month that it won't raise rates at least through next summer. That helped cushion any impact in **financial markets** from the bank's decision to phase out its €2.5 trillion ($2.9 trillion) bond-buying program, known as quantitative easing or QE, later this year. But some analysts questioned this interest-rate guidance given that eurozone inflation, at 2% in June, is slightly above the ECB's medium-term target.

The minutes of the ECB's last policy meeting on June 13-14 show that, even as they decided to end QE, officials worried about signs of an economic slowdown and headwinds from trade tensions and fractious **financial markets**. A decline in an index of European purchasing managers in July, reported Tuesday, confirmed this softening trend.

ECB officials are expected to underscore a message of caution after a policy meeting on Thursday. President Mario Draghi is likely to face questions at a news conference about the threat of trade and currency wars.

Ironically, one reason for the euro's recent weakness is precisely Mr. Trump's rhetoric, specifically his threat of tariffs on European goods, says Dirk Schumacher, an economist with French bank Natixis in Frankfurt.

"Of course the ECB's monetary policy does impact the exchange rate. But did the ECB purposefully act to weaken euro? I don't think so," Mr. Schumacher said. "It's now clearly moving in the other direction by ending its bond-buying program."

Write to Tom Fairless at tom.fairless@wsj.com

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Treasury Plans to Sell $135 Billion in Debt

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The U.S. Treasury Department will auction $135 billion in securities next week, comprising $84 billion in new debt and $51 billion in previously sold debt. Details (all with minimum denominations of $100):

-- Monday: $51 billion in 13-week bills, a reopening of an issue first sold on April 19, 2018, maturing Oct. 18, 2018. Cusip number: 912796QD4.

Also, $45 billion in 26-week bills, dated July 19, 2018, maturing Jan. 17, 2019. Cusip number: 912796QT9.

Noncompetitive tenders for both issues must be received by 11 a.m. EDT Monday and competitive tenders by 11:30 a.m.

-- Tuesday: $26 billion in 52-week bills, dated July 19, 2018, maturing July 18, 2019. Cusip number: 912796QR3. Noncompetitive tenders must be received by 11 a.m. Tuesday and competitive tenders by 11:30 a.m.

-- Thursday: $13 billion in **10**-**year Treasury** inflation-protected securities, dated July 31, 2018, maturing July 15, 2028. Cusip number: 912828Y38. Noncompetitive tenders must be received by noon Thursday; competitive tenders by 1 p.m.

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THE WALL STREET JOURNAL.
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Uncertainty Puts Hold on Steel's Rally

By Amrith Ramkumar
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27 July 2018
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Steel prices in the U.S. have eased after hitting their highest level in a decade in early June, a relief for some large manufacturers facing higher input costs.

Futures contracts for U.S. hot-rolled coil steel have fallen to about $850 a ton since hitting a fresh multiyear high of $935 on June 11, with investors assessing the full impact of tariffs on steel and aluminum imports. Thousands of requests for exemptions from the tariffs have been filed, and analysts are also trying to determine if protectionism will slow the global economy and lower demand for materials.

Analysts also say the surge in domestic prices so far this year means U.S. steel is so much more expensive than global benchmarks that some companies will likely opt to pay the Trump administration's 25% import tariffs. Some think domestic steelmakers also could ramp up production, lowering prices.

Adding to the unknowns: The political landscape keeps changing. President Trump said Wednesday the U.S. and European Union would resolve steel and aluminum tariffs.

The various factors have unnerved some investors and hurt shares of steel producers, which have lagged behind the commodity.

U.S. Steel Corp. shares fell $1.02, or 2.7%, to $37.24 Thursday and are 19% below their March 1 multiyear peak. Shares of Nucor Corp. and AK Steel Holding Corp. also fell Thursday.

"The uncertainty is the killer," steel analyst Charles Bradford of Bradford Research said. "People are sitting on their hands waiting to see what happens."

Mr. Bradford said it also remains unclear how much of the steel-price surge was driven by people trying to obtain more metal before the tariffs took effect, leading to swings in inventories that could moderate in the coming weeks.

Even with the tariffs on steel, supply has grown steadily outside the U.S. Global steel production increased 4.6% in the first half from a year earlier, according to the World Steel Association and Capital Economics, with China and India fueling the rise.

"We expect this trend to continue over the coming months, which underpins our **bearish** view on prices this year," Capital Economics analysts said in a Thursday note to clients.

Prices of other industrial metals used heavily in construction and manufacturing have also been **volatile**.

The cost to have aluminum delivered in the Midwest peaked last month at a multiyear high after the U.S. imposed 10% tariffs on aluminum imports at the end of May. Like steel, aluminum has pulled back, with its moves prompting swings in the stock prices of producers.

The price moves for copper have been even more drastic, with the red metal down 15% from a four-year high reached June 8.

Calmer metals markets could be a boon for some manufacturing companies contending with uncertain costs. Although many have existing supply deals in place and won't feel the impact of the levies until next year, others are starting to increase cost estimates.

Appliance maker Whirlpool Corp. cut its full-year profit outlook earlier this week as its costs continue to rise, with Chief Executive Mark Bitzer saying that domestic steel prices "have reached unexplainable levels."

The company's shares fell 15% on Tuesday, their largest one-day drop since 1987. The stock fell an additional 3.6% a day later before rebounding 2.8% on Thursday.

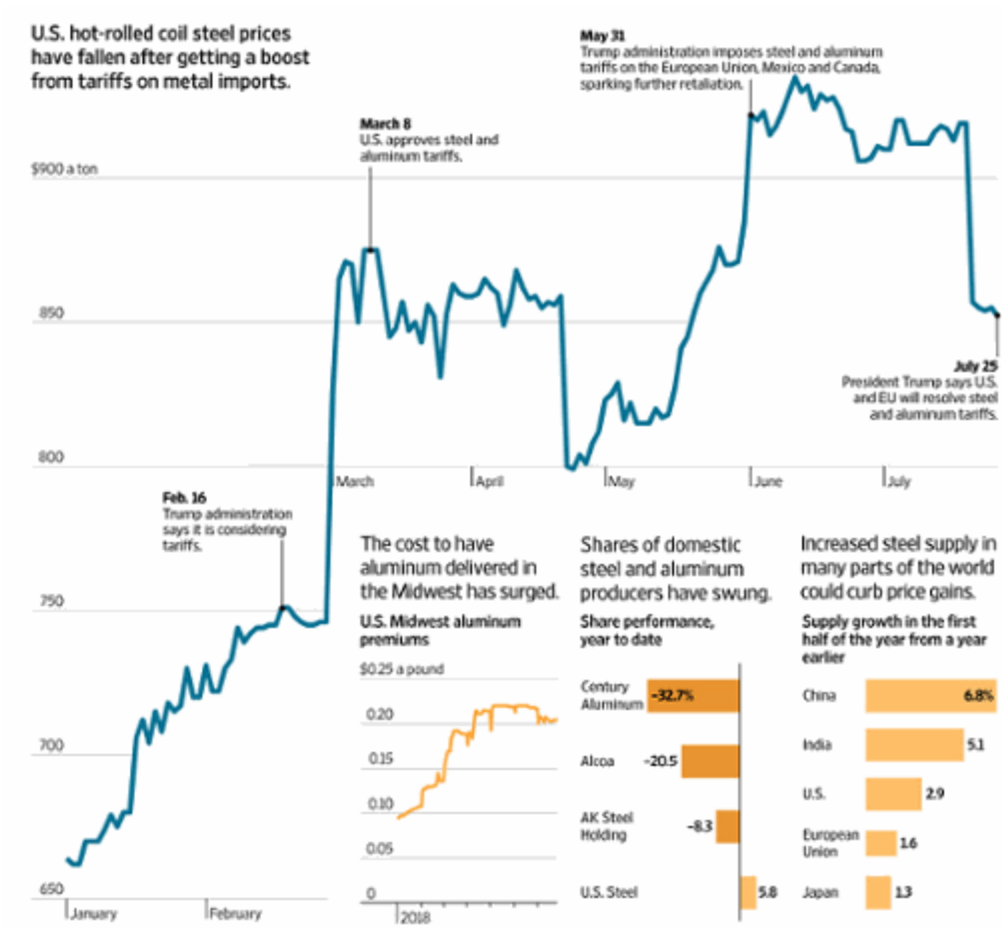
On Wednesday, auto makers General Motors Co. and Ford Motor Co. lowered their profit outlooks for 2018, and both companies said fallout from U.S. tariffs on steel and aluminum is weighing on their bottom lines. GM shares have fallen 6.7% this week, while Ford is down 6.3%.

Some analysts expect domestic metal prices to come down, but even a moderate decline would leave prices elevated.

Citigroup expects domestic steel to remain around $850 a ton in the second half.

Some analysts think those levels could challenge industrial firms that have so far been shielded from tariff impacts but will soon be negotiating new contracts.

"We're actually not seeing the full impact in 2018 of what the steel or aluminum tariffs are, and it's anybody's guess how long those stay in place," United Technologies Corp. Chief Executive Greg Hayes said on the company's Tuesday earnings call.



Sources: FactSet (steel price, steel and aluminum producers' shares); Thomson Reuters (aluminum premiums); World Steel Association data compiled by Capital Economics (steel supply)

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