THE WALL STREET JOURNAL.

Heard on the Street
Markets

Why Amazon Needs to Do Everything; Tech giant's surging market value is predicated on hitting lofty growth ambitions

By Dan Gallagher
506 words
30 June 2018
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The Wall Street Journal Online
WSJO
English

It seems only natural for the Everything Store to be doing, well, everything. It is also a necessity.

Amazon.com just gave the world a strong reminder of its ambitions. On Thursday, the company announced a new effort to beef up its own package-delivery network by recruiting small-business owners to operate fleets of Amazon-branded vehicles. On the same day, Amazon also announced its acquisition of online pharmacy PillPack for a reported $1 billion.

The latter move inserts Amazon squarely into the $400 billion U.S. prescription drug market. That is likely only part of the company's health-care ambitions. Amazon is also working with Berkshire Hathaway and JPMorgan Chase on a new venture aiming to reimagine health-care delivery for their own employees, now collectively numbering close to 1.2 million.

These latest efforts come barely a year after Amazon burst into the grocery market with its $13.7 billion acquisition of Whole Foods Market. In fact, it has been years since the online retailer focused exclusively on online retail. Amazon is now also a consumer electronics designer, Hollywood studio and advertising firm, just to name a few. And don't forget the cloud-computing business that now accounts for 10% of the company's revenue and 96% of operating income.

All these efforts feed a growth machine unmatched for a company of Amazon's size. It is now generating nearly $200 billion in annual sales. Analysts expect that to top $350 billion by the end of 2020 and to surpass the $500 billion mark by 2023. To do that, Amazon will need to keep averaging annual revenue growth above 20% going forward—no small feat. The six U.S.-based companies with more than $200 billion in sales in the past year averaged less than 8% sales growth over the trailing 12 months, according to S&P Capital IQ.

If Amazon meets those ambitious goals, it won't be just from selling goods over the Internet. The company already accounts for about 44% of online retail sales in the U.S., according to eMarketer. While online sales continue to grow, their advance will slow.

Amazon's share of the overall retail market is much smaller. Amazon's North American revenue for the first quarter represented about 3% of total U.S. retail sales for the period, according to Commerce Department data. Getting more of that will require Amazon to at the very least turbocharge its Whole Foods grocery business, but other ventures will have to kick in too.

Amazon's **stock price** has surged 45% this year, having gained another 2% just on the latest announcements. That has made the company the second most valuable business on the planet, which represents a sizable bet by investors that Amazon will indeed be everywhere soon, and not in a small way.

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THE WALL STREET JOURNAL.

Markets
Government Bond Yields Climbed in 2nd Quarter on Trade Tensions, Slower Growth; The benchmark 10-year U.S. Treasury note breached the 3% threshold

By Orla McCaffrey
831 words
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The yield on the benchmark 10-year U.S. Treasury note rose for the fourth straight quarter, briefly topping 3% before concerns about mounting trade tensions and slower global growth drove investors to the relative safety of government debt.

Signs that inflation could accelerate, continued job gains for U.S. workers and speculation that the Federal Reserve could raise interest rates four times this year helped boost the yield to a nearly seven-year high of 3.109% on May 17. Yields rise as **bond prices** fall.

Yields have since fallen—settling Friday at 2.847%—as investors have focused on the threat posed to global economic growth by rising trade tensions between the U.S. and its major trading partners. Tariffs proposed by President Donald Trump, which would affect imports from countries including China, Germany and Canada, could impede the flow of goods and money across borders, while disrupting supply chains for auto makers and other industries.

The movement of the 10-year yield is important because it affects borrowing costs for consumers, companies, and state and local governments. It tends to rise and fall along with expectations for the pace of growth and inflation. Economic growth can reduce the appeal of government debt by making other assets more attractive, while inflation erodes the purchasing power of the debt's fixed-interest and principal payments.

The Fed, at its June meeting, penciled in two more rate increases, yet many investors are uncertain about whether the economy can continue to grow fast enough to justify higher bond yields. And some investors think the Fed's rate increases have boosted the value of the dollar versus emerging-market currencies, fueling **volatility** that could also hinder growth.

"We've probably seen the high in the 10-year unless things start to resolve with tariffs and in emerging markets," said Andrew Brenner, head of global fixed income at NatAlliance Securities.

Yields rose quickly in the early part of the quarter, but have retreated from their highs, hovering around 2.9% as trade tensions increased. Tariffs have yet to affect the price of consumer goods, some analysts said, with many investors seeing them as negotiating tactics rather than harbingers of a slowdown. But the tensions have investors debating the impact of tariffs on economic growth and employment gains.

"Any and all trade agreements have a long fuse," said Jim Vogel, head of government bond strategy at FTN Financial. "You don't necessarily change [the] economic forecast based on where we are today; the market has recognized that there's a potential impact from tariffs."

This quarter's rise in yields has amplified struggles in emerging markets, as foreign investors shift cash away from developing economies. Countries whose debt is issued in dollars particularly feel the brunt of rising yields, some analysts said, since the strength of the dollar often increases alongside Treasury yields.

Recent data have shown signs of a pickup in inflation, raising investors' hopes that prices are breaking out of a postcrisis rut. Rising **oil prices** have also helped fuel expectations inflation will climb, with U.S. crude gaining roughly 23% since the start of the year.

Yet, as with tariffs, analysts said that hasn't yet translated to higher prices for goods. And the 10-year break-even rate, which indicates investors' bets on average annual inflation over the next 10 years, has slipped from a recent high in May, ending Friday at 2.12 percentage points.

Some analysts say they do believe the 10-year yield probably will surpass this year's peak later this year. But even then, the crosscurrents will prevent it from climbing much higher.

"There's too much geopolitical risk out there," said Gary Pollack, head of fixed-income trading at Deutsche Bank Private Wealth Management. "While yields will rise, it's going to be very slow."

If the Fed raises rates four times in 2018, that would mark the most in any year since 2005, when rates went up eight times. Fed-funds futures, used by investors to bet on central bank policy, recently showed a 48% chance the Fed would raise rates twice more this year, according to CME Group data.

The gap between the yield on the two- and 10-year Treasurys this quarter hit its narrowest in more than a decade. Several analysts said that signals investor confidence the Fed will continue its path of rate increases, tempered by skepticism about the longer-term outlook for growth and inflation.

"The Fed has been fairly aggressive in its speeches and rhetoric in the past couple of months," said Tom di Galoma, managing director and head of Treasury trading at Seaport Global Holdings. "They want to raise rates to ensure they have enough ammunition going forward if the economy does fall into a recession."

Daniel Kruger contributed to this article.

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THE WALL STREET JOURNAL.
U.S. EDITION

EXCHANGE --- Heard on the Street: Wall Street's Sucker's Bets --- Investors keep putting money into funds that keep losing. Is it investing or gambling?

By Spencer Jakab
824 words
30 June 2018
The Wall Street Journal
J
B14
English

[Financial Analysis and Commentary]

People who compare Wall Street to a casino are usually just bitter about a bad experience. When it comes to some wildly popular products, though, the description fits.

Owning stocks is mostly a winner's game. Since 1928, the stock market has risen on 54% of days, 58% of months and 73% of years. Over that time a $10,000 investment in U.S. stocks in 1928 would have grown to $40 million. Take the same money into a casino and bet on a roulette wheel coming up red and your odds of winning are 47%. Stick around for a few hours and your bankroll will almost certainly be gone.

So what do you call funds that trade on the stock market but have odds resembling a casino game, occasional jackpots included? A popular one, the Direxion Daily Financial Bear 3X Shares fund, has lost money on 54% of days and every calendar year since its launch in late 2008. The fund produces three times the inverse of an index of financial companies, so it posted some spectacular gains during the financial crisis. They faded quickly. For example, the fund doubled in four sessions in January 2009 but gave up those gains in the next six. The following month it doubled again in seven days but lost 60% in the next four and then another 50% in the following seven sessions -- quite a ride.

"One of the open secrets of the financial-services world is that we're also in the entertainment and gaming industry," says James Angel, a finance professor at Georgetown University.

The savings-destroying combination of volatility and daily compounding is what makes these leveraged inverse funds losing propositions. A $10,000 investment in the Daily Financial Bear 3X fund made in 2008 is now worth about $2. Such funds rarely fade away, though, because investors who think they can beat the odds keep pouring in fresh capital. In fact, far more money has poured into leveraged inverse funds than their current roughly $15 billion market value, according to figures from ETFGI, while holding periods are typically days or hours.

On June 25, a volatile day for stocks, 10 similar funds had greater share turnover than blue chips Walt Disney, Amazon.com or Delta Airlines.

Those in the industry point out that not all leveraged products are duds. Some, such as those that add leverage to long positions, have performed marvelously during the nine-year bull market. Sylvia Jablonski, head of capital markets and institutional strategy at asset manager Direxion, which offers 76 inverse or leveraged ETFs, points out that typical holding periods are short for such products.

"We consider it a trading tool," she says. "We're very clear with clients that these are products that aren't meant to be held." There is pretty much one scenario where a long-term shareholder would make money in a fund like the financial-bear one -- a year of bad performance of the index amid low volatility. That hasn't happened yet.

The distinction between an investment and a gamble lies in the odds of success. On average gamblers lose over time. So why does the Securities and Exchange Commission allow anyone with a brokerage account to put their nest egg into something that typically loses money?

A spokeswoman declined to comment. Defenders of these funds point out that, unlike games of chance, some people believe that they have a unique insight into which way the market might move tomorrow. Others use inverse funds to hedge their shareholdings. Unlike complicated stock options, they "democratize leverage," in Ms. Jablonski's words.

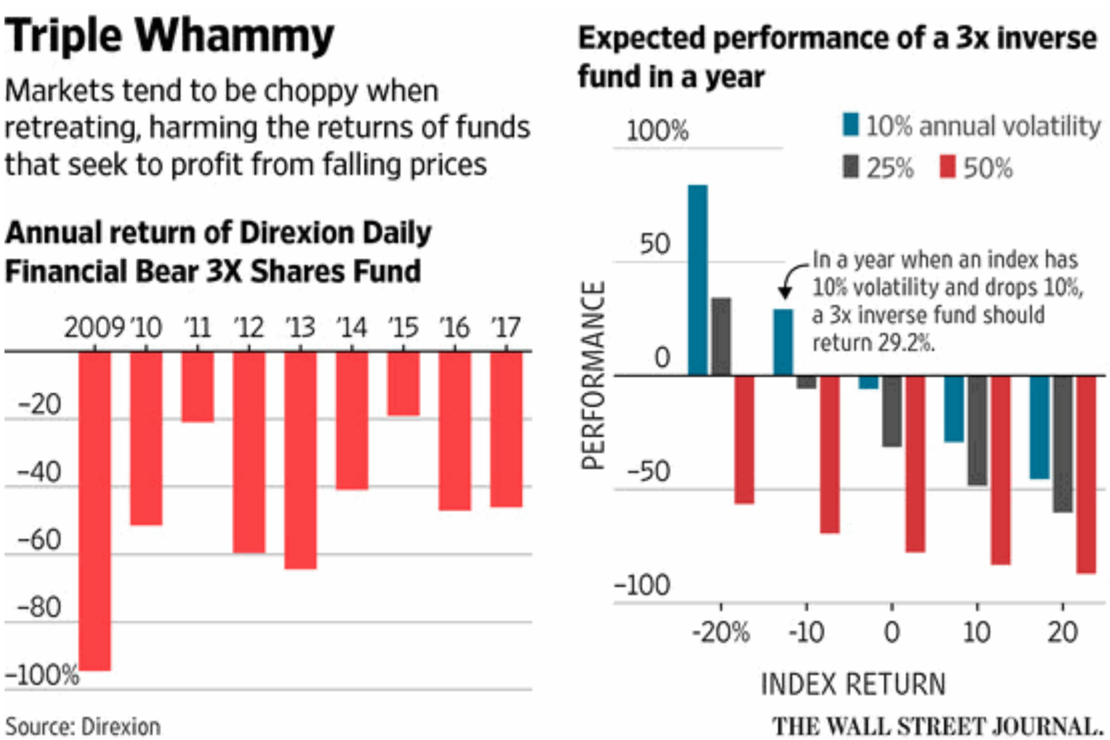
Mr. Angel sees the funds mostly as gambles, yet he doesn't object to their existence sinceauthorities also allow individuals to make even more dangerous bets such as stock options, penny stocks, or for that matter, to play the lottery.

Some speculators make wild gains. Keeping them is another matter. Take the experience of "TheSkepticizer," a commenter on social-investing message board StockTwits. He claims he profited on June 25 trading SQQQ, which produces three times the inverse of the Nasdaq 100. The index plunged that day on trade fears and the ETF gained 6.4%.

"Made some money here today, but sold on the dip. Hmmm, probably shouldn't have . . . maybe can buy back in tomorrow."

He claims to have done so the next morning. An hour later the fund was already down 2% and he was eyeing a 3x long semiconductor ETF to make up for a 10% drop that day in a triple inverse oil fund he owned.

TheSkepticizer might not have done much better in Las Vegas, but at least there would have been free drinks.



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THE WALL STREET JOURNAL.
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EXCHANGE --- Yuan Slid 3.4% Against Dollar in June

By Saumya Vaishampayan
558 words
30 June 2018
The Wall Street Journal
J
B13
English

The Chinese yuan suffered one of its worst months on record, tumbling 3.4% against the dollar in June.

An escalation in global trade tensions and investors' growing conviction that U.S. interest rates will continue to rise combined to wallop many emerging-market currencies over the course of the month. The South Korean won and New Taiwan dollar, which are also sensitive to disruptions to global trade, lost about 3% and 1.4% against the dollar, respectively by the end of Asian trading Friday. It was the won's biggest monthly decline since November 2016.

The yuan's swoon accelerated after a volley of tariff threats between the U.S. and China in the middle of the month and tumbled to a more than six-month low this past week. The currency was little changed at the end of Asian trading Friday, but its monthly decline was the worst since at least December 1998, based on data from Thomson Reuters. One dollar bought 6.6246 yuan as of Friday afternoon in China. Late in New York, one dollar bought 6.6225 yuan.

Declines were even more pronounced in Argentina, where authorities have been struggling to arrest a slide in its currency and turned to the International Monetary Fund for financing. The Argentine peso slumped 11% against the greenback in June.

The South African rand dropped more than 7%, its most in a month since May 2016, while Brazil's real lost nearly 4%.

What was different in the recent bout of global emerging-market turmoil was the Chinese currency's weakness, analysts said. "China has now become front and center of this EM stress," said Sameer Goel, head of Asia macro strategy at Deutsche Bank in Singapore. The idea that the yuan could depreciate further and amplify the **volatility** for emerging markets has added to investors' concerns, he added.

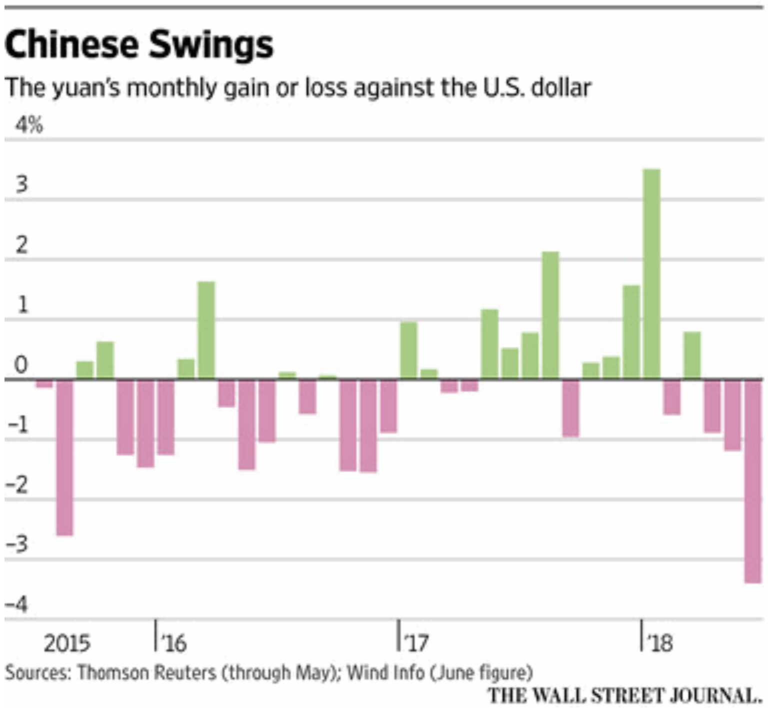
Some emerging markets came under pressure in April because of a rebound in the dollar. While the pain was initially concentrated in countries with large external financing needs, such as Turkey and Argentina, it started to spread after trade tensions heated up and investors pulled cash out of riskier assets and markets.

The Federal Reserve raised short-term rates on June 13 and signaled it could accelerate the pace of interest-rate increases in coming months, adding to the pain in emerging markets. Higher rates make the U.S. more appealing for yield-seeking investors, who had flocked to emerging markets when global interest rates were low.

President Donald Trump has backed away from plans for tough new restrictions on Chinese investments in the U.S. Still, both the U.S. and China have proposed tariffs on billions of dollars of each other's goods that are slated to go into effect on July 6.

Ultimately, whether the trade spats between the U.S. and some of its key trading partners will actually reduce global trade remains an open question, said Stephen Howard, chief executive of Howard Trading in Hong Kong.

"We are cautious. Where we are invested, we're trying to be long **volatility**" he said, explaining that his firm holds options on stock indexes to protect its portfolio from losses if there are large market swings.



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THE WALL STREET JOURNAL.
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EXCHANGE --- Strategy: The Texas Well that Started a Revolution --- Two decades ago, an engineer got permission to try a new way to get gas out of the ground. Energy markets and global politics would never be the same

By Russell Gold
1,348 words
30 June 2018
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J
B6
English

Twenty years ago, a well was drilled in Dish, Texas, that changed the world.

Nothing at the time suggested the unassuming well in the rural town north of Fort Worth would hobble OPEC, the powerful oil cartel that had governed prices of the world's most important commodity for more than a generation. Or that it would help turn the U.S. into a global energy exporter, or shuffle the geopolitical deck.

But it did all of that -- and more. The well used hydraulic fracturing to crack the incredibly tight shale rocks below. It fired the first shot in the fracking revolution -- a blast soon felt in Riyadh, Tehran and Moscow.

"I had no idea it would cause so much change. I was just trying to keep my job," said Nick Steinsberger on a recent visit to the well pad. He was the engineer who obtained permission to try a new approach to completing the well that had been drilled a mile and a half deep into a thick gray wedge of rock known as the Barnett Shale.

Mr. Steinsberger, now 54, called the experiment "my slick-water frack." It was the first commercially successful use of sand, water and chemicals, pumped into the shale under high pressure, to break open the rock and unleash the natural gas trapped inside. It was the beginning of modern fracking.

"It was a good well, cost $600,000 or $700,000," Mr. Steinsberger said, walking over the pad to the chain-link fence that surrounds the well. A sign identifies it as the S. H. Griffin Estate 4.

Today, most wells drilled in the U.S. use some variation of Mr. Steinsberger's fracking technique. It has unleashed an unimaginable wealth of natural gas, gas liquids and crude oil, turning the U.S. from an energy pauper into a muscular exporter. It also started an often acrimonious environmental debate about the potential impacts and trade-offs of fracking.

"It is one of the most extraordinarily important, disruptive, technologically driven changes in the history of energy," said Ed Morse, global head of commodity research at Citigroup. "It was revolutionary for the U.S. economy and it was revolutionary geopolitically."

Mr. Steinsberger's modest experiment demonstrated that the oil and gas industry had the tools to fracture the rocks where fossil fuels were slowly baked over the millennia. A huge trove of natural gas was accessible at an economical cost.

It was such a novel idea that it spread slowly at first, as doubters couldn't believe that anyone could successfully tap the source rocks. After a few years, more companies began to copy the wells drilled by Mr. Steinsberger's employer, Mitchell Energy, the firm founded by the late George P. Mitchell.

It started in the Barnett Shale. Then other gas-bearing shales were discovered. The Marcellus Shale in Appalachia turned out to be larger and more fecund than the Barnett.

In 2008, more than a decade after Mr. Steinsberger's well, the industry made another quantum leap: Not only could fracking liberate small natural gas molecules from rocks, it also worked on the longer hydrocarbon chains that make up crude oil. Companies such as EOG Resources Inc. began to drill and frack shales bearing crude oil and natural gas liquids in North Dakota and Texas. The technique has since spread to other countries such as Argentina.

The proliferation of oil and gas production transformed the U.S. energy landscape. A looming dearth of natural gas had led companies to build import terminals. Now there is so much gas the U.S. exports the fuel around the world.

The low-cost fuel has become the leading source of power generation in the U.S. Its rise has reshaped electricity markets, leading to the closure of more than 200 coal plants, as well as a number of nuclear plants. The Trump administration's current proposal to subsidize coal and nuclear plants is an indirect result of fracking.

The impact on oil markets might be, if anything, more significant. U.S. oil production had fallen persistently for years, dropping below five million barrels a day. And then: fracking. This year, it hit a new all-time high, reaching 10.9 million barrels a day in June. It is now the world's largest producer of crude and other valuable petroleum liquids, ahead of Russia and Saudi Arabia.

The surge has weakened the Organization of the Petroleum Exporting Countries. Facing a growing supply of oil from the U.S., the group stumbled and fought over what to do. It unsuccessfully tried to crush frackers by ramping up production in 2014 to drive down the price of oil, before making its peace with them. Last week, the cartel's members coordinated with Russia to produce more barrels to prevent **oil prices** from rising further. Shale output was outside of their control.

The U.S. emerged as a newly confident energy powerhouse. It was no longer fearful that an embargo could maim its economy. This attitude was reflected in a more aggressive foreign policy, as shown by its willingness to take a tough negotiating posture with Iran.

"The fracking boom was the biggest energy story around the world. But it was also the biggest geopolitical story and the biggest environmental story," said Michael Webber, deputy director of the Energy Institute at the University of Texas at Austin.

The proliferation of natural gas, displacing coal, helped the U.S. lower its overall greenhouse gas emissions by 13.4% in the last decade, while growing its gross domestic product, according to BP PLC's Statistical Review of World Energy.

While fracking has produced environment benefits at a global scale, it has created local problems. Dust, noise, truck traffic and emissions from diesel engines turned rural regions into industrial zones during periods of peak development.

The headlong rush to drill and frack meant that the industry raced out in front of state regulators. Concerns arose about fracking's impact on water and the impact of methane gases leakage on the climate. Eventually, federal and state regulators responded with increasingly sophisticated rules. And the industry adopted some voluntary measures as well.

Fracking has split the environmental movement. Some environmentalists opposed fracking entirely; others recognized its potential benefits and have worked to minimize its negative impacts.

Fred Krupp, president of the Environmental Defense Fund, praised natural gas for helping clean up local air pollution, lower greenhouse gas emissions and reduce electricity costs. "The abundance of natural gas has helped, but it is important to work to make it as clean as it can be," he said.

Meanwhile, fracking continues to evolve. Supersized fracks have become commonplace.

Fracking uses grains of sand to prop open the newly formed cracks to allow gas or oil to flow out. While Mr. Steinsberger's well required 229,000 pounds of sand, a large contemporary well might require 30 million pounds of sand. The amount of water needed has increased as well.

The S. H. Griffin well has continued to produce gas for two decades. Over the years, more than 2.6 billion cubic feet have flowed out, worth some $8 million at today's prices. A new well with a supersized frack can produce as much in a day as the original could in two months.

The proliferation of large wells has kept gas below $4 per million British thermal units since December 2016, after topping $10 in 2008. Mr. Steinsberger, who still oversees eight to ten fracks a year, doesn't see that changing for a long time.

"One day, there might be lasers shooting at the rock" thousands of feet underfoot, he said. "I can't predict that. But I can tell you natural gas prices will be low for the rest of our lives."

Seek And Ye Shale Find

The arrival of fracking helped turn the U.S. into an energy powerhouse. It's a major exporter of natural gas and became the world's largest producer of crude oil this year.

Sources: Joint Organisations Data Initiative (oil production); Baker Hughes (rig count); U.S. Energy Information Administration (natural gas production)

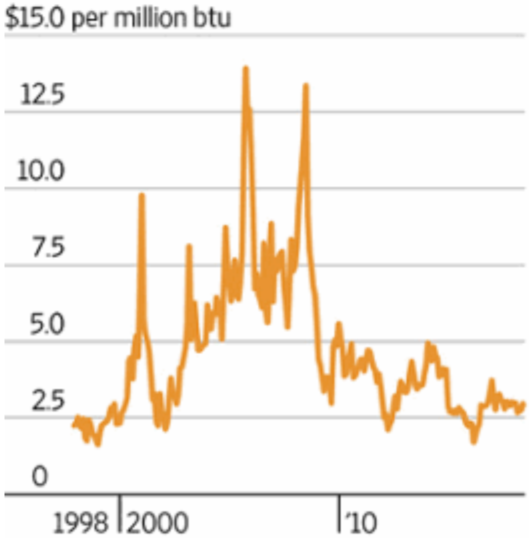
THE WALL STREET JOURNAL.

Front-month crude-oil price

$150 a barrel

Front-month natural-gas price

$15.0 per million btu



Source: WSJ Market Data Group

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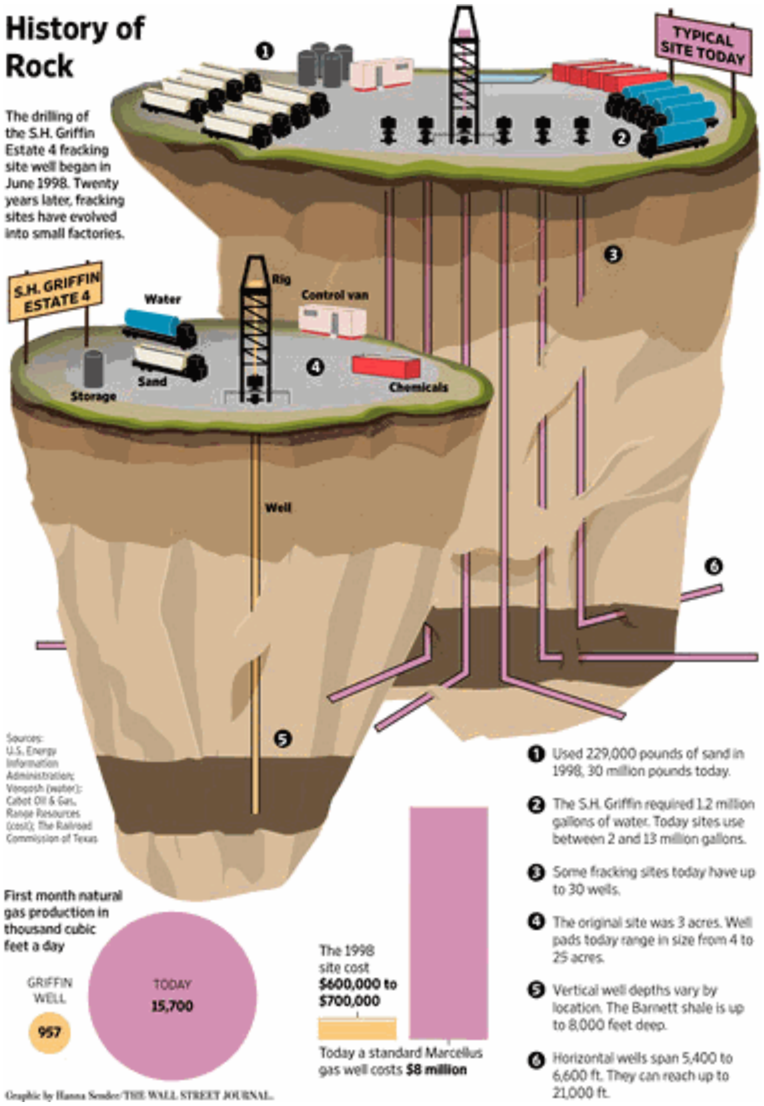

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EXCHANGE --- The Score: The Business Week in 7 Stocks

By Caitlin Ostroff
683 words
30 June 2018
The Wall Street Journal
J
B2
English

AMAZON.COM INC.

AMZN +2.5%

Amazon reached a deal to buy an online pharmacy called PillPack, rattling shares of drugstores, health-insurance companies and drug wholesalers Thursday. Walgreens Boots Alliance Inc., CVS Health Corp. and Rite Aid Corp. lost more than $11 billion in market value combined. A separate announcement that Amazon would partner with small businesses to deliver some of it packages dented United Parcel Service Inc. and FedEx Corp.

HARLEY-DAVIDSON INC.

HOG -6%

Harley-Davidson said Monday it plans to shift production of more of its iconic motorcycles overseas to avoid European Union tariffs, a move that sent its shares tumbling. The 31% levy enacted by the EU last week was in response to U.S. tariffs on aluminium and steel, and would raise the cost of each Hog Harley ships to Europe from the U.S. by about $2,200. President Donald Trump on Tuesday condemned Harley's decision, saying it would mark "the beginning of the end" of the iconic brand. "[T]hey will be taxed like never before!," he tweeted.

GENERAL ELECTRIC CO.

GE +7.8%

GE shares notched their best day in three years, after the company said Tuesday it would shed two of its units in an effort to reverse a painful slump. GE, whose appliances once filled American homes, will spin off its health care division and sell its ownership stake in oil-services company Baker Hughes. The company also plans to shrink its headquarters operations with $500 million in additional cuts by the end of 2020. The announcement coincided with the first day Walgreens Boots Alliance replaced GE in the **Dow Jones Industrial Average**.

CONAGRA BRANDS INC.

CAG -7.3%

Conagra is stocking up on frozen food with an agreement to buy Pinnacle Foods Inc. for about $8.2 billion. Over the past year, Conagra's Chief Executive Sean Connolly has focused on revamping the company's older brands like Healthy Choice, Marie Callender's and Banquet to include trendy ingredients like edamame, kale and quinoa, driving a 3.8% increase in sales. With Pinnacle, he would add brands such as Birds Eye, Hungry-Man and Celeste pizza. But investors sent the company's shares down Wednesday amid skepticism that the frozen-food renaissance can continue.

CHIPOTLE MEXICAN GRILL INC.

CMG -6.3%

Investors were left cold by the turnaround blueprint unveiled by Chipotle CEO Brian Niccol, who plans to introduce pick-up shelves for mobile orders, add snack foods to the menu and offer a happy-hour promotion each afternoon. The former Taco Bell chief also wants to close underperforming stores and cut some management roles. But there was no immediate plan for aggressive stock buybacks or an international push, and analysts at

Guggenheim said that left investors "hangry" on Thursday, when shares suffered their biggest one-day drop since February.

LENNAR CORP.

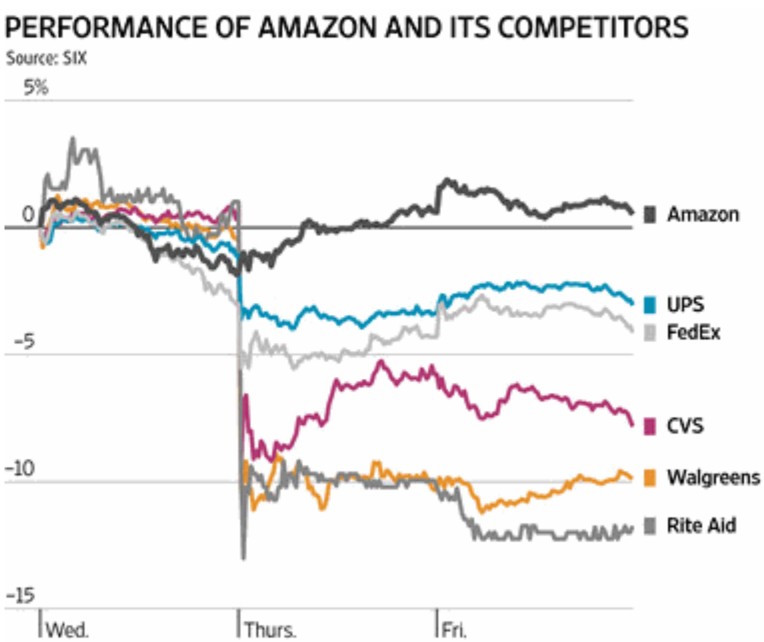
LEN +4.9%

Low unemployment and increasing wages for U.S. workers fueled a strong second quarter for home builder Lennar, offsetting fears that rising interest rates and higher construction costs would cut into profits. The company reported a 45% profit increase to $310.3 million Tuesday. Its stock rose 4.9%, and fellow home builders D.R. Horton Inc., PulteGroup Inc. and NVR Inc. also climbed. The results came a day after the Commerce Department released data showing that sales of new homes increased in May while sales of existing homes declined that month.

NIKE INC.

NKE +11%

Nike shares enjoyed their biggest gain in nearly four years Friday after the sportswear company revealed that U.S. sales rose 3% in the most recent quarter, after three straight periods of declines. The company attributed the gains in part to partnerships with e-commerce giants, such as Amazon, and sales through its own website and apps. Nike's sales directly to customers increased 15% for the year ending in May, compared with growth of 4% in its traditional wholesale business over the same period.



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Cross Country: Why California Is Losing Teachers and Laying Off Secretaries

By Allysia Finley
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30 June 2018
The Wall Street Journal
J
A11
English

Nine years into a **bull market**, housing prices in California have reached record highs. Investors are enjoying soaring capital gains, which in turn has created a windfall for the state budget. California is now sitting on $16 billion in budget reserves while many states struggle to balance their budgets. But beneath this patina of prosperity, many cities are careening toward bankruptcy. Schools are laying off employees and slashing programs. Some districts complain they are having trouble retaining teachers. What gives?

California property taxes, which fund local governments, are capped by the state constitution's Proposition 13 at 1% of a home's value and can't rise by more than 2% annually. So although housing costs have soared since the recession -- the median home price in San Francisco is $1.6 million -- cities and school districts aren't rolling in the dough.

At the same time, municipalities are getting socked with big bills from the California Public Employees' Retirement System and the California State Teachers' Retirement System, known as Calpers and Calstrs. For years the two funds overestimated their investment returns while underestimating their expected payouts. This helped keep local-government and worker pension costs low for a while, but now the state, cities and school districts are having to play catch-up.

School-district pension costs have more than doubled since 2013, and the state legislative analyst's office predicts they will climb another 30% over the next two years. For every dollar cities spend on worker salaries, they have to pay 32 cents to Calpers. This effective payroll "tax" charged by Calpers will increase to nearly 50 cents on the dollar by 2024. Retirement costs already equal 44% of teacher pay in San Francisco.

"Cities want to make it clear that our foundation is rocky at best," Dane Hutchings, a representative of the League of California Cities, told the Calpers Investment Committee last month. "It's crunch time, and quite frankly, we simply cannot stand another market slowdown or substandard returns."

Mr. Hutchings warned of impending municipal bankruptcies and urged Calpers to shoot for higher investment returns to forestall layoffs and cuts to public services. Schools last year issued thousands of pink slips. Hundreds more have gone out this year. Many are laying off secretaries and support staff to pay for teacher raises and pension benefits that have been collectively bargained.

Meanwhile, California's high cost of living is making it harder for districts to recruit and retain teachers. A Sacramento Bee analysis found that about 18,000 teachers left the state between 2003 and 2016, with the biggest losses occurring during the housing-price peaks. A third of the teachers went to Texas, where the average teacher salary is $53,167, compared with $81,126 in California.

Golden State teacher salaries are the second highest in the country after New York and about $13,000 above the state's median annual household income. A midcareer teacher in an affluent district can earn six figures. But even then, many will struggle to afford a home. Thanks to local zoning and state environmental regulations, which have restricted the housing supply, home prices have soared. The median home price in Orange County -- which encompasses high-poverty areas like Santa Ana and Anaheim -- is $714,000. Good luck finding a house for less than $1 million in the Bay Area. A condemned home in Fremont -- about 30 miles south of Oakland -- sold for $1.2 million in April.

School districts are raising pay to improve teacher retention, but their budgets are simultaneously being squeezed by increasing pension costs. In 2008 San Francisco voters approved a $198 parcel tax to "recruit and pay teachers a living wage so they don't keep leaving." Parcel taxes are a uniform surcharge on each home that lets school districts circumvent Proposition 13's limits because they are not based on the property's value. Between 2012 and 2017, teacher salary costs rose by a healthy 23%, but retirement costs soared 106%.

In June, voters approved another $298 parcel tax to cover a 16% pay raise so that, according to the referendum, school districts can "increase the salaries of teachers and paraeducators, and ... increase the compensation or benefits of other school district employees." But Reeta Madhavan, chief financial officer of the San Francisco Unified School District, said the second parcel tax was necessary because pension costs are rising by about $5 million each year.

"Think about it: if we had that $5 million each year, we could put that towards teacher salaries versus paying it out in increased Calstrs contribution," Ms. Madhavan recently explained.

Meantime, higher salaries are pushing up pension costs. That's because teachers' annual pension benefits are linked to their salaries -- typically, final compensation multiplied by 0.02 multiplied by the number of years they worked. Calstrs contribution rates are also set as a share of total payroll. So when teacher salaries increase, so do district pension bills.

Local officials are typically loath to tell voters that they need to raise taxes because pensions are squeezing out services. To sell a $620 parcel tax in 2016, Davis Joint Unified School District in Yolo County warned: "Without the parcel tax, we could not sustain the enrichment and choice that other districts no longer can afford."

But the local teachers union complains that the parcel tax burdens school employees, who are being priced out of the area. State Sen. Bill Dodd, a Napa Democrat, has introduced a bill to exempt Davis school-district employees from the parcel tax. The bill passed the state Senate in May and is currently being considered by the Assembly.

"This bill would provide an additional incentive for public educators and school staff to live in the community in which they work, despite the severe shortage of affordable housing," a legislative analysis says.

Behold California's house of cards, propped up by subsidies and exemptions for Democrats' special friends, while taxpayers pay the mortgage.

Ms. Finley is a member of the Journal's editorial board.

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U.S. News: Long-Dormant Inflation Heats Up

By Harriet Torry
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30 June 2018
The Wall Street Journal
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English

Inflation in the U.S. is back after more than half a decade of falling short.

A price measure watched closely by the Federal Reserve hit the central bank's target after running below it every month for six years, as a strong labor market nudges wages higher and robust economic growth squeezes slack out of the economy.

Though inflation hits consumers and businesses with more expensive purchases and loans, the Fed believes a little bit of inflation at a consistent and predictable rate is needed to keep the economy growing steadily and at a healthy pace.

The Commerce Department's price index for personal-consumption expenditures, excluding food and energy costs, rose 2% in May from a year earlier after running below that mark every month since April 2012. The Fed prefers that measure because it strips out categories that make it hard to see underlying inflation trends.

The central bank also looks at a broader measure of inflation that includes food and energy costs. That measure was up 2.3% in May from a year earlier, the largest increase since March 2012, driven in part by higher gasoline prices.

The broader inflation measure has hit the 2% target a few times in recent years, typically when gas or food prices rose, but it tended to fall back below the target for much of the expansion. Its average is 1.3% since May 2011.

Economists have blamed factors like weak economic demand, a strong dollar and a slowly recovering labor market for low inflation in recent years. The strong dollar makes imports cheaper, and soft labor markets hold down wages.

Structural factors are also thought to have played a role, like an aging population spending less, cheap imports due to globalization and the "Amazon effect" of consumers spending less on goods online.

But demand is picking up and unemployment falling. Many forecasters estimate the U.S. economy grew at near 4% or even faster in the second quarter, twice the rate of the 2% average for much of the expansion. More demand tends to push prices higher.

"Gas in our area has gone up quite a bit" over the past year, said Herb Houck, a funeral director from Reading, Pa. "Supermarket is about the same, it goes up all the time," the 63-year old added.

In recent months, businesses have seen their own costs rise, in part because of high energy prices and labor shortages putting some mild upward pressure on wages. Now, some businesses say they are trying to pass those costs on to consumers.

Tyson Foods Inc., the largest U.S. meat company by sales, figures rising freight rates will cost it $155 million in its current fiscal year. In response, it is raising prices for chicken, pork and beef, counting on consumers' appetite to help the company negotiate with restaurants and retailers.

"It's not an easy discussion to have with customers," Tom Hayes, Tyson's chief executive, said at an event in May. "We will do our best to make sure we get all the value back for our shareowners and for ourselves."

General Mills Inc. has raised some prices in recent months and started selling smaller boxes of cereal at a higher price-per-ounce, thanks in part to higher freight and food commodity costs.

Chief Executive Jeff Harmening said grocery stores have been hesitant to pass those higher costs on to customers, but that they understand the pressures manufacturers face. "We don't need to fully offset the inflation, but we need just a little bit of pricing to go along with efficiencies," he said.

Trade tariffs could shift the inflation picture further. Tariffs impose a duty on goods imported to the U.S., costs that companies may try to pass to consumers. The Trump administration has imposed tariffs on washing machines, steel and aluminum and threatens tariffs on cars and as much as $250 billion worth of goods imported from China.

"Our goal continues to be to pass the cost increases on to the marketplace," Timothy Hassinger, chief executive of Lindsay Corp, which makes crop-irrigation systems, saidon Thursday. "We've led the industry this year in the implementation of the steel surcharges. Our intention is to continue with this strategy."

For the broader economy, hitting the 2% inflation target is "encouraging," Michael Feroli, chief U.S. economist at JPMorgan Chase & Co., said in an interview. It means the economy is in better balance after slow growth in the wake of the severe 2007-2009 recession. However, "touching 2% isn't grounds for victory" after the long run of low inflation, Mr. Feroli said. Fed officials "want to see it sustained."

The central bank won't be surprised by the latest readings. When inflation slowed last year, officials looked past the drop, believing it was due to temporary factors, including one-off cuts in cellphone-service plans.

Fed Chairman Jerome Powell in June projected that "later this summer there's a good chance that headline inflation will move up above 2% because of (higher) **oil prices**."

Now, officials need to consider how high, and for how long, they should let inflation rise. With the expansion entering its 10th year in July and unemployment at an 18-year low, the central bank has been raising short-term interest rates to prevent the economy from overheating.

The Fed drew some unusual attention from the White House on Friday.

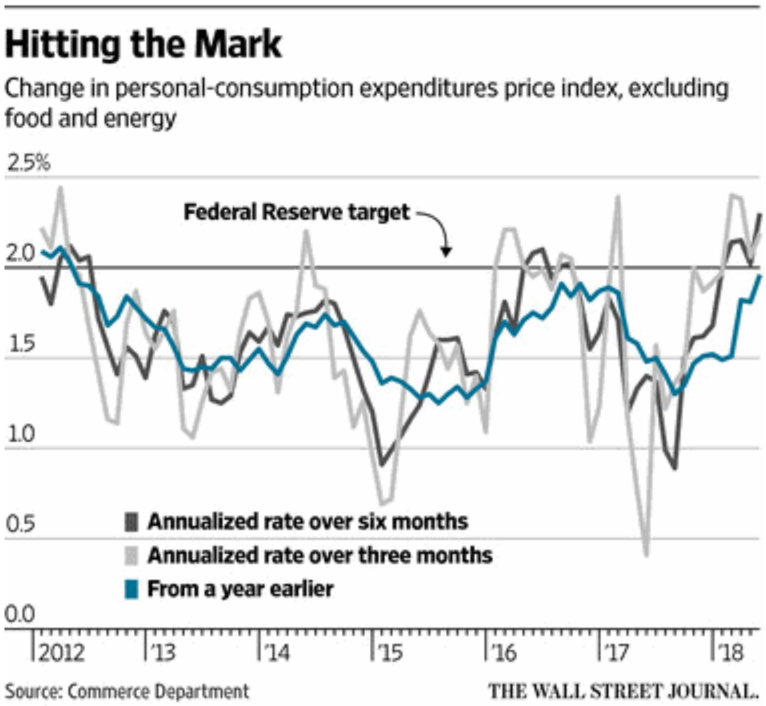
Lawrence Kudlow, President Donald Trump's top economic adviser, said on Fox Business Network that he hoped the central bank would move interest rates up "very slowly" -- breaking with a 25-year White House precedent of generally refraining from commenting on monetary policy in deference to central-bank independence.

Fed officials voted in June to boost their benchmark rate by a quarter point to a range between 1.75% and 2%. They have penciled in two further quarter-point increases for 2018 and project more increases to over 3% by 2019.

Fed officials estimate core inflation will steady at 2% this year and inch up to 2.1% in the two following years.

Fifty-four economists surveyed by The Wall Street Journal recently said on average the Fed would tolerate annual core PCE inflation as high as 2.5% before raising rates more aggressively than planned.

Paul Kiernan, Annie Gasparro and Jacob Bunge contributed to this article.



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THE WALL STREET JOURNAL.

Markets

Emerging Markets Stumble as Global Investors Sour on Risk; Recent declines cut short a rally that had powered emerging-market stocks and bonds higher in 2017

By Julie Wernau
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Emerging markets tumbled in the second quarter after a stronger dollar and higher U.S. interest rates led many investors to flee from riskier investments in the developing world.

The MSCI Emerging Markets **stock index** fell 8.5% over the past three months, the index's worst quarterly performance since the third quarter of 2015. Emerging-markets bonds lost 3.6% in the J.P. Morgan EMBI Global Diversified, a benchmark bond index.

Currencies in places like Argentina and Turkey, which rely heavily on outside capital to finance their budgets, dropped the most against the dollar. That raised fears that their dollar debt would be harder to pay off and more expensive to sell, widening their deficits.

Fears that the U.S. and China could escalate a trade dispute has become another concern, especially for trade-dependent countries like Russia, South Korea and Brazil.

Emerging markets' recent declines cut short a rally that had powered these stocks and bonds higher in 2017, as the period of low interest rates caused many investors to look at Asia, Latin America and Eastern Europe for yield.

Some emerging-markets investors say they are ready to dip their toes back into these markets, believing that recent declines make prices attractive again. But many global investors say they are hesitant when the Federal Reserve and other major central banks are paring back the stimulus policies that kept global interest rates low and encouraged risk. At the same time, higher **oil prices** are delivering a blow to countries that rely heavily on oil exports.

"We will stay cautious," said Andy Wong, senior investment manager at Pictet Asset Management's international multi-asset team.

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The New York Times

Business/Financial Desk; SECTB
Trade Tensions Temper Markets' Gains

By THE ASSOCIATED PRESS
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6
English

Markets ended the week mostly higher on Friday, but surrendered much of an early gain as worries about rising tariffs once again dampened investors' enthusiasm.

The Federal Reserve allowed most of the largest financial institutions in the United States to pay bigger dividends to shareholders and buy back tens of billions of dollars in stock. Wells Fargo stock made its biggest gain since shortly after the 2016 presidential election. Nike shares had their biggest surge in almost four years after the company said sales in North America improved in its latest quarter.

The Commerce Department said spending by consumers rose a disappointing 0.2 percent in May. But wages continued to improve, and Shawn Cruz, manager of trader strategy for TD Ameritrade, said that suggested that spending would rise.

"Investors wanted to see what the potential is for consumer spending in the future," Mr. Cruz said. "Wage growth came in solid enough that there wasn't a major concern."

The **Standard & Poor's 500**-**stockindex** edged up 2.06 points, or 0.1 percent, to 2,718.37. The **Dow Jonesindustrial average** gained 55.36 points, or 0.2 percent, to 24,271.41. The **Nasdaq composite** rose 6.62 points, or 0.1 percent, to 7,510.30. The Russell 2000 index of smaller-company stocks lost 1.95 points, or 0.1 percent, to 1,643.07.

The Dow rose as much as 293 points in the middle of the day, but those gains eroded as investors again focused on the trade concerns that have rocked the market since late February. Canada announced $12.6 billion in retaliatory tariffs on American goods in response to the United States tariffs on steel and aluminum imports. General Motors warned that if the Trump administration placed import taxes on cars and car parts, it would likely face retaliation and might have to eliminate domestic jobs.

The Federal Reserve allowed 32 of the 35 largest banks to raise their quarterly dividends and buy back more stock. The central bank determined that those institutions were in good enough financial shape to weather a major downturn in the economy.

Wells Fargo shares gained 3.4 percent to $55.44. While the Fed's "stress tests" measure a bank's financial health and are separate from its business tactics, investors felt the Fed's approval was a notable win for Wells. Earlier this year the Fed ordered the bank to replace several of its directors and limited its growth in response to abusive practices, including opening accounts in consumers' names without permission.

Wells Fargo admitted to those practices in 2016 and has since agreed to pay more than $1.5 billion in fines, penalties and legal settlements.

Nike, the athletic apparel company, said revenue in North America grew after several quarters of declines, and its fourth-quarter profit and sales blew past Wall Street forecasts. The company also said it would buy back $15 billion in stock over the next four years. It gained 11.1 percent to $79.68.

With trade tensions in focus throughout the second quarter, stocks did not make big gains after a very strong round of first-quarter corporate reports. The **S.&P. 500** rose 2.9 percent over those three months and the Dow added just 0.7 percent.

Investors felt technology companies and smaller, more United States-focused companies were safe picks in case the trade tensions got worse. The **Nasdaq composite** jumped 6.3 percent and the Russell 2000 index advanced 7.4 percent. Both set records as recently as last week.

Only a week remains before the United States and China each place tariffs on tens of billions of dollars in imports. Mr. Cruz, of TD Ameritrade, said the outcome of the broader trade tensions would help determine what stocks do in the months to come: he said stocks might set more records if the situation was resolved in a way the market liked, but if the tensions ended up hurting global economic growth, stocks could fall further.

Shares of energy companies and **oil prices** continued to climb. Benchmark United States crude gained 1 percent to $74.15 a barrel in New York and rose 14 percent during the second quarter, to its highest price since late 2014. The **S**.**&P**. **500 index** of energy companies climbed almost 13 percent this quarter, far better than the rest of the market and its biggest gain in six and a half years.

Brent crude, used to price international oils, rose 1.9 percent to $79.44 a barrel in London.

Wholesale gasoline climbed 2.2 percent to $2.18 a gallon. Heating oil rose 1.4 percent to $2.21 a gallon. Natural gas lost 0.5 percent to $2.92 per 1,000 cubic feet.

Bond prices wobbled and turned lower. The yield on the **10**-**year Treasury** note rose to 2.86 percent from 2.84 percent.

Gold added 0.3 percent to $1,251.40 an ounce. Silver gained 1 percent to $16.20 an ounce. Copper fell 0.2 percent to $2.97 a pound.

The dollar rose to 110.70 yen from 110.51 yen. The euro rose to $1.1675 from $1.1564.

In France, the CAC-40 gained 1.1 percent and the DAX in Germany added 0.9 percent after a deal on migration relieved pressure on the coalition government of Chancellor Angela Merkel. In Britain, the FTSE 100 added 0.3 percent.

The benchmark Nikkei 225 edged 0.2 percent higher in Japan. The Kospi in South Korea advanced 0.5 percent and in Hong Kong, the Hang Seng added 1.6 percent.

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Friday. (Source: Reuters)

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WSJ PRO CENTRAL BANKING

Economy

Federal Reserve's Eric Rosengren Discusses Economic Outlook and Risks; Boston Fed president speaks to The Wall Street Journal in wide-ranging interview

By WSJ Staff
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Federal Reserve Bank of Boston President Eric Rosengren spoke with Wall Street Journal reporters and editors in Washington on Wednesday, June 27, 2018. He discussed his outlook on employment, inflation and the prospect of additional interest-rate increases this year, and his concerns about international trade disputes creating risks to the outlook.

Here is a partial transcript of the interview, lightly edited for clarity and length.

WSJ: Has your view about the economy or the outlook changed at all since the beginning of the year, since we knew about the fiscal packages that were put in place?

ERIC ROSENGREN: The economy has come in quite strong. This quarter looks like it's going to be above 3% (annual rate of growth). If you look at the forecasters, they're expecting 3% for the rest of the year. That actually is gratifying, that we thought it was going to be a pretty strong economy over this year, but I think it's probably come in a little bit stronger than we might have anticipated.

Now, having said that, with a baseline that's quite strong, I'd also say in some respects this forecast is more fragile. So we both have a very strong economy, but I would say some of the risks are a little more accentuated now than they were before. And there are actually risks on both sides, so let me explain what I mean by that.

On one side is clearly the trade issues. When I did my Summary of Economic Projection, I did not expect that trade was going to be a meaningful macroeconomic effect. As time goes on, it's less clear whether that assumption is accurate. It's still my baseline, but we'll learn a lot over the next couple weeks about whether this is going to become a full-fledged issue or whether it's going to become relatively contained. As an economist, I'm no better than a reporter in judging what the likelihood is that this accelerates rather than diminishes. So the baseline is strong, but it's reflecting data that doesn't incorporate the potential for a significant disruption coming from international trade disputes. So it's fragile in that respect—that risk is more elevated than it was, or at least that I thought it was, three or four months ago.

The second risk is that the unemployment rate's been dropping relatively quickly. We're now at 3.8%. That was where the (Federal Open Market Committee) at the beginning of the year thought we'd end the year. And if you get 3% growth, that's well above potential, so that implies that the unemployment rate, more than likely—unless we pull a lot of people into the labor force—will go down further. There have not been many times when we've seen the unemployment rate this low. The last time was in the 1960s. At that time there was a buildup of fiscal policy related both to the poverty program and to the Vietnam War. It was a different world. Unions were more powerful. There were a lot of other things that were different in the 1960s. But nonetheless, it was an environment where we got the unemployment rate very low and wages and prices picked up.

We don't have a lot of historical data on an unemployment rate in the range of 3.5%, so I think it remains to be seen whether we see more wage and price pressure. Wages have been going up gradually. We're now pretty clearly going to be at our 2% inflation target, and I think everybody's very close to the 2% inflation target for the end of this year in the SEP. So I think there's a widespread agreement that we're going to be around 2% inflation at the end of this year. Wages have definitely gone up. They're not at a point that it's troubling at this point. But I would say that when the economy becomes beyond what we think is sustainable, it becomes a little bit less predictable exactly what's going to happen. So wages and prices are one possibility. Asset prices, real estate values, other things are another possibility. So we don't have that much historical experience pushing the economy really low, and so there are some risks that we're taking on the other side, which is that we'll be pushing the economy too hard, and it's unclear exactly how that will manifest itself. But I do have some concerns that if we push the economy too hard, that will also shorten the time that we have a long recovery.

I think one of the goals should be to have a very long period where we don't suffer a recession. And so sometimes, by pushing too hard now, you actually reduce the probability that you'll have a long and sustained period where we don't have a recession.

So that's something I'm definitely keeping an eye on. And I think it's why it's very consistent that we've been gradually increasing rates up to now. We're roughly at the rate of inflation at this point. We'll have to see how the economy evolves, and we will have some information on the international side hopefully in the next couple of weeks.

So I'm worried about that two-tailed risk. And I think both of these risks are a little bit clearer in the data than they were, say, four or five months ago.

WSJ: If some of these trade developments do materialize, if we do actually see the tariffs stick, for example, the ones that have already taken effect or that have been announced—how would that change your view about what is needed from monetary policy?

MR. ROSENGREN: So, first, it's a little bit hard to exactly predict because we don't have very many experiences in the postwar data where we've had international trade disruptions occurring in a broad sense. So it's going to be hard to tease that out just out of our models.

When you talk to firms, I think there are a couple ways that it would start manifesting itself. Supply chains have become very important and they're international supply chains. So how disruptive a change in supply chains are is something that we can't model very easily, but I think is nonetheless important.

So there was an example where I was talking to a retailer focused on apparel. They source a lot of their materials in China currently. They're starting to look at alternative sources.

So we're going to be relying on incoming data maybe a little more than we normally would, because I don't know that we can look at the last 40 years of history and say, well, this is clearly what happens when we have a widespread disruption on international trade.

The question will be, over time, are we seeing more of these areas where we start seeing that there are some unique elements that forces people to pass it on. And customers, in some sense, in both a very tight labor market and with a clearly identifiable price shock, it's understandable that they might be able to pass that pricing through in a way that they might not have been able to do in previous times.

WSJ: Is that the kind of inflation that the Fed has to worry about, something that is temporary, a one-time shock, and isn't necessarily a monetary or demand-driven?

MR. ROSENGREN: It's a good question, but part of it is where we are in the demand cycle. So if we start getting more comfortable with price increases and people get more comfortable with the idea that prices are going to be passed through, you do wonder whether expectations of that are going to change, particularly in the labor market.

The unemployment rate—we're already at 3.8%—it'll probably get down to the mid-3s. We think we're going to have a 3% growth rate over the course of this year. So it's going to be a very tight labor market and an environment where relative prices are changing and it's going to start becoming difficult to completely disentangle how much price changes are because of tight labor markets and how much of it is because of some other kinds of disruptions that are currently going on.

So I think you're right. If it's nothing but a one-time change and it's offset right away—doesn't get into people's expectations—and that's not something that we would have to offset. I think it's a little unpredictable because we haven't had a period where the unemployment rate has been this low at the same time that we've had something that could potentially cause some significant relative price changes.

If it were purely a relative price change and, let's say, the tariffs went off very quickly—people's expectations didn't change at all—that's not something we should react to. If, on the other hand, in a tight labor market the relative prices are changing and different products and different firms are reacting in different ways, it's going to be a little bit harder to disentangle what's a relative price change and what is more reflective of a general price change. If that starts getting into expectations, that's something we're going to have to watch very carefully.

And because we don't have a lot of historical data on this, I don't know that we can necessarily model it particularly well based on our statistical models using kind of postwar data.

WSJ: The other side of the risks: you just described we're likely to continue growing above potential through the rest of the year; unemployment is likely to continue to fall; and the fed-funds rate, if you adjust for inflation, is at zero. So you said that's consistent with gradually increasing rates. Are you uncomfortable with the gradual pace? Is it time to start picking it up a bit?

MR. ROSENGREN: A lot depends on what you think the neutral rate is for the interest rate.

WSJ: What do you think the neutral rate is?

MR. ROSENGREN: The committee has a neutral (federal-funds) rate that is just under 3%. But there's a wide spread, and that number has changed over time. So the first thing to emphasize is the interest rate—that's the equilibrium interest rate, and consistent with not being restrictive or accommodative—is a pretty wide span. We don't estimate it with any precision and it's unobservable.

So there is a disagreement among the committee. You can see it on when asked what we think the federal-funds rate will be in the long run, and there is a pretty decent spread in terms of what people think. And if you go back for five years, that rate has been coming down over the last five years. So we, obviously, don't estimate this with precision. So part of it is observing what's actually happening in the world.

So I may have an estimate, and my estimate is not that different from the consensus. It's probably a little bit under 3% for the nominal federal-funds rate. So you take 2% away—roughly, a 1% real or 0.75%-1% real. So there's certainly some people lower than that. There's some people that are higher than that.

But the unemployment rate is still dropping. So if you think about (the neutral fed-funds rate) being 2.75%, for example, that's only three (rate) increases. So three increases from now, that will be the beginning of next year. So if we really believe the neutral rate is 2.75%, we don't have that far to go. Now, we may find out that the neutral rate actually is higher than we were expecting, in which case we have to go higher.

But one reason we can be gradual is because our estimate of where we think we're not being accommodative any longer is much lower than it used to be. So if we thought that the equilibrium rate was over 4%, then we'd have a lot further to go and you'd be more uncomfortable with a gradual pace. If you thought that—there are members that think it's as low as 2.25%—well, we're only one tightening away from being very close to that number.

WSJ: Do you distinguish between short-term equilibrium and a long-term equilibrium?

MR. ROSENGREN: Yes, I do.

WSJ: And explain how your thinking works around short-term equilibrium, long-term equilibrium, and where you think we are right now.

MR. ROSENGREN: So because we measure this so imprecisely, I don't find the equilibrium in fed-funds rate as compelling a concept as some of my colleagues. And so I would be more focused on what we think is going to be happening to inflation and unemployment over the longer run in looking at our forecasts.

I do think we're already pushing the unemployment rate to low levels that are likely to be unsustainable in the long run, and we're at our 2% inflation target so there's ample reason to be continuing to gradually remove accommodation. But I do believe that the rates are lower—so the precision is enough that there's a difference between the short run and the long run, and they're both estimated with a lot of imprecision.

So if we have an economy where we're creating 190,000 jobs (per month), on average—that's, roughly, what we've been averaging over the last year—that's much stronger than would be consistent with keeping the unemployment rate level. So if you think that the right equilibrium interest rate for right now is 2.25%—we're only one tightening away—you have to explain how you're going to get from 190,000 to a much slower job growth so that we don't keep pushing the unemployment rate lower and lower. So I think it's much higher than the lowest estimates that people are putting the equilibrium interest rate.

WSJ: To go to something that's more observable, you're famous now for mentioning asset prices and commercial real estate as areas where, in the past, you've cited some concerns. So where are you in terms of just looking at the landscape of asset prices and any specific areas that might be areas of concern, and how much of a concern are they to you right now?

MR. ROSENGREN: Real estate valuations haven't come down much, and we have been raising interest rates. So the other thing that is important to think about is how much the tightening that we've done to date has actually tightened **financial markets**, and if you look at their assessments of what financial conditions are, it's a little bit tighter. But it wouldn't be as tight as the amount of increase that we've had in the federal-funds rate. So there are sectors of the economy that I do have concerns about, and real estate would be one of those areas that I still think the valuations are pretty rich for this stage of the cycle.

WSJ: Commercial and residential?

MR. ROSENGREN: No. More commercial than residential. So the valuations are quite rich and I think we're at a stage in the cycle where we can't keep—commercial real estate is certainly helped by more people having jobs. But there is a point at which the unemployment rate gets so low that you can't be expecting payroll employment growth to be growing very rapidly. That means you don't need as much increase in commercial real estate. I can walk around Washington, New York, or Boston, and I still see an awful lot of cranes. Now, some of those are multifamily properties. Some of them are commercial properties. But I'm not sure all that space is going to get filled. And I am worried that the valuations are pretty rich, and commercial real estate is something that is pretty cyclical. So I think that's a good example. It's something that I'm keeping a close watch on.

WSJ: You've been using that cranes anecdote for years now.

MR. ROSENGREN: Valuations can be high for a long time. And if you look at the commercial real estate cycle, it's a long ways. It's not sharp. We're in a world where it's digital and everybody expects something to happen in the next six hours. But that's not the way the economy works. Wages move up very slowly. Real estate valuations can be out of whack for quite a time. Residential real estate prices got out of whack (for) quite a period of time before they came down.

So we don't have a great model for asset valuation of individual assets. We can say that they diverge significantly from where they have been historically, and unless you think you're in a different paradigm, at least be thinking about why you think the valuations are so different than what they've been historically.

So, yes, I have been using it for a while, but I do think valuations can be inflated for a long period of time, and then something triggers the devaluation. That usually occurs when an economic cycle comes to an end and people start realizing the collateral valuation is rich, and you start getting vacant properties. And the pricing of a vacant property is very different than a full property.

WSJ: Last month when we spoke, you said this would be a good time to raise the countercyclical capital buffer. What undergirds that argument?

MR. ROSENGREN: There are a number of things we can do to make the next down part of the cycle, which I'm not predicting is going to occur anytime soon necessarily. The next time there's a downturn, there are things that we could be doing now that make that downturn less severe.

And one of the ways that we have downturns that are severe is the way that we implement our capital ratio. So if we look at the last crisis in the late '80s, early '90s, it was a period where capital asset ratios became binding and banks reacted by shrinking their assets. In effect, they were creating problems for their borrowers because of problems with their balance sheet. So if we want to avoid those kind of outcomes, the countercyclical capital buffer is designed to automatically come down when we have a bad outcome, like a recession, and collateral values are depressed and when most reserves are up. And so it gives us enough of a buffer that banks can react by not having the same strong incentive to shrink.

So I think there's an economic logic that is trying to mitigate some of the effects of the next downturn. So I don't think it's just bank regulation, but I think there are examples in bank regulation. Monetary policy is traditionally one of the ways that we address an economic downturn. We lower interest rates in order to try to moderate and mitigate the effects of a severe recession. But, again, in the speech, I highlight that that may not be as flexible as it has been in the past, because the likelihood we hit zero next time I think is quite high. So unless we get the short-term federal-funds rate much higher, whenever we do have that next recession the likelihood is that it gets to zero.

WSJ: The stress test scenario, is that countercyclical enough? It's very difficult, the scenario this year. And it's even more difficult because the baseline is better, so you have further to go to get to the doomsday. Is that countercyclical enough?

MR. ROSENGREN: So it is good in raising capital during the goods times. The question is, how much banks are comfortable that it'll be reduced in the bad times. So the feature of the countercyclical capital buffer is it is explicitly reduced so it becomes less binding during the bad times. If you actually—in a previous speech, I went through what the various scenarios have been and noted the exact thing that you noted, which is on the upcycle it has been a tougher stress test, in general. But we can't give assurances, necessarily, if you don't know who's going to be at the Federal Reserve, you don't know what stress tests are going to be used the next time we have an economic downturn.

It's not as well designed to actually mitigate the action of any banks to shrink. So I do think it does serve a purpose, in that it's building a buffer during the good times. I'm just not sure those buffers are released during the bad times. It's much harder when nonperforming loans are going up, capital is being depleted to say we're not going to stress in the stress scenario, because those are primarily a micro-prudential tool. So they're worried about solvency of the institution, and I think that's appropriate. But if you combine the goal of solvency of an institution with mitigating some of the business cycle factors that bank regulation can induce, the countercyclical capital is a preferred way of doing it so that we don't have the shrinkage of bank assets which is, in effect, affecting the customers of the bank, and exporting some of the balance sheet problems to borrowers, either through higher lending rates or through more difficulty in actually getting loans. That would be the time you'd actually like the exact opposite.

WSJ: Just as a technical matter, the fed-funds rate is still drifting to kind of the top of the range, despite the adjustment to interest on excess reserves you made at the last meeting. Are you uncomfortable with the fed-funds rate being so high? And are you worried that the Fed is losing control of the fed-funds rate? And do you think you might have to make another adjustment to IOER to push it down closer to the midpoint of the range?

MR. ROSENGREN: So our target is on the fed-funds rate. And I don't think we've lost at all control of the federal-funds rate. One of the changes that occurred with the financial crisis was we started to have regulations on liquidity. And one of the things that that induced was to have banks hold high-quality liquid assets. So they could hold that as bank reserves, or they could hold it as Treasury securities. And so as we reduce our balance sheet, we may find a point at which with the high-quality liquid assets now being a part of the liquidity requirement—that they want to hold more reserves. And so even with a balance sheet that's larger than we've historically had, it may be having more upward pressure on short-term interest rates that we anticipated. And I think that's partly an empirical question tied to how banks are thinking about the substitutability of reserves and Treasury securities. And you can imagine a reason for why, if you had a Treasury securities portfolio and a lot of excess reserves, the reserves don't get observed very frequently.

And Treasury securities, if you're going into the market and selling them, it's observable. So if I had a whole lot of these, particularly at a time when reserves weren't that different, in terms of what the Treasurys were paying and what the reserves were paying, you can see why they might prefer to actually hold their high-quality liquid assets in reserves. So I think it's something that we have to monitor and watch. I don't think it says anything about our ability to control. It does say that we may have to make technical adjustments if we find out that this high-quality liquid asset requirement is causing more demand for reserves at a higher balance sheet than we might have anticipated.

WSJ: What's your assessment of the deregulatory agenda right now?

MR. ROSENGREN: We made a lot of supervisory changes during the crisis. And I think directionally they were correct. I think it does make sense to reevaluate and ask, has the pendulum swung too far in certain areas, and make sure that the cost/benefit actually makes sense. So I have no problem with reevaluating what we have. That being said, I think it's very, very important that banks have sufficient capital. That we don't worry about their financial solvency. And as I've said, one reason why I want a countercyclical capital buffer is I'd like to have banks less sensitive to economic downturns than they have been historically.

So we're at a stage of the cycle with an unemployment rate of 3.8% and asset valuations pretty high. But I'd want to make sure that there is a good buffer for banks so that they don't become a problem the next time we have an economic downturn.

So, within that framework, there are lots of things that you can do to think about what makes sense and what doesn't make sense, and a lot of these adjustments are technical adjustments, which I think are appropriate. And the goal isn't to have unduly restrictive regulations that don't have much benefit, and so now that we have a little bit more experience with that framework, I think it is a good time to reevaluate. So we should reevaluate.

I wouldn't want to see the aggregate level of capital diminish; in fact, I think you could make an argument with a countercyclical capital buffer that that should be a non-zero number right now.

WSJ: Based on what you said on the countercyclical buffer, it sounds like you are starting to think that we are getting really late in the cycle, that we're really getting close to the next downturn. Is that right?

MR. ROSENGREN: So I'm not predicting a downturn is imminent, but I am saying we are at a stage of a cycle, and we're far enough—I do worry about imbalances if we push the economy too hard. And the last chart that I show on that shows you what happens when you push the economy well below what the CBO has historically thought was the natural rate. And there's really only one period where we stayed below for a long period of time—that's the '65 to '70 period. That's not a period that normally we think of as being the right way to conduct monetary policy. That's when inflation started to pick up, and you kind of created the problems that then you kind of fought through the entire 1970s and that Volcker brought back down.

I'm not predicting that will happen. There are lots of things that have changed in the economy since the 1960s, but I do think I worry about imbalances, and those imbalances can, over time, be manifested in wages and prices, or they can be manifested in asset prices.

Ironically, (former Fed Chairman William McChesney) Martin is known for his taking the punch bowl away. When you don't take the punch bowl away, it's not that predictable what's going to happen. You don't know if people are going to get in a fight, you don't know if somebody will get in a car that shouldn't get in a car, you don't know if they'll destroy the property. What you do know is that predictions for bad outcomes have increased. And so what I want to avoid is the conditions for bad outcomes. And that's one reason to be gradually increasing now.

WSJ: Do you favor two more rate increases this year?

MR. ROSENGREN: So my own personal view would be that we should continue on the path that we are currently on, and so I have argued—so the median for the committee went from three to four for this year. I think I'm very comfortable with that direction.

WSJ: Do you think the fact that we're seeing another trend of divergence in the U.S., and Europe, and the rest of the world on monetary policy and that sort of broader economics, does that exacerbate the risk of being imbalanced this year?

MR. ROSENGREN: One question is on trade. So we're less dependent on trade than other countries, and so we tend to focus on the implications of trade disruptions on our own country. But for other countries that are exporting to us, this is a big disruption as well. And so you have to be concerned. Foreign economies are going to slow down more, and part of it is just the uncertainty. And I talked a little bit about the uncertainty both in supply chains, uncertainty about businesses and how they should be thinking about their investment strategy in a world where they're not quite clear what the relative prices are going to be, both through inputs and outputs. And so I can understand why the entire world is concerned that there be a disruption.

We'll see if that actually happens. Until fairly recently, I thought the probability of that was quite low, but I read The Wall Street Journal, and obviously the probabilities increased over the last couple of months so it's a scenario that we have to think about.

WSJ: How is your view on global growth shifting? Are you marking down your estimates for global growth? And to what extent is it a global phenomenon, and to what extent is there like a two-track economy right now where the U.S. is doing very well and Europe and other economies are slowing down?

MR. ROSENGREN: They are slowing down, but I wouldn't say they are doing poorly. So for example, the Europeans are talking about very gradually exiting from their strategies, so that's something that you would only do if you thought that the economy was growing reasonably well and that they were going to hit their inflation target.

So I think other countries are very slowly thinking about exiting their unusual monetary policies. They're not growing as fast as the United States. They haven't had the same fiscal stimulus that the United States has had. So I think the progress is a little slower than would be ideal. It would be nice if Europe was coming back more quickly. It would be nice if Japan was coming back more quickly. And I do think the potential for trade disruptions are going to probably have a more magnified effect on countries that depend on exports more than we do.

WSJ: Going back to the housing boom and before that the technology bubble, should monetary policy have been anything different in those two cycles?

MR. ROSENGREN: It's very hard for monetary policy. We did tighten during that period. As you'll remember, we were tightening at every meeting. It wasn't that we weren't in a tightening cycle. We tightened to a much higher rate than, for example, we are right now. It's not that we didn't tighten rates.

You could argue could we have started sooner or done more, but I don't think that was the primary cause of the problem. The primary cause of the problem was that banks [were] not particularly well capitalized. Liquidity requirements didn't focus on how banks could weather the storm, and [banks had] too much reliance on wholesale funding.

So there are other factors that do a better job of explaining why the last recession was so severe. And I don't think the federal-funds rate was the predominant culprit in why that was such a severe downturn. We've rectified a lot of those concerns. We have much better capital regulation. We have much more liquidity. So banks are much better positioned now than they were. The next recession is probably going to occur from a different cause than the last one.

WSJ: There's an argument right now from some of your colleagues that the reason to possibly slow down the pace of rate increases or to pause at some point is because they don't want to invert the yield curve. How much sympathy do you have for that argument?

MR. ROSENGREN: So I think it's very relevant to ask if we tightened too much. I don't know that I would look at a short-term rate compared to the 10-year rate. The most common spread that people seem to talk about is the 2-year, 10-year spread. The 10-year spread is a particularly difficult spread at this juncture, because we have a bigger balance sheet than we've had historically. And so do the Japanese. So do the Europeans.

So the strategy for monetary policy since we hit zero interest rates was to press long-term interest rates. And until our balance sheet becomes more normalized, and that of our trading partners becomes more normalized, you would expect long rates to be more depressed than they have. And term premiums are quite low by historical standards.

So I would not focus on the 2-year, 10-year spread. I think it's much more relevant if you look at the fed-funds relative to the fed-funds futures. Does the market think that we're going to have to reverse course? If there's widespread belief that over the next year and a half that the Fed's tightened too much, I think that is a reasonable indicator that we should actually be able to have. But I don't think I would put the same emphasis on the two-year, 10-year spread that some people do, and because it's being affected by these other monetary-policy actions that haven't occurred in the past.

So people are looking at an historical relationship. But the 10-year rate is depressed for a reason. It's depressed because monetary policy in Europe, Japan, the United States has depressed that rate. So it's not that the fundamental insight that if the Fed tightens too much, that's a problem. But I would look at the shorter end of the market rather than that kind of spread.

From the Interview

* Rosengren Says It's Time to Take Away Monetary-Policy Punch Bowl (June 28)

* Fed Should Raise Banks' Capital Buffer, Now at Zero, Official Says (June 27)

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Economy
Federal Reserve's Eric Rosengren Discusses Economic Outlook and Risks; Boston Fed president speaks to The Wall Street Journal in wide-ranging interview

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Federal Reserve Bank of Boston President Eric Rosengren spoke with Wall Street Journal reporters and editors in Washington on Wednesday, June 27, 2018. He discussed his outlook on employment, inflation and the prospect of additional interest-rate increases this year, and his concerns about international trade disputes creating risks to the outlook.

Here is a partial transcript of the interview, lightly edited for clarity and length.

WSJ: Has your view about the economy or the outlook changed at all since the beginning of the year, since we knew about the fiscal packages that were put in place?

ERIC ROSENGREN: The economy has come in quite strong. This quarter looks like it's going to be above 3% (annual rate of growth). If you look at the forecasters, they're expecting 3% for the rest of the year. That actually is gratifying, that we thought it was going to be a pretty strong economy over this year, but I think it's probably come in a little bit stronger than we might have anticipated.

Now, having said that, with a baseline that's quite strong, I'd also say in some respects this forecast is more fragile. So we both have a very strong economy, but I would say some of the risks are a little more accentuated now than they were before. And there are actually risks on both sides, so let me explain what I mean by that.

On one side is clearly the trade issues. When I did my Summary of Economic Projection, I did not expect that trade was going to be a meaningful macroeconomic effect. As time goes on, it's less clear whether that assumption is accurate. It's still my baseline, but we'll learn a lot over the next couple weeks about whether this is going to become a full-fledged issue or whether it's going to become relatively contained. As an economist, I'm no better than a reporter in judging what the likelihood is that this accelerates rather than diminishes. So the baseline is strong, but it's reflecting data that doesn't incorporate the potential for a significant disruption coming from international trade disputes. So it's fragile in that respect—that risk is more elevated than it was, or at least that I thought it was, three or four months ago.

The second risk is that the unemployment rate's been dropping relatively quickly. We're now at 3.8%. That was where the (Federal Open Market Committee) at the beginning of the year thought we'd end the year. And if you get 3% growth, that's well above potential, so that implies that the unemployment rate, more than likely—unless we pull a lot of people into the labor force—will go down further. There have not been many times when we've seen the unemployment rate this low. The last time was in the 1960s. At that time there was a buildup of fiscal policy related both to the poverty program and to the Vietnam War. It was a different world. Unions were more powerful. There were a lot of other things that were different in the 1960s. But nonetheless, it was an environment where we got the unemployment rate very low and wages and prices picked up.

We don't have a lot of historical data on an unemployment rate in the range of 3.5%, so I think it remains to be seen whether we see more wage and price pressure. Wages have been going up gradually. We're now pretty clearly going to be at our 2% inflation target, and I think everybody's very close to the 2% inflation target for the end of this year in the SEP. So I think there's a widespread agreement that we're going to be around 2% inflation at the end of this year. Wages have definitely gone up. They're not at a point that it's troubling at this point. But I would say that when the economy becomes beyond what we think is sustainable, it becomes a little bit less predictable exactly what's going to happen. So wages and prices are one possibility. Asset prices, real estate values, other things are another possibility. So we don't have that much historical experience pushing the economy really low, and so there are some risks that we're taking on the other side, which is that we'll be pushing the economy too hard, and it's unclear exactly how that will manifest itself. But I do have some concerns that if we push the economy too hard, that will also shorten the time that we have a long recovery.

I think one of the goals should be to have a very long period where we don't suffer a recession. And so sometimes, by pushing too hard now, you actually reduce the probability that you'll have a long and sustained period where we don't have a recession.

So that's something I'm definitely keeping an eye on. And I think it's why it's very consistent that we've been gradually increasing rates up to now. We're roughly at the rate of inflation at this point. We'll have to see how the economy evolves, and we will have some information on the international side hopefully in the next couple of weeks.

So I'm worried about that two-tailed risk. And I think both of these risks are a little bit clearer in the data than they were, say, four or five months ago.

WSJ: If some of these trade developments do materialize, if we do actually see the tariffs stick, for example, the ones that have already taken effect or that have been announced—how would that change your view about what is needed from monetary policy?

MR. ROSENGREN: So, first, it's a little bit hard to exactly predict because we don't have very many experiences in the postwar data where we've had international trade disruptions occurring in a broad sense. So it's going to be hard to tease that out just out of our models.

When you talk to firms, I think there are a couple ways that it would start manifesting itself. Supply chains have become very important and they're international supply chains. So how disruptive a change in supply chains are is something that we can't model very easily, but I think is nonetheless important.

So there was an example where I was talking to a retailer focused on apparel. They source a lot of their materials in China currently. They're starting to look at alternative sources.

So we're going to be relying on incoming data maybe a little more than we normally would, because I don't know that we can look at the last 40 years of history and say, well, this is clearly what happens when we have a widespread disruption on international trade.

The question will be, over time, are we seeing more of these areas where we start seeing that there are some unique elements that forces people to pass it on. And customers, in some sense, in both a very tight labor market and with a clearly identifiable price shock, it's understandable that they might be able to pass that pricing through in a way that they might not have been able to do in previous times.

WSJ: Is that the kind of inflation that the Fed has to worry about, something that is temporary, a one-time shock, and isn't necessarily a monetary or demand-driven?

MR. ROSENGREN: It's a good question, but part of it is where we are in the demand cycle. So if we start getting more comfortable with price increases and people get more comfortable with the idea that prices are going to be passed through, you do wonder whether expectations of that are going to change, particularly in the labor market.

The unemployment rate—we're already at 3.8%—it'll probably get down to the mid-3s. We think we're going to have a 3% growth rate over the course of this year. So it's going to be a very tight labor market and an environment where relative prices are changing and it's going to start becoming difficult to completely disentangle how much price changes are because of tight labor markets and how much of it is because of some other kinds of disruptions that are currently going on.

So I think you're right. If it's nothing but a one-time change and it's offset right away—doesn't get into people's expectations—and that's not something that we would have to offset. I think it's a little unpredictable because we haven't had a period where the unemployment rate has been this low at the same time that we've had something that could potentially cause some significant relative price changes.

If it were purely a relative price change and, let's say, the tariffs went off very quickly—people's expectations didn't change at all—that's not something we should react to. If, on the other hand, in a tight labor market the relative prices are changing and different products and different firms are reacting in different ways, it's going to be a little bit harder to disentangle what's a relative price change and what is more reflective of a general price change. If that starts getting into expectations, that's something we're going to have to watch very carefully.

And because we don't have a lot of historical data on this, I don't know that we can necessarily model it particularly well based on our statistical models using kind of postwar data.

WSJ: The other side of the risks: you just described we're likely to continue growing above potential through the rest of the year; unemployment is likely to continue to fall; and the fed-funds rate, if you adjust for inflation, is at zero. So you said that's consistent with gradually increasing rates. Are you uncomfortable with the gradual pace? Is it time to start picking it up a bit?

MR. ROSENGREN: A lot depends on what you think the neutral rate is for the interest rate.

WSJ: What do you think the neutral rate is?

MR. ROSENGREN: The committee has a neutral (federal-funds) rate that is just under 3%. But there's a wide spread, and that number has changed over time. So the first thing to emphasize is the interest rate—that's the equilibrium interest rate, and consistent with not being restrictive or accommodative—is a pretty wide span. We don't estimate it with any precision and it's unobservable.

So there is a disagreement among the committee. You can see it on when asked what we think the federal-funds rate will be in the long run, and there is a pretty decent spread in terms of what people think. And if you go back for five years, that rate has been coming down over the last five years. So we, obviously, don't estimate this with precision. So part of it is observing what's actually happening in the world.

So I may have an estimate, and my estimate is not that different from the consensus. It's probably a little bit under 3% for the nominal federal-funds rate. So you take 2% away—roughly, a 1% real or 0.75%-1% real. So there's certainly some people lower than that. There's some people that are higher than that.

But the unemployment rate is still dropping. So if you think about (the neutral fed-funds rate) being 2.75%, for example, that's only three (rate) increases. So three increases from now, that will be the beginning of next year. So if we really believe the neutral rate is 2.75%, we don't have that far to go. Now, we may find out that the neutral rate actually is higher than we were expecting, in which case we have to go higher.

But one reason we can be gradual is because our estimate of where we think we're not being accommodative any longer is much lower than it used to be. So if we thought that the equilibrium rate was over 4%, then we'd have a lot further to go and you'd be more uncomfortable with a gradual pace. If you thought that—there are members that think it's as low as 2.25%—well, we're only one tightening away from being very close to that number.

WSJ: Do you distinguish between short-term equilibrium and a long-term equilibrium?

MR. ROSENGREN: Yes, I do.

WSJ: And explain how your thinking works around short-term equilibrium, long-term equilibrium, and where you think we are right now.

MR. ROSENGREN: So because we measure this so imprecisely, I don't find the equilibrium in fed-funds rate as compelling a concept as some of my colleagues. And so I would be more focused on what we think is going to be happening to inflation and unemployment over the longer run in looking at our forecasts.

I do think we're already pushing the unemployment rate to low levels that are likely to be unsustainable in the long run, and we're at our 2% inflation target so there's ample reason to be continuing to gradually remove accommodation. But I do believe that the rates are lower—so the precision is enough that there's a difference between the short run and the long run, and they're both estimated with a lot of imprecision.

So if we have an economy where we're creating 190,000 jobs (per month), on average—that's, roughly, what we've been averaging over the last year—that's much stronger than would be consistent with keeping the unemployment rate level. So if you think that the right equilibrium interest rate for right now is 2.25%—we're only one tightening away—you have to explain how you're going to get from 190,000 to a much slower job growth so that we don't keep pushing the unemployment rate lower and lower. So I think it's much higher than the lowest estimates that people are putting the equilibrium interest rate.

WSJ: To go to something that's more observable, you're famous now for mentioning asset prices and commercial real estate as areas where, in the past, you've cited some concerns. So where are you in terms of just looking at the landscape of asset prices and any specific areas that might be areas of concern, and how much of a concern are they to you right now?

MR. ROSENGREN: Real estate valuations haven't come down much, and we have been raising interest rates. So the other thing that is important to think about is how much the tightening that we've done to date has actually tightened **financial markets**, and if you look at their assessments of what financial conditions are, it's a little bit tighter. But it wouldn't be as tight as the amount of increase that we've had in the federal-funds rate. So there are sectors of the economy that I do have concerns about, and real estate would be one of those areas that I still think the valuations are pretty rich for this stage of the cycle.

WSJ: Commercial and residential?

MR. ROSENGREN: No. More commercial than residential. So the valuations are quite rich and I think we're at a stage in the cycle where we can't keep—commercial real estate is certainly helped by more people having jobs. But there is a point at which the unemployment rate gets so low that you can't be expecting payroll employment growth to be growing very rapidly. That means you don't need as much increase in commercial real estate. I can walk around Washington, New York, or Boston, and I still see an awful lot of cranes. Now, some of those are multifamily properties. Some of them are commercial properties. But I'm not sure all that space is going to get filled. And I am worried that the valuations are pretty rich, and commercial real estate is something that is pretty cyclical. So I think that's a good example. It's something that I'm keeping a close watch on.

WSJ: You've been using that cranes anecdote for years now.

MR. ROSENGREN: Valuations can be high for a long time. And if you look at the commercial real estate cycle, it's a long ways. It's not sharp. We're in a world where it's digital and everybody expects something to happen in the next six hours. But that's not the way the economy works. Wages move up very slowly. Real estate valuations can be out of whack for quite a time. Residential real estate prices got out of whack (for) quite a period of time before they came down.

So we don't have a great model for asset valuation of individual assets. We can say that they diverge significantly from where they have been historically, and unless you think you're in a different paradigm, at least be thinking about why you think the valuations are so different than what they've been historically.

So, yes, I have been using it for a while, but I do think valuations can be inflated for a long period of time, and then something triggers the devaluation. That usually occurs when an economic cycle comes to an end and people start realizing the collateral valuation is rich, and you start getting vacant properties. And the pricing of a vacant property is very different than a full property.

WSJ: Last month when we spoke, you said this would be a good time to raise the countercyclical capital buffer. What undergirds that argument?

MR. ROSENGREN: There are a number of things we can do to make the next down part of the cycle, which I'm not predicting is going to occur anytime soon necessarily. The next time there's a downturn, there are things that we could be doing now that make that downturn less severe.

And one of the ways that we have downturns that are severe is the way that we implement our capital ratio. So if we look at the last crisis in the late '80s, early '90s, it was a period where capital asset ratios became binding and banks reacted by shrinking their assets. In effect, they were creating problems for their borrowers because of problems with their balance sheet. So if we want to avoid those kind of outcomes, the countercyclical capital buffer is designed to automatically come down when we have a bad outcome, like a recession, and collateral values are depressed and when most reserves are up. And so it gives us enough of a buffer that banks can react by not having the same strong incentive to shrink.

So I think there's an economic logic that is trying to mitigate some of the effects of the next downturn. So I don't think it's just bank regulation, but I think there are examples in bank regulation. Monetary policy is traditionally one of the ways that we address an economic downturn. We lower interest rates in order to try to moderate and mitigate the effects of a severe recession. But, again, in the speech, I highlight that that may not be as flexible as it has been in the past, because the likelihood we hit zero next time I think is quite high. So unless we get the short-term federal-funds rate much higher, whenever we do have that next recession the likelihood is that it gets to zero.

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MR. ROSENGREN: So it is good in raising capital during the goods times. The question is, how much banks are comfortable that it'll be reduced in the bad times. So the feature of the countercyclical capital buffer is it is explicitly reduced so it becomes less binding during the bad times. If you actually—in a previous speech, I went through what the various scenarios have been and noted the exact thing that you noted, which is on the upcycle it has been a tougher stress test, in general. But we can't give assurances, necessarily, if you don't know who's going to be at the Federal Reserve, you don't know what stress tests are going to be used the next time we have an economic downturn.

It's not as well designed to actually mitigate the action of any banks to shrink. So I do think it does serve a purpose, in that it's building a buffer during the good times. I'm just not sure those buffers are released during the bad times. It's much harder when nonperforming loans are going up, capital is being depleted to say we're not going to stress in the stress scenario, because those are primarily a micro-prudential tool. So they're worried about solvency of the institution, and I think that's appropriate. But if you combine the goal of solvency of an institution with mitigating some of the business cycle factors that bank regulation can induce, the countercyclical capital is a preferred way of doing it so that we don't have the shrinkage of bank assets which is, in effect, affecting the customers of the bank, and exporting some of the balance sheet problems to borrowers, either through higher lending rates or through more difficulty in actually getting loans. That would be the time you'd actually like the exact opposite.

WSJ: Just as a technical matter, the fed-funds rate is still drifting to kind of the top of the range, despite the adjustment to interest on excess reserves you made at the last meeting. Are you uncomfortable with the fed-funds rate being so high? And are you worried that the Fed is losing control of the fed-funds rate? And do you think you might have to make another adjustment to IOER to push it down closer to the midpoint of the range?

MR. ROSENGREN: So our target is on the fed-funds rate. And I don't think we've lost at all control of the federal-funds rate. One of the changes that occurred with the financial crisis was we started to have regulations on liquidity. And one of the things that that induced was to have banks hold high-quality liquid assets. So they could hold that as bank reserves, or they could hold it as Treasury securities. And so as we reduce our balance sheet, we may find a point at which with the high-quality liquid assets now being a part of the liquidity requirement—that they want to hold more reserves. And so even with a balance sheet that's larger than we've historically had, it may be having more upward pressure on short-term interest rates that we anticipated. And I think that's partly an empirical question tied to how banks are thinking about the substitutability of reserves and Treasury securities. And you can imagine a reason for why, if you had a Treasury securities portfolio and a lot of excess reserves, the reserves don't get observed very frequently.

And Treasury securities, if you're going into the market and selling them, it's observable. So if I had a whole lot of these, particularly at a time when reserves weren't that different, in terms of what the Treasurys were paying and what the reserves were paying, you can see why they might prefer to actually hold their high-quality liquid assets in reserves. So I think it's something that we have to monitor and watch. I don't think it says anything about our ability to control. It does say that we may have to make technical adjustments if we find out that this high-quality liquid asset requirement is causing more demand for reserves at a higher balance sheet than we might have anticipated.

WSJ: What's your assessment of the deregulatory agenda right now?

MR. ROSENGREN: We made a lot of supervisory changes during the crisis. And I think directionally they were correct. I think it does make sense to reevaluate and ask, has the pendulum swung too far in certain areas, and make sure that the cost/benefit actually makes sense. So I have no problem with reevaluating what we have. That being said, I think it's very, very important that banks have sufficient capital. That we don't worry about their financial solvency. And as I've said, one reason why I want a countercyclical capital buffer is I'd like to have banks less sensitive to economic downturns than they have been historically.

So we're at a stage of the cycle with an unemployment rate of 3.8% and asset valuations pretty high. But I'd want to make sure that there is a good buffer for banks so that they don't become a problem the next time we have an economic downturn.

So, within that framework, there are lots of things that you can do to think about what makes sense and what doesn't make sense, and a lot of these adjustments are technical adjustments, which I think are appropriate. And the goal isn't to have unduly restrictive regulations that don't have much benefit, and so now that we have a little bit more experience with that framework, I think it is a good time to reevaluate. So we should reevaluate.

I wouldn't want to see the aggregate level of capital diminish; in fact, I think you could make an argument with a countercyclical capital buffer that that should be a non-zero number right now.

WSJ: Based on what you said on the countercyclical buffer, it sounds like you are starting to think that we are getting really late in the cycle, that we're really getting close to the next downturn. Is that right?

MR. ROSENGREN: So I'm not predicting a downturn is imminent, but I am saying we are at a stage of a cycle, and we're far enough—I do worry about imbalances if we push the economy too hard. And the last chart that I show on that shows you what happens when you push the economy well below what the CBO has historically thought was the natural rate. And there's really only one period where we stayed below for a long period of time—that's the '65 to '70 period. That's not a period that normally we think of as being the right way to conduct monetary policy. That's when inflation started to pick up, and you kind of created the problems that then you kind of fought through the entire 1970s and that Volcker brought back down.

I'm not predicting that will happen. There are lots of things that have changed in the economy since the 1960s, but I do think I worry about imbalances, and those imbalances can, over time, be manifested in wages and prices, or they can be manifested in asset prices.

Ironically, (former Fed Chairman William McChesney) Martin is known for his taking the punch bowl away. When you don't take the punch bowl away, it's not that predictable what's going to happen. You don't know if people are going to get in a fight, you don't know if somebody will get in a car that shouldn't get in a car, you don't know if they'll destroy the property. What you do know is that predictions for bad outcomes have increased. And so what I want to avoid is the conditions for bad outcomes. And that's one reason to be gradually increasing now.

WSJ: Do you favor two more rate increases this year?

MR. ROSENGREN: So my own personal view would be that we should continue on the path that we are currently on, and so I have argued—so the median for the committee went from three to four for this year. I think I'm very comfortable with that direction.

WSJ: Do you think the fact that we're seeing another trend of divergence in the U.S., and Europe, and the rest of the world on monetary policy and that sort of broader economics, does that exacerbate the risk of being imbalanced this year?

MR. ROSENGREN: One question is on trade. So we're less dependent on trade than other countries, and so we tend to focus on the implications of trade disruptions on our own country. But for other countries that are exporting to us, this is a big disruption as well. And so you have to be concerned. Foreign economies are going to slow down more, and part of it is just the uncertainty. And I talked a little bit about the uncertainty both in supply chains, uncertainty about businesses and how they should be thinking about their investment strategy in a world where they're not quite clear what the relative prices are going to be, both through inputs and outputs. And so I can understand why the entire world is concerned that there be a disruption.

We'll see if that actually happens. Until fairly recently, I thought the probability of that was quite low, but I read The Wall Street Journal, and obviously the probabilities increased over the last couple of months so it's a scenario that we have to think about.

WSJ: How is your view on global growth shifting? Are you marking down your estimates for global growth? And to what extent is it a global phenomenon, and to what extent is there like a two-track economy right now where the U.S. is doing very well and Europe and other economies are slowing down?

MR. ROSENGREN: They are slowing down, but I wouldn't say they are doing poorly. So for example, the Europeans are talking about very gradually exiting from their strategies, so that's something that you would only do if you thought that the economy was growing reasonably well and that they were going to hit their inflation target.

So I think other countries are very slowly thinking about exiting their unusual monetary policies. They're not growing as fast as the United States. They haven't had the same fiscal stimulus that the United States has had. So I think the progress is a little slower than would be ideal. It would be nice if Europe was coming back more quickly. It would be nice if Japan was coming back more quickly. And I do think the potential for trade disruptions are going to probably have a more magnified effect on countries that depend on exports more than we do.

WSJ: Going back to the housing boom and before that the technology bubble, should monetary policy have been anything different in those two cycles?

MR. ROSENGREN: It's very hard for monetary policy. We did tighten during that period. As you'll remember, we were tightening at every meeting. It wasn't that we weren't in a tightening cycle. We tightened to a much higher rate than, for example, we are right now. It's not that we didn't tighten rates.

You could argue could we have started sooner or done more, but I don't think that was the primary cause of the problem. The primary cause of the problem was that banks [were] not particularly well capitalized. Liquidity requirements didn't focus on how banks could weather the storm, and [banks had] too much reliance on wholesale funding.

So there are other factors that do a better job of explaining why the last recession was so severe. And I don't think the federal-funds rate was the predominant culprit in why that was such a severe downturn. We've rectified a lot of those concerns. We have much better capital regulation. We have much more liquidity. So banks are much better positioned now than they were. The next recession is probably going to occur from a different cause than the last one.

WSJ: There's an argument right now from some of your colleagues that the reason to possibly slow down the pace of rate increases or to pause at some point is because they don't want to invert the yield curve. How much sympathy do you have for that argument?

MR. ROSENGREN: So I think it's very relevant to ask if we tightened too much. I don't know that I would look at a short-term rate compared to the 10-year rate. The most common spread that people seem to talk about is the 2-year, 10-year spread. The 10-year spread is a particularly difficult spread at this juncture, because we have a bigger balance sheet than we've had historically. And so do the Japanese. So do the Europeans.

So the strategy for monetary policy since we hit zero interest rates was to press long-term interest rates. And until our balance sheet becomes more normalized, and that of our trading partners becomes more normalized, you would expect long rates to be more depressed than they have. And term premiums are quite low by historical standards.

So I would not focus on the 2-year, 10-year spread. I think it's much more relevant if you look at the fed-funds relative to the fed-funds futures. Does the market think that we're going to have to reverse course? If there's widespread belief that over the next year and a half that the Fed's tightened too much, I think that is a reasonable indicator that we should actually be able to have. But I don't think I would put the same emphasis on the two-year, 10-year spread that some people do, and because it's being affected by these other monetary-policy actions that haven't occurred in the past.

So people are looking at an historical relationship. But the 10-year rate is depressed for a reason. It's depressed because monetary policy in Europe, Japan, the United States has depressed that rate. So it's not that the fundamental insight that if the Fed tightens too much, that's a problem. But I would look at the shorter end of the market rather than that kind of spread.

From the Interview

* Rosengren Says It's Time to Take Away Monetary-Policy Punch Bowl (June 28)

* Fed Should Raise Banks' Capital Buffer, Now at Zero, Official Says (June 27)

Document WSJO000020180629ee6t001jq

THE WALL STREET JOURNAL.

Markets
Investors Double Down on Tech in Rocky Quarter for Stocks; The tech-heavy Nasdaq Composite thrived in a tumultuous quarter for stocks as investors parsed trade tensions, political uncertainty and signs of slowing momentum

By Akane Otani and Michael Wursthorn
1,064 words
29 June 2018
03:07 PM
The Wall Street Journal Online
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English

The **Nasdaq Composite** Index overcame an early slump in the second quarter and is on course to book its eighth straight quarter of gains, as fears of a trade war stifling global growth pushed investors to dump industrial stalwarts and increase their bets on shares of large technology companies.

The tech-heavy index thrived in a tumultuous three months for U.S. stocks, which struggled to gain ground as investors were buffeted by worries about trade tensions , political uncertainty in the eurozone and signs of slowing momentum in the global economy.

The **S&P 500** and the **Dow Jones Industrial Average** rose 2.9% and 0.5%, respectively, for the quarter through Thursday, trailing the **Nasdaq** 's 6.2% advance. The first two indexes remain well below their January records, while the **Nasdaq** notched a series of all-time highs in June.

The one-directional nature of the stock rally has left investors increasingly worried that a market whose gains have been heavily dependent on technology stocks could reverse sharply in the second half of the year.

"A lot of the investing public is piling into the same things," said Jim Paulsen, chief market strategist at Leuthold Group , who added that the **S&P 500** would be mostly flat this year without technology companies. "There's a lot of sheep following one another."

Technology had mostly avoided the tariff turmoil for much of the quarter, including when President Donald Trump imposed steel and aluminum tariffs on the European Union , Mexico and Canada on May 31. Industrial stocks in the **S&P 500** fell 1.5% that day, as shares of Boeing Co . and other multinational manufacturers posted losses, while the **Nasdaq Composite** suffered a modest 0.3% decline.

Trade actions have had a muted impact on tech stocks going back to 1995, according to Bank of America Merrill Lynch data that showed the sector tends to be among the best-performers in the 30 days following the announcement, implementation or the end of such a policy. But some analysts warn that the latest trade battle could play out differently considering the Trump administration's focus on protecting U.S. intellectual property and tech's growing prominence in the global economy.

The **Nasdaq** on Monday posted its biggest one-day decline since April after reports suggested the Trump administration was planning to curb foreign investment in U.S. technology firms. The tech sector's high exposure to foreign revenue also exposes it to swings in the foreign-exchange market: Should the recent rebound in the U.S. dollar continue, that could hurt multinational companies whose goods will become more expensive to foreign buyers, and overseas revenue will be worth less when converted back into dollars.

"A lot of technologies are borderless," said Tony Kim, portfolio manager of the BlackRock Technology Opportunities Fund, who said the threat of protectionist policies against China is one of the bigger perceived risks for investors right now. "Tech needs to be in a stable environment, and this would inject a sense of instability."

Any stumbles in tech-stock prices could raise the risk of market contagion and wreak havoc on portfolios.

Tech's growing dominance has skewed the broader **S&P 500** away from so-called defensive stocks—sectors such as utilities, consumer staples and health care—that investors have traditionally gravitated toward during bouts of market **volatility**. That has left some analysts concerned that investors in index-tracking funds could be dangerously exposed to a pullback.

The degree of defensiveness within the **S&P 500**, which Leuthold Group calculated by using the percentage of the index's market capitalization comprised of defensive sectors, has fallen nearly 60% from 1991 through early June, according to the group's data. That has increased the weighting of highflying growth stocks within the **S&P 500**, reducing its overall effectiveness as a diversified portfolio for investors who opt to passively track the broad index, Mr. Paulsen said.

The **S&P 500** is "not the same index it was when your father bought it," he added.

Yet some analysts worry that, with uncertainty swirling over whether the U.S. will ratchet up trade tensions with China, the European Union and others, investors have mispriced the risk that the tech sector faces.

Technology companies in the **S&P 500** have the highest share of overseas revenue of the broad index's 11 sectors, with a foreign-exposure level of about 59%, according to FactSet and BofA Merrill Lynch data. That is greater than the broader **S&P 500**, which gets about one-third of its revenue from overseas and indirect exposure via commodities, the bank added.

Still, some investors have been viewing tech stocks as a safety play, betting that companies that have produced double-digit percentage gains this year will be able to continue growing earnings even under more restrictive global trade conditions. Amazon.com Inc .'s quarterly profit topped $1 billion for the first time in the most recent quarter, while Facebook Inc .'s earnings soared even after its user-data crisis and Microsoft Corp . posted double-digit growth in profit and revenue.

"Long term, it looks like a legit growth story," said Paul Christopher , head of global market strategy for Wells Fargo Investment Institute .

Even as investors say technology firms as a whole appear to be on more stable footing than they were at the height of the dot-com era in 2000, many remain cautious, citing the tendency for the **stock market** to contract when it is led by just a handful of outperformers.

"Whenever the market narrows like this and everyone wants to own the same stocks like the [FAANG—Facebook , Amazon , Apple Inc ., Netflix Inc . and Alphabet Inc .] stocks, there is a feeding frenzy that can go on for a while," said Mike Balkin, a portfolio manager at William Blair. "When it ends, it usually doesn't end well."

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* Stocks Edge Higher, Post Quarterly Gains

* Congrats, Investors! You're Behaving Less Badly Than Usual

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THE WALL STREET JOURNAL.
U.S. EDITION

Go for Growth, Fellow Dems

By Tony James
888 words
29 June 2018
The Wall Street Journal
J
A15
English

We Democrats assumed a Trump presidency would be disastrous for the economy. But despite a disorderly administration and confusion in Washington, the economy is on a roll and the **stock market** has soared. Whether we view President Trump as a nightmare to be endured or a foe to be battled, Democrats should hear a wake-up call.

Economic growth, hourly wages, consumer confidence and personal spending are accelerating. Unemployment is the lowest in two decades. For the first time, job openings exceed the number of unemployed. Some of the current expansion is built on the foundation laid by the Obama administration. And although Mr. Trump's lack of fiscal discipline risks ballooning deficits, Democrats cannot dismiss the critical importance of new policies that have helped propel the economy.

Many Trump voters -- high-school-educated Americans battered by globalization -- are our natural constituents. We need to win them back. If Democrats are going to return to power, we need a strong pro-prosperity platform that includes pragmatic and economically inclusive policies that drive growth.

Let's look at regulation. The attitude that regulation is fundamentally good -- and any attempt to reduce it bad -- is far too prevalent among Democrats. In 2012 and again in 2016 the U.S. Supreme Court unanimously held that landowners could sue to challenge Environmental Protection Agency decisions to protect wetlands. No one at the EPA seems to have asked if its regulations were actually the best way to preserve wetlands. Regulation of the wrong sort hurts economic growth and diminishes U.S. competitiveness.

The new tax bill is also instructive. Let me state something that is heresy with some Democrats: Cutting the corporate tax rate was good for the economy. It levels the playing field with other countries, keeps thousands of jobs at home, and makes billions of dollars available for reinvestment, especially in smaller companies with limited access to capital markets.

A recent Morgan Stanley survey showed that companies expect to reinvest the bulk of the tax savings in higher wages, increased capital expenditures and research and development. The companies surveyed anticipated passing only a quarter to shareholders in dividends and buybacks. That squares with the plans of the companies our firm has invested in, and is corroborated by the significant jump in capital expenditures -- 24% -- by **S&P 500** companies last quarter.

Many think corporate tax reform was not the appropriate national priority. It certainly didn't do enough to help struggling Americans, and the personal tax cuts were insufficiently progressive. But heated rhetoric from Democrats often dismisses tax reform altogether. From the results, it appears that these policies have given the economy a significant boost. As Democrats, what blinded us? Did our overriding disdain of all things Trump mean we failed to recognize that some of his policies make economic sense?

It is time we built a closer partnership with business, and prioritize ideas over criticisms. One example is infrastructure. Investment in infrastructure would provide fiscal stimulus, create high-paying jobs, improve safety, and increase productivity. Over the longer term, fixing aging infrastructure can add 0.5% to annual economic growth.

Another driver of economic expansion is growth in our labor force. That means we need immigrants -- skilled and unskilled. Tech businesses struggle with the deficit of workers trained in science, technology, engineering and math. Agriculture suffers from a lack of seasonal workers. A more accommodating immigration policy would be embraced by business, unleashing further economic growth and expanding the tax rolls.

Addressing trade inequities would also help U.S. producers protect jobs at home. The U.S. has effective tariffs of 9%; China, 27%. Beyond tariffs, China also appears to have benefited disproportionately from current trading rules and has not taken sufficient steps to open its own economy. The result for the U.S. is a trade deficit of $375 billion a year.

Contrary to the prevailing views of most corporate executives, economic evidence shows that a higher minimum wage would benefit business because the added demand more than offsets the added cost. It doesn't help anyone to have consumers at the poverty line. By engaging constructively with business leaders, Democrats should be able to build consensus on this issue.

There are other areas where Democrats' priorities and business goals should align: What business executive wouldn't favor more-efficient health care for everyone, an effective retirement system, better education for more talented employees, and federal support for technological innovation?

Embracing business doesn't mean turning a blind eye to its flaws. Sensible regulation is vital to a vibrant market economy. More fundamentally, Americans have to feel that the economic system is fair and can work for everyone.

But if we want voters to hand us back the reins of government, we must be able to help the economy grow. That means establishing a constructive partnership with private business. As Democrats, we have already conceded faith, family and freedom to the Republican Party. We need to be the party of inclusive prosperity. Let's not also concede that to the Republicans.

Mr. James is executive vice chairman of Blackstone and author of "Rescuing Retirement."

(See related letters: "Letters to the Editor: There's Already a Party That Favors Growth" -- WSJ July 6, 2018)

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THE WALL STREET JOURNAL.

Heard on the Street
Markets
The Trans-Atlantic Catch-Up Trade Has Gone Awry; European markets were supposed to follow the U.S. with higher stocks and bond yields this year. The first half has turned out differently.

By Richard Barley
507 words
29 June 2018
04:59 AM
The Wall Street Journal Online
WSJO
English

This was supposed to be the year global markets moved in sync, Europe following the U.S. with higher bond yields and stock prices. But at halftime things don't look so simple.

For now, the bet on risky assets beating haven debt is still working in the U.S., although it has lost a lot of momentum. As of June 28, the ICE BofAML U.S. Treasury index was down 1.1%, the **S&P 500** up 2.6% on a total-return basis. But in Europe, the opposite has happened: The total return on the Euro Stoxx is minus 1.2%, while German bunds have returned 1.5%.

Incredibly, yields on northern European government bonds are actually lower now than at the start of the year. The 10-year German yield is just 0.34%, versus 2.85% for the **10**-**year Treasury**. The persistent disappointment in European economic data that started in the first quarter has undermined the catch-up trade, even as some themes have played out as expected, notably the U.S. Federal Reserve and European Central Bank both gradually withdrawing from ultraloose monetary policy.

This means the valuation gaps that investors seized on at the start of the year have grown only more extreme. European stocks still look cheap versus U.S. stocks, while European bonds look even more expensive versus Treasurys. Meanwhile, the euro has gone into reverse against the dollar, summing up the way Europe and the U.S. have diverged rather than converged.

The underlying rationale for taking risk and shunning safety still has its attractions. There seems to be little risk of a sharp downturn in growth in the near-term. And there have been some tentative signs of stabilization in European data in recent weeks.

But there are also more concerns to deal with now, including the risk of a trade war and renewed political turmoil over migration. European Union leaders patched together a deal early Friday to help the countries facing the biggest problems, but tensions may persist. The troubles in emerging markets have spread, with investors now starting to focus again on China, particularly given the sharp decline in its currency.

That leaves markets vulnerable. While U.S. growth is strong now, there are worries about next year as the Fed tightens further and fiscal stimulus fades. If the bet on Europe catching up is to gain fresh life in the second half, it badly needs signs that growth outside the U.S. is solid. With the U.S. expansion already so extended, the clock is ticking.

The catch-up theme is logical, but events just keep getting in the way. It may prove as elusive in the second half as it has been in the first.

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

Sorry OPEC, Oil's Surge Is Made in America; Oil is up a lot, but the reason is not OPEC's decision to boost production

By Spencer Jakab
362 words
29 June 2018
11:17 AM
The Wall Street Journal Online
WSJO
English

Your perception of how the world is moving depends a lot on where you are standing—especially when it comes to the world oil market.

Energy-related headlines in the U.S., the world's largest crude consumer and soon to be its largest producer, have been almost unremittingly **bullish** in the past several days. The main reason is that crude prices surged to a three-and-a-half year high in the wake of last week's meeting of the Organization of the Petroleum Exporting Countries, despite that group's decision to raise output quotas.

But it is the U.S. benchmark, West Texas Intermediate, that has surged, not the globally important Brent that tends to be more sensitive to OPEC's decisions. As of Friday morning, the former had rallied by 12.5% in three weeks while Brent was a mere 1.7% higher over the same time.

Much has to do with North American rather than global conditions. Surprisingly strong drops in inventories at Cushing Okla., the delivery point for the WTI futures contract, are the biggest reason. Most recently at 29.89 million barrels, inventories have dropped 4.7 million barrels in three weeks and are now half their level this time last year.

Another reason is a major outage in western Canada affecting 360,000 barrels a day. While those barrels don't necessarily flow to Cushing, refiners may source replacement barrels from U.S. producers. The problem could last several weeks. A one-month outage would create a 10-million-barrel deficit.

WTI's surge also comes from an extreme and unsustainable discount relative to Brent. By late May, the discount had reached its highest since 2015 at over $10 a barrel. That reflects surging U.S. production temporarily swamping local shipping capacity. Before the surge in shale production, WTI often traded at a small premium to Brent.

OPEC's solidarity has been impressive, but not that impressive.

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THE WALL STREET JOURNAL.

Markets

U.S. Government Bonds Little Changed After Inflation Data; More investors believe the Fed will raise interest rates twice more this year

By Daniel Kruger
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English

U.S. government**bond prices** edged higher Friday after data showed inflation may be starting to gather momentum.

The yield on the benchmark **10**-**year Treasury** note fell to 2.847% from 2.849% Thursday. The 10-year yield rose for a fourth consecutive quarter, up from 2.741% on March 29.

The two-year Treasury yield rose to 2.528% from 2.522% on Thursday. It was 2.270% at the end of March. Yields rise as **bond prices** fall.

Yields climbed briefly after the Commerce Department said the personal-consumption expenditures price index, a broad measure that serves as the Federal Reserve's preferred inflation yardstick, rose 2.3% in May from a year earlier, its biggest annual rise since March 2012. The year-over-year increase in April was 2%.

The acceleration in inflation could help Federal Reserve officials make the case that they should raise interest rates at their September meeting, analysts said. Officials penciled in two more increases when they met earlier in June to assess the path of interest-rate policy. At that meeting, policy makers raised rates for a second time this year.

Fed funds futures, which investors use to bet on the direction of interest-rate policy, late Friday showed a 46% probability that central bank officials will raise rates at least two more times this year, up from 44% Thursday, according to CME Group data.

"The markets may be underpricing the Fed's willingness to push ahead with further rate hikes," said Bill Merz, a director of fixed income at U.S. Bank Wealth Management. The market's tepid response to the inflation data is "a yellow flag," suggesting investors may be looking ahead to slowing growth in what has been an almost nine-year-long economic expansion, he said.

The gap between yields on Treasury notes maturing in two- and 10-years, known as the yield curve, flattened to 0.319 percentage point, the lowest since August 2007. Investors look to the yield curve as an indicator of the direction of the economy. Steeper curves suggest faster future economic growth.

Write to Daniel Kruger at Daniel.Kruger@wsj.com

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WSJ PRO CENTRAL BANKING

Economy
Kudlow Says White House Hopes Fed Will Raise Rates 'Very Slowly'; Remarks break with general precedent of White House refraining from comments on monetary policy

By Nick Timiraos
1,276 words
29 June 2018
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WSJ Pro Central Banking
RSTPROCB
English

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.

Lawrence Kudlow, the director of the National Economic Council, made the comments Friday morning during an interview on the Fox Business Network in which he extolled the impact of the tax cuts enacted six months ago.

"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, referring to the central bank's new chairman, Jerome Powell, who was nominated by Mr. Trump and took office in February. "My hope is they understand that, and they will move very slowly."

Mr. Kudlow said he speaks periodically to Mr. Powell, adding, "He's a good man."

Mr. Kudlow also said he expected the tax-overhaul legislation would raise economic growth and federal revenues to offset lower receipts from the rate cuts.

The U.S. government's budget deficit "is coming down. And it's coming down rapidly. Growth solves a lot of problems," he said.

There is no evidence that growth is outpacing government debt. In May, the deficit rose to its highest level in 5½ years, reaching 3.8% of gross domestic product, or $765 billion, over the prior 12-month period. That was up from a deficit of $611 billion, or 3.2% of GDP, in May 2017.

The tax cuts won't generate enough growth to pay for themselves and will add about $1 trillion to budget deficits over a decade, according to official estimates from the congressional Joint Committee on Taxation.

In an interview later Friday with The Wall Street Journal, Mr. Kudlow said his comment about the deficit was his own forecast about what he believed would happen in the next two years. Growth is "going to be significantly faster than virtually any forecasters think," he said.

Mr. Kudlow's predecessor, Gary Cohn, pointedly refrained from commenting on monetary policy during his 14 months as NEC director, following a precedent set during the Clinton administration and followed by subsequent Republican and Democratic presidents and their advisers.

The Fed declined to comment on Mr. Kudlow's comments Friday. In a speech last month, Mr. Powell said central bankers have been fortunate to enjoy relative independence from political pressures but low levels of trust in government institutions have created a "challenging moment" for central banking.

"In this environment, central banks cannot take our measure of independence for granted," he said.

Central bankers say such independence allows them to make unpopular decisions in the economy's long-run best interest, such as raising rates to curb inflation even if it means slowing growth, as then-Fed Chairman Paul Volcker did in the early 1980s.

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 have penciled in two more increases this year and three next year.

Officials say they want to make sure strong economic growth doesn't give way to asset bubbles or excessive inflation, and they see gradual rate increases as the best insurance policy.

Inflation data released Friday likely bolstered their plans. Consumer prices rose in May at their fastest annual rate in six years, the Commerce Department said. The personal-consumption-expenditures price index, the Fed's preferred inflation gauge, rose 2.3% last month from a year earlier.

Excluding **volatile** food and energy categories, so-called core inflation rose 2% in May, the first time it has reached that level since April 2012. The Fed watches core PCE inflation closely as an indicator of longer-run inflation trends.

The Fed seeks to keep inflation at 2% because it views that level as consistent with an economy with healthy demand for goods and services. In recent months, officials have gone to considerable lengths to clarify that their target isn't a ceiling and that, instead, they are comfortable with inflation rising temporarily above that goal.

Mr. Kudlow's comments Friday are the clearest indication yet of how a dispute over assumptions about the economy's long-run growth rate could lead to a collision between the central bank and the White House if inflation pressures build and the Fed pushes rates higher.

Mr. Kudlow said recent economic data point show the tax cuts are already increasing the supply-side of the economy.

"We're expanding the economy's potential to grow. That's the new equipment. That's the new structures. That's the new technology that we're doing," said Mr. Kudlow. "That cannot be inflationary. Don't tell somebody in the Rust Belt, don't tell somebody in the middle of the country that working and growing is a bad idea."

Fed officials say they see more uncertainty in the inflation outlook because the unemployment rate is falling to levels not seen in 50 years.

They expect the tax cuts and a separate federal funding increase to juice economic growth this year and next. But they don't share the Trump administration's view that the growth increase will be sustained after next year, and some officials have said recent increases in business investment may instead reflect a rebound in the energy sector as rising **oil prices** spur new drilling activity.

Mr. Powell has said he sees some potential for the tax cuts to raise the productive capacity of the economy. This would allow the economy to grow faster without overheating, and could let the Fed stick to its gradual path of rate increases or possibly lead to a slower pace. But it also could cause the Fed to raise its benchmark rate higher than otherwise.

"You have a lot of uncertainty around what the effects will be," Mr. Powell said at a news conference last month. "They could be large. We hope they're large. But our approach is going to be to watch and see and hope that, in fact, we do get significant effects."

While Fed officials have revised their economic-growth projections in the short run, they don't see the fiscal-policy changes raising the long-run annual growth rate of the economy, which they expect is 1.8%.

Mr. Cohn has been more reserved than Mr. Kudlow in predicting an immediate growth boost from the tax cuts, suggesting it can take years for investments in new factories, equipment and other productivity-enhancing measures to filter into the economy.

"When you look at corporations and you look at investment of capital, if you want to go out and build a big factory tomorrow, you can't decide on Friday to build a factory on Monday. It's not the way it works," Mr. Cohn said at an event hosted by the Washington Post earlier this month.

Mr. Cohn said companies are just beginning to implement new five- and 10-year spending plans. "You won't see this money enter the economy and this job creation" until "maybe next quarter, the second half of this year—and that would be extraordinarily fast," he said.

Write to Nick Timiraos at nick.timiraos@wsj.com

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The New York Times

Technology
Time Split to the Nanosecond Is Precisely What Wall Street Wants

By John Markoff
1,222 words
29 June 2018
02:09 PM
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English

SAN FRANCISCO — Computer scientists at Stanford University and Google have created technology that can track time down to 100 billionths of a second. It could be just what Wall Street is looking for.

System engineers at **Nasdaq**, the New York-based stock exchange, recently began testing an algorithm and software that they hope can synchronize a giant network of computers with that nanosecond precision. They say they have built a prototype, and are in the process of deploying a bigger version.

For an exchange like **Nasdaq**, such refinement is essential to accurately order the millions of stock trades that are placed on their computer systems every second.

Ultimately, this is about money. With stock trading now dominated by computers that make buying and selling decisions and execute them with blazing speed, keeping that order also means protecting profits. So-called high frequency trading firms place trades in a fraction of a second, sometimes in a bet that they can move faster than bigger competitors.

The pressure to manage these high-speed trades grows when the **stock market** becomes more **volatile**, as it has been in recent months, in part to prevent the fastest traders from taking unfair advantage of slower firms. High frequency traders typically account for more than half of daily stock trading volume in the United States, according to data from the Tabb Group.

“The financial industry has easily become the most obsessed with time,” said Balaji Prabhakar, a Stanford University electrical engineer who is one of the designers of the new synchronization system.

Because the orders are placed from locations around the world, they frequently arrive at the exchange’s computers out of sequence. The new system allows each computer to time stamp an order when it takes place.

As a result, the trades can be sorted and executed in correct sequence. In a networked marketplace, this precision is necessary not only to prevent illicit trading on advance information known as “front-running,” but also to ensure the fair placement of orders.

The importance of technical advances in measuring time was underscored by European regulations that went into effect in January and that require financial institutions to synchronize time-stamped trades with microsecond accuracy.

Being able to trade at the nanosecond level is vital to **Nasdaq**. Two years ago, it debuted the **Nasdaq** Financial Framework, a software system that it has envisioned eventually trading everything from stocks and bonds to fish and car-sharing rides.

The new synchronization system will make it possible for **Nasdaq** to offer “pop-up” electronic markets on short notice anywhere in the world, Mr. Prabhakar said. He cited the World Cup as a hypothetical example of a short-term electronic marketplace.

“There are tickets needed, housing, people will need transportation,” he said. “Think of an electronic market almost like a massive flea market hosted by **Nasdaq** software.”

To go from trading equities to managing all sorts of financial transactions will require more than an order of magnitude speedup in the company's networks of computers. It will be possible only if all of the exchange's computers agree on time with nanosecond accuracy.

A generation ago, computing usually took place in a single mainframe or personal computer. Now it is routinely spread across thousands of independent processors in machines that can be separated by a few feet or entire continents.

Chip designers have long struggled to maintain the precise timing needed to order mathematical operations inside individual computing chips. And synchronizing these vast ensembles of them has become the limiting factor in the speed and processing power of what Google describes as "planetary-scale" computers.

"It's kind of mind-boggling," said Peter Hochschild, a Google software engineer who specializes in the challenges associated with spreading software and data across networked computers. "Inside a processor, an enormous amount of stuff happens in a billionth of a second."

A billionth of a second is roughly the time it takes light to travel one foot. It has long been viewed as a crucial measure in computing. In the 1960s, the computing pioneer Grace Murray Hopper would hand out 11.8-inch lengths of wire to illustrate how designing smaller electronic parts would create faster computers.

Distance has become even more significant as software has begun to escape the boundaries of individual computers and make its way into the cloud — the web of giant computer data centers that have come to blanket the planet.

They are near dams to take advantage of cheap hydroelectric power and in cold climates to save on cooling costs. Microsoft has even begun submerging them in the ocean to take advantage of power generated by tidal surges.

Because software and data are no longer in the same place, correctly calculating the order of the events that may be separated by feet or miles has become the dominant factor in the speed with which data can be processed.

"So much of our expectation about computing being correct depends essentially on knowing this order," said Krishna Palem, a theoretical computer scientist at Rice University.

In the world of cloud computing, entire databases are scattered among different computers and data centers.

That has created tremendous challenges for the designers of electronic commerce systems. The new software synchronization standard under which **Nasdaq**'s system would work, known as Huygens, is intended to replace a 33-year-old Network Time Protocol, or N.T.P., as well as more expensive approaches that have relied on atomic clocks and global positioning satellites.

Huygens, named for the Dutch physicist Christiaan Huygens, who invented the pendulum clock in 1656, uses so-called machine-learning techniques to synchronize a network of computers to within 100 billionths of a second. In contrast, the N.T.P. standard can synchronize computers no more accurately than a millisecond, or one thousandth of a second.

To ensure that buyers and sellers are treated fairly, **Nasdaq** has for decades looked for ways to ensure that trades are processed in the order they are placed.

While building a network for **Nasdaq** in the 1990s, Brian Reid, a computer scientist at Digital Equipment Corporation, experimented by coiling large rolls of cables of different lengths in a Massachusetts warehouse in order to insert tiny delays in the time it took data to travel in a network to make sure that messages were delivered fairly. He then employed timing information from satellites to synchronize clocks at different locations.

Google would later use this method to synchronize computers based on GPS data and atomic clocks to make sure that their database system could correctly order transactions. But since the system requires super-accurate clocks and satellite receivers, it is more costly than the software-based Huygens approach.

Mr. Reid built his original system in an era when the Securities and Exchange Commission required that all stock sales be entered by humans.

"Five millisecond accuracy in clock synchronization pleased everyone," he said. "It took much longer than five milliseconds to press the 'Enter' key on the big green terminals that people used."

Follow John Markoff on Twitter: @markoff.

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WSJ PRO CENTRAL BANKING

Economy

U.S. Consumer Spending Moderated in May; Year-over-year inflation posts its largest increase in over six years

By Harriet Torry
524 words
29 June 2018
10:42 AM
WSJ Pro Central Banking
RSTPROCB
English

WASHINGTON—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.

Personal-consumption expenditures, a measure of household spending on everything from baseball bats to coffee machines, increased a seasonally adjusted 0.2% in May from the prior month, the Commerce Department said Friday.

That undershot economists' expectations for a 0.4% rise.

Personal income, reflecting Americans' pretax earnings from salaries and other sources including investments, rose 0.4% in May, in line with economists' expectations.

Americans moderated their spending in May after two strong months of growth, as the 0.2% increase was the weakest since February.

April's spending was revised to a 0.5% increase from an earlier 0.6% reading, while March spending was revised higher to 0.6%.

Consumer spending accounts for more than two-thirds of U.S. economic output.

The data suggest "a solid rebound in consumer spending growth" in the second quarter after a lackluster first quarter, "but a slowing trend going into the second half of the year," Gregory Daco, an economist at Oxford Economics, said in a note to clients.

The report showed inflation firmed. The price index for personal-consumption expenditures, the Federal Reserve's preferred inflation measure, rose 0.2% in May and was up 2.3% from a year earlier.

The index had been at 2%, the Fed's year-over-year target, since March of this year. The 2.3% increase in May was the largest since March 2012.

Excluding **volatile** food and energy costs, prices rose 0.2% in May from April, and increased 2% from a year earlier. May was the first month that core inflation hit 2% since April 2012.

The Fed targets 2% year-over-year inflation because policy makers view that level as consistent with keeping prices stable and employment high.

With the jobless rate at a seasonally adjusted 3.8% in May, an 18-year low, the central bank has been raising short-term interest rates to prevent the economy from overheating. Officials voted earlier this month to increase their benchmark federal-funds rate by a quarter percentage point to a range between 1.75% and 2.00%. They have penciled in two further quarter-point rate increases for 2018.

The Commerce Department said lower spending on services such as household utilities in May was partially offset by more spending on goods, particularly on recreational goods and vehicles. Outlays for goods rose 0.4%. Spending on durable goods—expensive items such as cars and appliances—rose 0.1%, while spending on services also increased 0.1%.

The saving rate ticked higher in May to 3.2% from 3% in April, as incomes rose more than spending.

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

More on the Economy

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WSJ PRO CENTRAL BANKING

Economy

Chicago Business Barometer Rises in June; New orders rise to a five-month high, order backlogs also increased

By Allison Prang
306 words
29 June 2018
10:35 AM
WSJ Pro Central Banking
RSTPROCB
English

The Chicago Business Barometer rose in June as new orders rose, but output fell and firms saw higher input prices.

The barometer rose to its highest level since January hitting 64.1 this month, up from 62.7 in May. Economists polled by The Wall Street Journal were expecting a reading of 60.

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 in about seven years as businesses saw higher input costs. New orders also rose to a five-month high and order backlogs also increased. The indicator for supplier deliveries also climbed. Some businesses also struggled to restock items quickly enough, MNI Indicators said in a news release.

MNI Indicators also asked those surveyed about the effects of trade discussions on short-term purchasing decisions and less than a quarter of those surveyed said business was being significantly impacted by those talks. Just over 39% said they were impacted minimally. A little over 37% said they were either unsure or weren't affected.

"Confusion surrounding the trade landscape continues to breed uncertainty among businesses and their suppliers and has led to many firms' altering their immediate purchasing decisions," 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.

Write to Allison Prang at allison.prang@wsj.com

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THE WALL STREET JOURNAL.
U.S. EDITION

India Rupee Hits Lowest Level Ever

By Debiprasad Nayak
553 words
29 June 2018
The Wall Street Journal
J
B11
English

MUMBAI -- The Indian rupee weakened to a new low against the dollar, driven by concerns that rising **oil prices** will undermine the country's strong economic fundamentals.

The Indian currency broke through 69 to the dollar for the first time on Thursday to touch an intraday record low of 69.09. The previous record, 68.90, was set in 2016.

While most currencies have been losing ground against the dollar, the rupee's 8% slide in 2018 makes it Asia's worst-performing currency. Among other emerging markets, only Argentina, Brazil, Russia, Turkey and South Africa have performed worse.

India is the world's fastest-growing large economy in recent quarters, but the continued climb of **oil prices** could change that, so many investors are lowering their exposure to its currency.

"I never thought the rupee would go down to this level," said Madan Sabnavis, chief economist at Care Ratings. "The fundamentals aren't great at this point of time."

Oil prices rose to their highest level in more than three years this week, as the U.S. said it would put sanctions on countries that don't reduce oil imports from Iran, India's third-largest crude-oil supplier after Saudi Arabia and Iraq.

Asia's third-largest economy is particularly vulnerable to the fluctuation in **oil prices** because it imports 80% of its energy needs. The country's current account and budget deficits are likely to widen this year, fueled by the higher cost of oil imports. Meanwhile, higher gas prices hit Indian consumers at the pump.

Oil prices could even have an impact on the relatively stable political outlook of India. Prime Minister Narendra Modi's party had been expected to easily win national elections scheduled for early next year. But if **oil prices** lead to less growth and higher inflation, the party may struggle, since it campaigned on the promise of building a better economy.

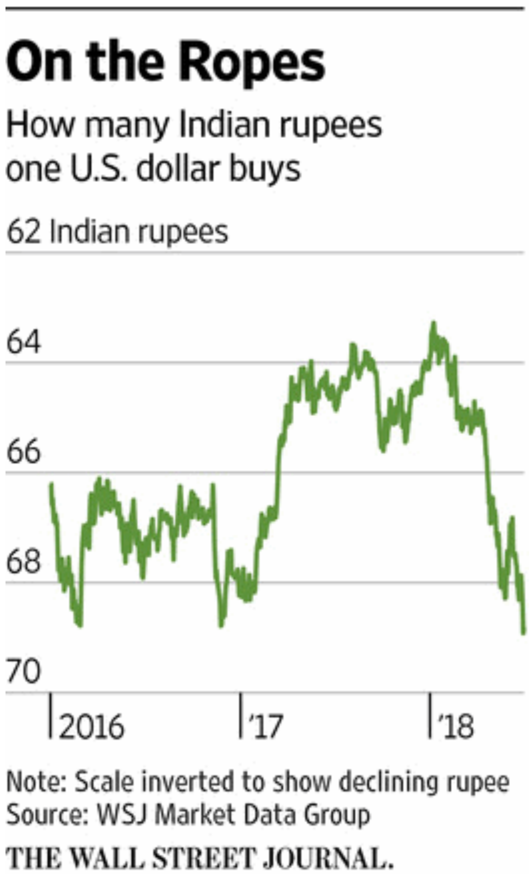
Foreign investors have already sensed these problems and are leaving Indian debt. For the current year they have been net sellers of $6 billion in Indian debt, including $1.6 billion this month. Last year they were net buyers of $23 billion.

The rupee has been sliding despite central-bank efforts to prop it up and attract investment. Earlier this year, the Reserve Bank of India increased corporate-bond investment limits and relaxed rules for foreign owners of government bonds.

The rupee regained some ground against the dollar to end trading in India back below 69 rupees to the dollar, but the pressure on the currency is likely to continue amid global uncertainty about how growing trade friction and rising lending rates around the world will evolve, said Dushyant Padmanabhan, a currency strategist at Nomura.

Optimists say the Indian currency probably doesn't have much farther to fall.

Investors are reassessing their outlooks on India but even with rising **oil prices**, it is in much better shape than in 2013, during the so-called taper tantrum, when it was labeled one of the "fragile five" emerging-market currencies, said Shilan Shah, senior India economist at Capital Economics. Today, India has a much thicker cushion of foreign-exchange reserves and a much lower current-account deficit, he said.



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THE WALL STREET JOURNAL.
U.S. EDITION

World News: Saudis Move to Profit From Iran Sanctions --- Kingdom ramps up oil production as prices rise and U.S. tries to isolate Tehran

By Summer Said and Michael Amon
760 words
29 June 2018
The Wall Street Journal
J
A18
English

The Trump administration's effort to drive Iranian oil exports down to "zero" is boosting the fortunes of Tehran's rival, Saudi Arabia, and putting the U.S. ally on a stronger footing for a showdown across the Persian Gulf.

Saudi Crown Prince Mohammed bin Salman's government is planning to increase oil production to a record high of nearly 11 million barrels a day by next month to replace Iranian crude expected to be lost because of U.S. sanctions, people close to the Saudi oil ministry said.

After years of austerity measures following the 2014 **oil-price** crash, increased oil revenue could allow Prince Mohammed to expand military spending and economic and social reforms.

The benefits for the kingdom highlight the central place Saudi Arabia holds in President Donald Trump's confrontation of Iran over its nuclear program and military posture in the region.

Saudi Arabia is "an essential linchpin" of the Trump administration's strategy against Iran, said Helima Croft, managing director and global head of commodity strategy at RBC Capital Markets. "A better economy is a big win for MbS," she said, using a common nickname for the 32-year-old prince.

Mr. Trump pulled the U.S. from a 2015 multination deal that lifted sanctions in exchange for curbs on Iran's nuclear activity, and vowed to reimpose wide-reaching sanctions on Tehran by November -- a course advocated by Saudi Arabia, Israel and other Iran foes in the region.

In addition to seeking to force Iran to abandon weapons programs, the U.S. is working to force Iran to pull back its support for military proxies such as Hezbollah, which threatens Israel in Lebanon, and the Houthis, who are fighting a Saudi-led coalition for control of Yemen and have terrorized Riyadh with rockets.

U.S. pressure has already begun rippling through Iran. The National Iranian Oil Co. has ordered affiliates to be ready for a reduction in oil production of 200,000 to 500,000 barrels a day, Iranian oil contractors said.

President Hassan Rouhani on Wednesday urged his people to stay strong as the U.S. tries to isolate their country. Protesters shut down Tehran's Grand Bazaar this week over the country's depreciating currency.

At the same time, the Saudis are planning for a rare moment in the oil market when they can ramp up petroleum production and still benefit from a crude-price rally. Saudi oil production is likely to hit 10.8 million to 10.9 million barrels a day in July, up from around 10.6 million in June and 10.03 million in May, according to the people close to the oil ministry. That May-July increase would mean nearly $25 billion a year in additional revenue, at $75 a barrel.

On Thursday, Brent crude, the international benchmark, was up over 4% since a senior State Department official said Tuesday that the U.S. would try to force all Iranian oil buyers to stop their purchases.

A fiscal bump could help at what is a period of uncertainty for the Saudi economy. The unemployment rate for Saudi citizens remains above 12%. Consumer spending slowed this year after the government introduced a 5% value-added tax in January and cut energy subsidies, making essentials like gasoline and electricity more expensive.

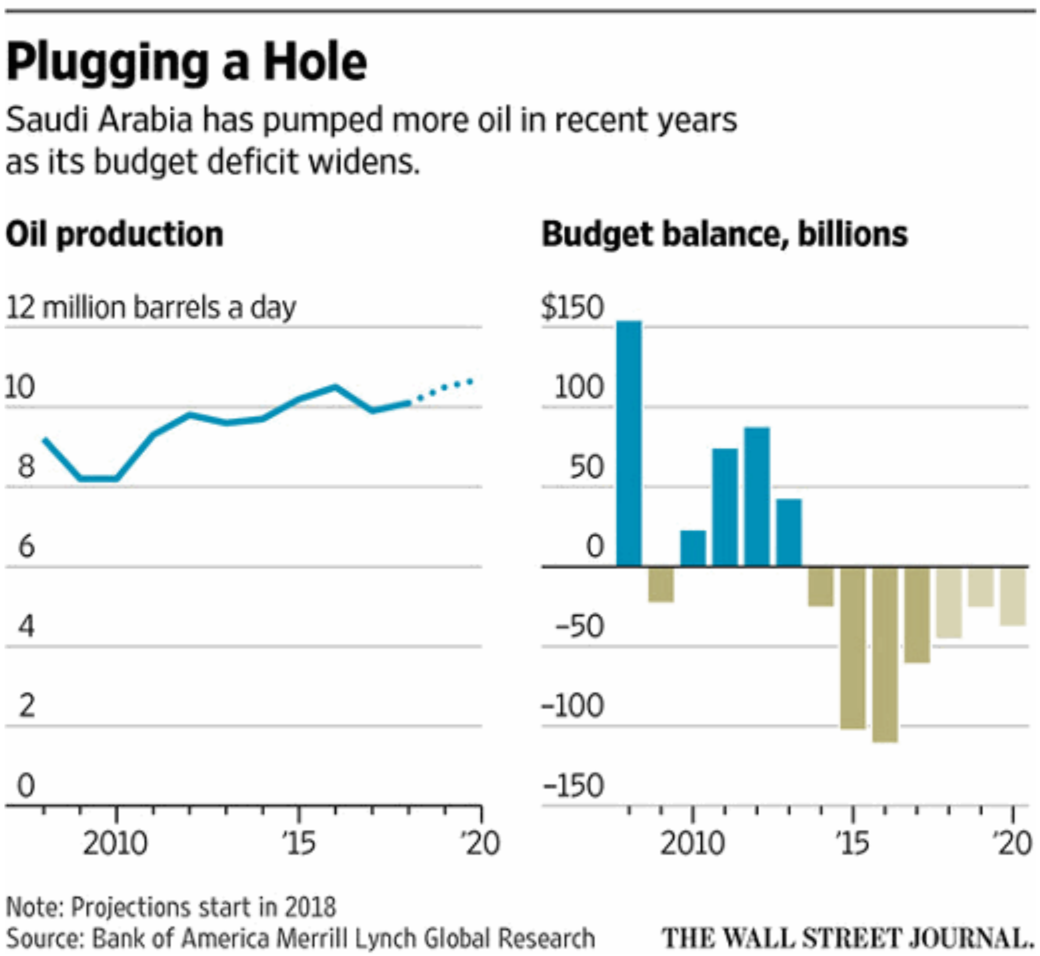
"Business is not like before, that's for sure," said Abu Ahmad, who owns a spice and nut shop at a traditional Arab market in Riyadh. "My profit margins are reduced."

Prince Mohammed would likely use at least some revenue from oil sales to press ahead with initiatives aimed at developing new non-oil industries and avoiding "politically unpopular austerity measures," Ms. Croft said.

As U.S. sanctions give Saudi Arabia an economic boost and leverage over its biggest rival, Ms. Croft said, Mr. Trump could use help from the Saudis on Middle East initiatives such as an Israeli-Palestinian peace plan, winding down the Syrian war and weapons deals.

The Saudis are working to shield oil consumers from the recipe for higher prices underlying the oil market today: robust demand coupled with supply outages from Iran to Venezuela to Canada. Production increases could prevent an **oil-price** spike in the middle of the summer driving season in the U.S.

Donna Abdulaziz and Benoit Faucon contributed to this article.



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THE WALL STREET JOURNAL.
U.S. EDITION

Energy Topples Technology as Top Sector

By Danielle Chemtob
780 words
29 June 2018
The Wall Street Journal
J
B12
English

Energy stocks are on pace to be the best-performing group in the **S&P 500** this quarter after **oil prices** broke through $70 a barrel, a level they have struggled to reach and stay above for almost four years.

Energy companies have rallied 12% -- and are poised for the biggest quarterly gain since 2011 and to be the top sector out of the 11 in the **S&P 500**. The broader equity gauge is on course to eke out a 2.9% gain in the second quarter.

Oil prices have jumped amid signs of falling global supply. This week's move higher in crude comes after the Organization of the Petroleum Exporting Countries reached an agreement last Friday to increase global production by an amount below what many had expected. The decision sent **oil prices** surging 6.1% over four days.

Harsh rhetoric from the Trump administration on Iran sanctions also lifted prices this week, while production from Venezuela has been plummeting for months as the country sinks deeper into economic turmoil. Stockpiles in the U.S. have also drained. On Wednesday, the U.S. Energy Information Administration reported a 9.9-million-barrel decline in crude inventories last week, the biggest weekly drop since September 2016 and more than triple the amount that analysts had predicted.

West Texas Intermediate, the benchmark for U.S. crude, rose 0.9% to settle Thursday at $73.45 a barrel, the highest level since November 2014. Brent, the global benchmark, climbed 0.3% to $77.85. The energy sector's performance has historically been linked to the price of oil.

"The pendulum has swung," said Bill Costello, senior portfolio manager at Westwood Holdings Group. Investors went from being "not willing to touch [energy] to being **bullish**."

Energy hasn't been the **S&P 500**'s top sector since the second quarter of 2016, when energy companies were recovering from a two-year rout triggered by shale producers in Texas and North Dakota unleashing supply into the market. **Oil prices** plunged starting in 2014 from a high of over $100 a barrel to below $30 in a span of months. Meanwhile, technology companies, favored by investors in recent years, have been harder hit recently by rising trade tensions between the U.S. and China.

China is targeting crude oil in its retaliatory tariffs on U.S. imports, but the broader ramifications for energy demand are a bigger concern for investors, said Quincy Krosby, chief market strategist at Prudential Financial Inc.

"The question becomes how much of a slowdown we're going to see, if any," Ms. Krosby said. "That also translates into how much energy use we'll see."

Oil producers and pipeline operators are considered cyclical companies, meaning they are sensitive to economic conditions and their businesses tend to ramp up when growth is robust. A trade war between the U.S. and China, the world's two biggest economies, could hurt global energy demand.

Federal Reserve Chairman Jerome Powell said this month that businesses were increasingly expressing concerns to the central bank about how a trade war might affect plans for investment and hiring.

Investors have preferred some energy companies over others. Petroleum refiner HollyFrontier Corp. has rallied 37% this quarter. Refiners tend to be better insulated from swings in **oil prices**. Meanwhile, shares of Concho

Resources Inc., a major producer in the Permian Basin, have declined 8.4% this quarter as bottlenecks such as congested pipelines weigh on regional crude prices.

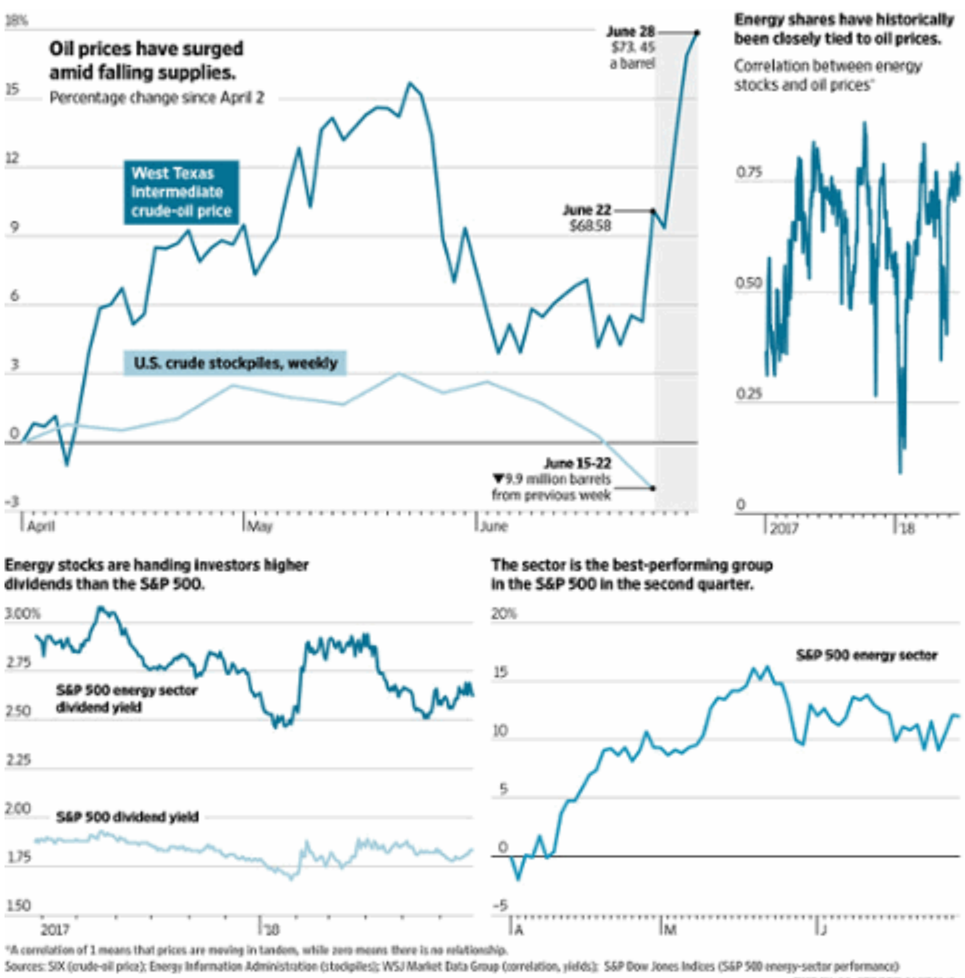
"People are being very selective of the energy names they want," said Mr. Costello.

Nonetheless, given the fresh highs in **oil prices**, analysts expect a strong earnings season from energy companies. The group has seen the largest increase in earnings estimates out of any sector since the start of the quarter, according to analysts surveyed by FactSet. Twenty-two of the 31 companies in the group had an increase in their average earnings estimate.

Energy companies also have boosted their dividends this year. Investors in the **S&P 500** energy sector earn a 2.62% dividend, according to FactSet data as of Wednesday, compared with a 1.84% rate for the **S&P 500** as a whole.

While bond yields have risen as the Fed has increased interest rates, diminishing the lure of dividend-yielding stocks, many of these energy companies are still attractive to income-seeking investors, said JJ Kinahan, chief market strategist at TD Ameritrade Holding Corp.

Traders are "trying to figure out how to position those stocks in the face of all these factors changing quickly," Mr. Kinahan said.



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THE WALL STREET JOURNAL.
U.S. EDITION

Banking & Finance: SEC Acts to Approve ETFs Faster --- Regulatory overhaul stands to streamline the process for clearing new products

By Asjylyn Loder and Gabriel T. Rubin
460 words
29 June 2018
The Wall Street Journal
J
B10
English

The exchange-traded-fund market is getting a regulatory overhaul that is likely to grease the wheels for the approval of new products.

On Thursday, the Securities and Exchange Commission proposed rules for the rapidly growing $3.5 trillion ETF industry to replace a system that relies on narrow exemptions to rules written nearly 80 years ago.

Market participants hope industrywide guidelines, once they are in place, will make it easier for companies to offer new ETF products to investors.

Since ETFs were introduced in the 1990s, the industry has relied on individual exemptions to securities laws for approval of new products, a makeshift process that has given older participants advantages over newer entrants.

"Governing the space by exception has worked well enough for almost 30 years, but it's time to put a stop to it," said Ben Johnson, head of global ETF research for Morningstar Inc.

Under the proposed process, common ETF products, such as an **S&P 500 index** ETF, would receive streamlined SEC approval.

The rule would apply only to ETFs that disclose full portfolio holdings each day and doesn't cover funds that use leverage to amplify gains and losses.

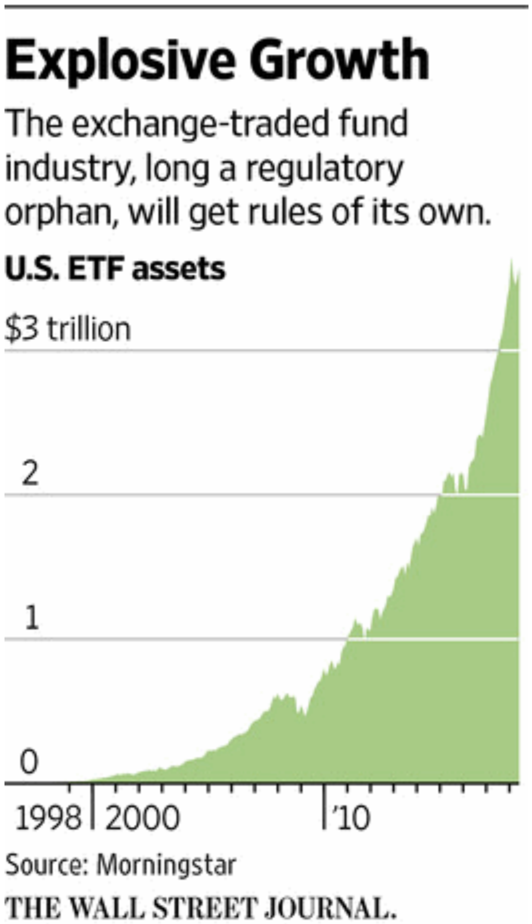
The proposed rules wouldn't open the floodgates to esoteric and potentially riskier products that have long received additional scrutiny, such as proposed funds with stock-picking strategies that don't disclose their holdings or, perhaps, a cryptocurrency ETF, SEC officials said.

It is common for new types of investment products to receive SEC approval through an exemption process, but the agency usually moves to write industry-specific rules after a handful of exemptions have been granted, said Ed Baer, an attorney with Ropes & Gray. There have been hundreds of exceptions for ETFs so far, and they still don't have a regulatory framework of their own, he said.

The SEC first proposed an ETF rule a decade ago, but deliberations were derailed by the financial crisis. Since then, the industry has grown from a financial backwater with less than $1 trillion in assets into a behemoth with more than 2,000 products that invest in everything from Argentine debt to derivatives on Wall Street's fear gauge.

The decades of tailor-made exceptions have given some industry participants a competitive edge, specifically when it comes to portfolio management. Most investors never notice these behind-the-scenes mechanics, but it is an important part of how the ETF market works.

The proposal will soon open for a 60-day public comment period, after which the SEC will consider a final rule.



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THE WALL STREET JOURNAL.

Markets

The $2 Trillion Challenge Facing Emerging Markets; In Asia's emerging markets, among the biggest issuers of dollar bonds, yields are now at their highest in nearly five years

By Mike Bird
768 words
29 June 2018
06:54 AM
The Wall Street Journal Online
WSJO
English

After a decadelong borrowing spree by governments and companies, dollar-denominated bonds in developing economies are coming under increasing pressure as U.S. interest rates rise, tensions about trade ratchet higher and the American currency strengthens.

The average yield on dollar-denominated bonds in emerging markets globally has risen to 4.7%, up from 3.7% at the beginning of the year, according to Bloomberg Barclays index data. Bond yields rise as their prices fall. In Asia's emerging markets, among the biggest issuers of dollar bonds, yields are now at their highest in nearly five years.

That is a significant rise in the cost of funding for developing countries, which have

$2 trillion in outstanding dollar-denominated bonds—a figure that has tripled in the past 10 years—according to the Bank for International Settlements.

The bond market selloff has coincided with growing strains in other asset classes, as investors fret about rising trade tensions between the U.S. and China. China's main stock benchmark entered a **bear market** this week, having declined 20% from January highs, while the yuan dropped 1.4% against the dollar.

The dilemma now facing policy makers in less-developed countries is whether to try to keep pace with the Federal Reserve, which is on course to raise interest rates four times this year. Higher rates could help stem capital outflows from emerging markets: The danger is that such moves would crimp domestic growth.

Indonesia's central bank on Friday raised its benchmark interest rate by 0.5 percentage point to 5.25%, its third such move in just six weeks. The southeast Asian nation is among the emerging markets most exposed to foreign investors, who together own roughly 40% of the government's debt securities.

After the global financial crisis, rock-bottom interest rates in the U.S. helped emerging-market companies and governments in places such as Indonesia to access billions of dollars of funding at relatively low cost. While yields on emerging-market bonds may have been low by historical standards at that point, they were still attractive for investors stuck in low-interest developed markets.

The situation has now changed. The International Monetary Fund estimates the effect of U.S. rate increases and bond sales this year and next year could reduce inflows into emerging markets by about $70 billion—a turnaround from the $260 billion it reckons has flowed into those economies since 2010 as a result of the Fed's earlier policies.

For sure, some investors say the recent selloff has been overdone.

"We don't think this is an accurate pricing of emerging-market fundamentals," said Mark Baker, a Hong Kong-based investment manager at Aberdeen Standard Investments. "It's not like 2013 when big countries were running current-account deficits. There's not much inflation about."

A large part of the explosive growth of emerging-market bond markets in the past decade is down to companies switching to issuing such debt rather than taking loans from banks, Mr. Baker said—meaning the overall rise in borrowing may not be as dramatic as it looks.

The bond market's structure has also shifted in a way that has left emerging-market issuers a little less at risk of having to repay large borrowing piles within a short period. A decade ago, 10% of emerging-market bonds were due to mature within one year, according to the Bank for International Settlements. That figure has now fallen to 6.5%.

One recent change is that Asian dollar bonds have become more of a worry, especially those issued by Chinese companies. Previous market wobbles between 2014 and 2016 centered on countries such as Russia, Brazil and Colombia.

For the first time since at least 2010, default rates among Asian high-yield corporate bonds are higher than in Latin America or the Middle East and Africa, according to Karan Talwar, an emerging-market fixed income investment specialist at BNP Paribas Asset Management. Chinese corporate bond defaults have increased this year as Beijing attempts to reduce the economy's leverage.

"We don't think this is going to be a full-scale blowout, or that there are massive defaults coming," said Mr. Talwar. "But demand for these asset classes has slowed down, companies maybe don't have the implicit [government] guarantee that was presumed by investors."

Write to Mike Bird at Mike.Bird@wsj.com

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WSJ PRO CENTRAL BANKING

Economy

Rosengren: Time to Take Away Punch Bowl | Bullard: Yield Curve Key Risk | Bostic: Increases Necessary | Hot Money Problem | Harrison's Take: Officials Agree On Risks; The Wall Street Journal's central banking newsletter for Friday, June 29, 2018

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Harrison's Take: Fed Officials Agree On Mounting Risks But Not On Much Else

Boston Fed's Rosengren Says It's Time to Take Away Monetary-Policy Punch Bowl

Fed's Bullard: Inverting Yield Curve ‘Key Near-Term Risk'

Fed's Bostic: Gradual Rate Increases Necessary to Keep Economy Stable

Why Hot Money Is a Problem for Britain at Just the Wrong Time

Fed Officials Agree On Mounting Risks But Not On Much Else

After hearing from two Federal Reserve officials Wednesday, it was hard not to get the sense that this expansion is on the downslope into the next recession. That doesn't mean a recession is imminent, of course, just that we're probably closer to the next downturn than we are to the previous one.

Boston Fed President Eric Rosengren and St. Louis Fed President James Bullard, in separate Wall Street Journal interviews, laid out their thoughts on the most pressing risks facing the U.S. economy. Although they see different risks and they offer differing prescriptions, both are worried that we could be sliding toward a downturn unless the Fed takes proper action.

Mr. Rosengren sees a threat from rising asset values and wants the Fed to raise rates to stop another financial bubble from forming. For Mr. Bullard, the biggest threat comes from raising interest rates too much and choking off the expansion.

These aren't new positions for the two officials. What seemed different was the sense of urgency that both brought to their comments.

"We're at a stage of the cycle [where] I do worry about imbalances if we push the economy too hard," Mr. Rosengren said.

Separately, asked for his thoughts on the biggest risk facing the U.S. economy right now, Mr. Bullard pointed to his colleagues at the Fed who have been gradually raising rates and projecting more.

Mr. Bullard thinks the neutral federal-funds rate – the level that neither stimulates nor slows the economy – is lower than many of his colleagues do. That means higher rates could push the economy into a downturn.

"A misinterpretation of where we are is a distinct possibility," he said. "That's why I'm trying to push against faster rate hikes."

It isn't uncommon for Fed officials to disagree. What was striking on Wednesday was their shared view that storm clouds are gathering.

Key Developments Around the World

Boston Fed's Rosengren Says It's Time to Take Away Monetary-Policy Punch Bowl

Banner job growth, soaring corporate profits and one of the longest expansions on record have many in Washington celebrating a booming economy. Not Eric Rosengren. The Boston Fed President Eric Rosengren came to town this week with a message to sober up before the economy heads south again. William McChesney Martin, the Fed chairman in the 1950s and 1960s, said the central bank could never be popular because its job is to take away the punch bowl just as the party gets going. "When you don't take the punch bowl away, it's not that predictable what is going to happen," Mr. Rosengren said in an interview Wednesday.

WSJ Interview Transcript: Read every word of our interview this week with Mr. Rosengren

Fed's Bullard: Inverting Yield Curve 'Key Near-Term Risk'

St. Louis Fed President James Bullard said Thursday he is watching the flattening of the yield curve with concern and the central bank should slow its rate increases to keep it from turning negative. The yield curve is a measure of the gap between short-term and long-term government debt, usually two-year and **10**-**year Treasury** notes. When the yield on two-year debt exceeds the yield on 10-year debt, the curve is said to be inverted, a development that can be a sign investors are worried about the short-term economic outlook.Speaking in St. Louis, Mr. Bullard noted that an inverted yield curve has been a reliable recession signal in the past. "I would see the yield curve inversion as a key near-term risk for the Fed," he said.

WSJ Interview Transcript: Read every word of our interview this week with Mr. Bullard

Fed's Bostic: Gradual Rate Increases Necessary to Keep Economy Stable

Atlanta Fed President Raphael Bostic told an advocacy group Thursday that the Fed's gradual interest rate increases are necessary to keep the economy on an even keel to allow low-income households to continue to benefit from the expansion. Speaking at an event with the Center for Popular Democracy's Fed Up campaign, Mr. Bostic said he was worried about letting the economy overheat, which could lead to another recession. Downturns hit black and low-income households particularly hard, he said, so the central bank's focus is on keeping the economy stable. "We have to be very careful and very sensitive to the fact that we can't be cavalier and say let's grow as fast as we can because I worry about the snapback," he said.

Powell To Testify Before Senate on July 17

Federal Reserve Chairman Jerome Powell will deliver his semiannual monetary policy report to the Senate Banking Committee on July 17, the committee said Thursday. The House Financial Services Committee hasn't announced when Mr. Powell will testify on the other side of Capitol Hill; traditionally that would happen the following day, July 18. A spokeswoman for the committee didn't respond to inquiries Thursday.

Goldman Sachs, Morgan Stanley Dinged in Fed Stress Tests

Regulators on Thursday cleared most of the biggest U.S. banks to return billions of dollars to shareholders but limited the ability of Goldman Sachs Group Inc. and Morgan Stanley to boost shareholder payouts. The results of the Federal Reserve's annual "stress tests" show that regulators believe the banking system is healthy enough to withstand another crisis. Six banks were forced to scale back their capital-return plans, showing that a growing economy and stronger bank earnings are emboldening executives eager to reward shareholders after lean years. Other banks were tripped up by recent tax-law changes and a doomsday scenario that was the toughest in the eight years of the Fed's annual tests.

Eurozone Inflation Tops ECB Target for First Time in More Than a Year

The eurozone's annual rate of inflation rose above the European Central Bank's target for the first time since early 2017 during June, but that was largely due to higher energy costs, while underlying price pressures remained muted. The European Union's statistics agency Friday said consumer prices in the 19 countries that use the euro were 2.0% higher than in June 2017, an increase from the 1.9% annual rate of inflation recorded in May and the highest since February of last year.

Why Hot Money Is a Problem for Britain at Just the Wrong Time

Britain seems to be developing a hot-money problem just as its economic future is becoming more uncertain. That's a big risk for local business and foreign investors alike. The U.K. has long relied on foreign investors to help fund its trade deficit, the biggest relative to output among the world's seven leading economies. But recent changes in the type of inflows Britain is seeing—and the kinds of assets foreigners are putting most money into—have left the country more vulnerable to tightening credit conditions, the Bank of England warned this week.

The spark for a credit crunch would be foreign investors deciding they wanted to cut their exposure to the U.K. That is a troubling thought when the country is moving rapidly toward an exit from the European Union.

World Cup to Boost U.K. Consumer, Says Bank of England's Haldane

The Bank of England's chief economist listed England's performance in 2018's soccer World Cup as one of his reasons for pushing for a rise in interest rates Thursday. Andrew Haldane said in a speech in London that consumer spending in Britain was recovering after a weak first quarter and should pickup further this year because of accelerating wage growth. He said that the England soccer team's performance at the World Cup, if sustained, would likely buoy consumer spirits.

Bank Indonesia Raises Interest Rates

Bank Indonesia raised interest rates more than expected Friday, in the latest move by an emerging-market economy to defend a currency roiled by higher U.S. interest rates and fears about U.S.-China trade tensions. The central bank raised its benchmark seven-day reverse repo rate to 5.25% from 4.75%."The decision is the continuation of Bank Indonesia's pre-emptive, front-loading and ahead-of-the-curve measures to maintain the attractiveness of the domestic **financial market** amid monetary policy changes in some countries and high uncertainty in the global **financial market**," Bank Indonesia Gov. Perry Warjiyo said.

Fearing Yuan's Slide, China Puts New Limits on Property Companies' Bonds

China's top economic planning body has told the country's heavily indebted property companies to curb their issuance of dollar-denominated bonds, a sign of Beijing's concern about the side effects of the yuan's recent slide. In a statement late Wednesday, the National Development and Reform Commission said it would ban property companies from selling bonds outside China, unless the proceeds were used to repay maturing debt or to prevent defaults. Beijing's move could lead to a sharp fall in Asian corporate dollar-bond issuance, an area where Chinese property developers have long been among the most active players. Such companies have issued $24.4 billion worth of dollar bonds this year, nearly a third of all such debt sold in Asia in 2018. But concern has been growing inside China that property companies, which generate revenue in yuan, would find it hard to service and repay their dollar debt as the Chinese currency weakens. The yuan has dropped 1.6% against the dollar this week, a fall driven by trade tensions between Washington and Beijing, as well as rising U.S. interest rates.

Brazil Central Bank Cuts 2018 GDP Growth Forecast to 1.6% From 2.6%

Brazil's central bankreduced its forecasts for economic growth and increased inflation projections as the economy deteriorated in the second quarter. In its quarterly inflation report released Thursday, the bank forecast gross domestic product growth of 1.6% this year, down from the 2.6% forecast in the March report. In both cases, the figures were in line with market projections. As for consumer prices, the bank forecast inflation ending 2018 at 4.2%, up from the 3.8% forecast in March but still below the 4.5% target. Earlier this month, the bank kept its benchmark interest rate steady at 6.5%, saying that inflation is rising toward its target while the economy remains sluggish.

Friday

8:30 a.m. EDT

U.S. Commerce Department releases May PCE index

10:30 a.m. EDT

Bank of Canada releases business outlook and senior loan officer surveys

Global Market Power and Its Macroeconomic Implications

Federico Diez, Daniel Leigh and Suchanan Tambunlertchai study the market power of large firms and find "market power has increased around the world, driven mostly by ‘superstar' firms." They write in a VoxEU column, "Higher markups are initially associated with increasing investment and innovation, but the reverse is true when market power becomes too strong. The share of income paid to workers also declines with rising market power."

Mario Draghi Can't Save Europe This Time

In the past decade, European leaders have "been able to duck difficult decisions, secure in the knowledge that the European Central Bank would step in and fix things. Mario Draghi did this repeatedly, first by providing a backstop to the monetary union and then supporting the recovery via a multi-billion euro bond-buying scheme. 'Whatever it takes,' as the ECB president put it...This time, though, the EU's mightiest institution may have reached the limits of its powers. Europe faces two new emergencies: Donald Trump's attacks on the global trading system and the migration crisis. In both cases, there's nothing the central bank can do other than stand by to react to any financial shock that might ensue," Ferdinando Giugliano writes for Bloomberg View. "Europe's problems today go well beyond the remit of central bankers. In the short term, its economy hinges more on decisions in Washington and Beijing about a possible trade war than anything Frankfurt might do to boost growth. The heightening of trade tensions over the past week have whacked the bond yields of weaker European states such as Italy and Portugal."

U.S. employers increased the number of workers they laid off last week, though the level hovered near multidecade lows.

Economic growth was slower at the beginning of this year than the government previously reported, as consumers pulled back spending and the housing market weighed down output. Gross domestic product, a broad measure of the goods and services produced across the U.S., expanded at a seasonally and inflation-adjusted annual rate of 2% in the first quarter, the Commerce Department reported Thursday. That was weaker than an earlier estimate of 2.2% growth.

The U.K. economy expanded in the first quarter at a faster clip than initially thought, according to a revised estimate Friday, though growth was still slower than many of its peers.

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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WSJ PRO CENTRAL BANKING

Economy
Bank Indonesia Raises Interest Rates

By I Made Sentana
691 words
29 June 2018
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WSJ Pro Central Banking
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English

JAKARTA—Bank Indonesia raised interest rates more than expected Friday, in the latest move by an emerging-market economy to defend a currency roiled by higher U.S. interest rates and fears about U.S.-China trade tensions.

The central bank raised its benchmark seven-day reverse repo rate to 5.25% from 4.75%.

"The decision is the continuation of Bank Indonesia's pre-emptive, front-loading and ahead-of-the-curve measures to maintain the attractiveness of the domestic **financial market** amid monetary policy changes in some countries and high uncertainty in the global **financial market**," Bank Indonesia Gov. Perry Warjiyo said.

Nine out of 12 economists surveyed by The Wall Street Journal predicted a rate increase, while three said they expected it to come in the second half of the year.

Mr. Warjiyo's predecessor, Agus Martowardojo, raised the benchmark rate by a quarter point on May 17, the first increase since November 2014. However, investors considered the rate increase to be insufficient, prompting Mr. Warjiyo to call for an additional meeting on May 30 to raise the rate by another quarter point. Mr. Warjiyo took over as governor on May 24.

The second tightening seemed to help the rupiah recover. But expectations that the Federal Reserve will raise interest rates four times this year instead of three previously expected, and the U.S.-China trade dispute, have dragged the rupiah to fresh lows since 2015.

"The rate increases in Asia's three weakest currencies—the Philippine peso, the Indian rupee and the Indonesian rupiah—have also yet to arrest their depreciation," DBS said Friday. The Singapore bank said it sees room for further weakness. "Between trade wars, higher U.S. dollar rates and a stronger U.S. dollar, the environment remains challenging for emerging markets."

The renewed weakness in the rupiah has also spread to the local stock and bond markets as foreign investors are cutting their holdings in rupiah assets to reduce exchange-rate losses.

Indonesian shares fell Thursday to a 13-month low, thanks in part to a selloff by foreign investors. Foreigners have cut their holdings by $3.5 billion so far this year, helping the market fall 10% since January.

In the government's rupiah-denominated bonds, of which foreigners currently hold nearly 40%, outflow amounted to $1.7 billion during the second quarter, pushing the 10-year yields up by 1.2 percentage point to 7.8%.

"A rate increase will help the stocks as we need [exchange-rate] stability," said Samuel International Managing Director Harry Su. Mr. Su called Bank Indonesia's rate increase Friday a "pleasant surprise."

The local stock benchmark index rose by 1.81% after the central bank's raised interest rates, and the rupiah bounced up to 14,300 to the dollar from 14,415 earlier.

Hariyadi Sukamdani, the chairman of the Indonesian Employers' Association, supported Bank Indonesia's effort to stabilize the rupiah. He said the prolonged exchange-rate **volatility** makes it difficult for companies to plan, especially for firms that have high dollar-denominated debts or that depend on imported materials.

Bank Indonesia also gained support from the government to increase interest rates even though the measures could crimp economic growth.

"The most important thing is economic stability. It's difficult to achieve economic growth if [the] exchange rate is unstable," said Suahasil Nazara, the head of the Finance Ministry's fiscal policy.

Indonesia's economy, the world's 16th largest, expanded by 5.06% in the first quarter from a year earlier, slowing from a 5.19% expansion in the fourth quarter. Finance Minister Sri Mulyani recently cut the 2018 economic growth projection to 5.2% from 5.4%.

President Joko Widodo, who is expected to seek another five-year term next year, has targeted 7% growth by the end of his current term.

To prevent the rate increase from hindering economic growth, Bank Indonesia said Friday it would relax regulations on mortgage lending, especially for first-time buyers, starting Aug. 1.

Write to I Made Sentana at i-made.sentana@wsj.com

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The New York Times

Business/Financial Desk; SECTB
Tech Rallies, and Amazon Shakes Up Two Industries

By THE ASSOCIATED PRESS
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29 June 2018
The New York Times
NYTF
Late Edition - Final
6
English

A rally for technology companies helped stocks recover some of their recent losses Thursday, but trading remained uneven as investors tried to figure out if the tensions between the United States and other nations will spill over into a trade war.

Technology companies and banks were responsible for the bulk of the gains. Amazon surged and shook investors in two separate industries.

Stocks started the day at their lowest levels in almost a month. Contradictory reports from American officials about trade policy have led the market to lurch between gains and losses, sometimes by the hour.

''What's happening is that the market is watching the president and his team, and the president is watching the markets,'' said Marina Severinovsky, an investment strategist at Schroders.

The **Standard & Poor's 500**-**stockindex** added 16.68 points, or 0.6 percent, to 2,716.31. The **Dow Jones Industrial Average** rose 98.46 points, or 0.4 percent, to 24,216.05. The **Nasdaq composite** gained 58.60 points, or 0.8 percent, to 7,503.68.

Amazon shook up multiple industries Thursday after it said it is buying online pharmacy PillPack, which offers pre-sorted dose packaging and home delivery. Investors expect Amazon to use its muscle to reduce costs and drug prices, leading to sharp losses for drugstores, pharmacy benefits managers and distributors.

Amazon rose 2.5 percent to $1,701.45 while Walgreens fell 9.9 percent to $59.70, and medication distributor Cardinal Health shed 4.8 percent to $50.37. Pharmacy benefits manager Express Scripts dipped 1.4 percent to $77.62.

Amazon also announced a program under which contractors can launch businesses that deliver Amazon packages, meaning Amazon will have new ways to deliver products. UPS lost 2.3 percent to $105.88, and FedEx declined 1.3 percent to $226.67.

Benchmark United States crude continued to surge and gained 0.9 percent to $73.45 a barrel in New York. It is at its highest price since November 2014.

The Trump administration is threatening other countries, including close allies such as South Korea, with sanctions if they do not cut off Iranian imports by early November, essentially erecting a global blockade.

Trade concerns are a major reason the market is having a downbeat finish to the second quarter. The **S**.**&P**. **500** is down 2.4 percent in the last two weeks, trimming its gain for the quarter to 3 percent.

The **volatility** may worsen at the beginning of the third quarter, as the United States is set to impose a 25 percent tariff on billions of dollars of Chinese products starting July 6. In response, China will raise import duties on $34 billion worth of American goods.

The yield on the **10**-**year Treasury** note rose to 2.84 percent from 2.83 percent.

The dollar rose to 110.64 yen from 110.20 yen. The euro edged up to $1.1564 from $1.1552.

Gold lost 0.4 percent to $1,247.80 an ounce.

CHARTS: 7-Year Treasury Notes: High yield at auction. (Source: Treasury Department); The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Thursday. (Source: Reuters)

Document NYTF000020180629ee6t00062

THE WALL STREET JOURNAL.

Business
Former Equifax Manager Charged With Insider Trading; Sudhakar Reddy Bonthu was accused of trading on nonpublic information related to the company's data breach

By Allison Prang
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28 June 2018
01:28 PM
The Wall Street Journal Online
WSJO
English

A former manager at Equifax Inc. is facing civil and criminal insider-trading charges related to the credit-reporting company's wide-reaching data breach last year.

The Securities and Exchange Commission accused Sudhakar Reddy Bonthu, who was a software engineering manager at Equifax, of trading on nonpublic information he received while creating a website for users affected by the breach.

In addition to the civil charges from the SEC, Mr. Bonthu also faces criminal charges from the U.S. Attorney's Office for the Northern District of Georgia.

Mr. Bonthu is the second person the SEC has charged with

insider trading related to Equifax's data breach . Jun Ying, former chief information officer of Equifax's U.S. Information Solutions unit, has also been indicted on criminal insider-trading charges. Mr. Ying's attorney declined to comment on the matter.

Mr. Bonthu spent more than $2,100 on put options on Equifax stock on Sept. 1, the SEC said in its complaint Thursday. With the derivatives Mr. Bonthu bought, he would profit only if Equifax 's share price fell below the option price before the contract expired.

The SEC said Mr. Bonthu ultimately made more than $75,000 from selling those options after the company's **stock price** declined following its September announcement about the data breach. Equifax had a policy prohibiting trading derivative securities, the regulator said.

Mr. Bonthu has agreed to return the money he made and to a permanent injunction to settle the SEC's charges, the SEC said.

Meg Strickler, Mr. Bonthu's attorney, said Mr. Bonthu looks forward to his case going through the criminal justice system.

Equifax said in September of last year that personal information of more than 140 million users—such as birth dates and Social Security numbers— had possibly been compromised after its systems were accessed by hackers.

Equifax fired Mr. Bonthu, 44 years old, in March for not cooperating with the company's investigation of his trading, the company said in a statement. Equifax said it will keep cooperating with the Justice Department and the SEC.

Equifax 's board investigated and cleared four executives last year after they were found to have sold shares in the company after suspicious activity on the company's systems was found. The board determined that none of the executives knew about the activity and that they didn't engage in insider trading. The Wall Street Journal reported at the time that the SEC was also looking into the situation.

Write to Allison Prang at allison.prang@wsj.com

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* Equifax Looks to AI Leadership to Boost Tech, Security (Jun 14)

* Equifax Directors Win Re-Election, Despite Concerns About Breach (May 3)

* Former Equifax Executive Charged With Insider Trading (March 14)

* Equifax Identifies Additional 2.4 Million Affected by 2017 Breach (March 1)

* CFPB Chief Says Equifax Probe Continues (Feb. 13)

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WSJ PRO FINANCIAL REGULATION

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WSJ PRO CYBERSECURITY

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By Allison Prang
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28 June 2018
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WSJ Pro Cybersecurity
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THE WALL STREET JOURNAL.
U.S. EDITION

China Unlikely to Use Treasurys as Weapon

By Daniel Kruger
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28 June 2018
The Wall Street Journal
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English

Intensifying trade tensions have U.S. investors parsing China's possible responses to the latest Trump administration salvos, concerned about everything from escalating tariffs to currency devaluation.

One thing nervous investors shouldn't worry about, some analysts say, is China dumping its $1.18 trillion of U.S. government bonds.

The nightmare scenario is that China, which owns about 8% of the U.S. government 's public debt, could drive down **bond prices** by unloading even part of its hoard. Such a move would likely send interest rates paid by the U.S. sharply higher.

Treasurys are a benchmark that helps set rates for mortgages, business loans and consumer debt, and such a move could drive up borrowing costs throughout the economy.

A decision by China to sell Treasurys could be the economic equivalent of "mutually assured destruction," said Mark McCormick, head of currency strategy at TD Securities .

So China would be loath to weaponize its financial assets, analysts say.

For starters, driving down prices on U.S. government bonds would erode the value of any securities China continued to hold. It could also damage the value of China's other extensive dollar-denominated holdings, such as corporate bonds and stocks.

The move also could prove counterproductive in other ways. Because China exported $505 billion of goods to the U.S. in 2017 and imported $130 billion, analysts have noted that President Donald Trump has more targets for tariffs than Chinese President Xi Jinping .

So instead of imposing additional tariffs, some said China could respond by devaluing the yuan.

Indeed, China recently has allowed the yuan to trade lower against the dollar. On Wednesday, the currency reached a six-month low.

Selling Treasurys would upend that plan. China for years has used dollars accumulated by running trade surpluses to purchase Treasurys. This is part of a strategy to prevent the yuan from appreciating, analysts and economists said.

That helps keep China's exports affordable to consumers around the world. Selling U.S. government debt and accumulating yuan could instead risk boosting the value of its currency, making China's exports relatively more expensive.

Such a move also could send shock waves throughout the global economy, unleashing currency **volatility** that China's central bank could be unable to contain. While the yuan fell Wednesday, China's central bank appeared to step in to keep the decline from getting out of control.

Escalating trade levies have the potential to slow global growth, one reason the yield on the benchmark **10**-**year Treasury** note has slipped from an almost-seven-year high of 3.109% in May, said Jeff Klingelhofer , who manages bond portfolios at Thornburg Investment Management.

While he can't rule out the possibility China will sell Treasurys, "my level of concern is pretty low," he said.

Selling dollar assets and repatriating yuan would add to China's trade problems and "help address U.S. trade problems" by hurting the value of the dollar and making U.S. exports cheaper, said Brad Setser , an economist at the Council on Foreign Relations .

Some argue that even if China wanted to sell its Treasury portfolio, it might not prove to be that effective a strategy. Mr. Setser estimates that if China were to sell all of its $1.18 trillion of Treasurys, along with about $100 billion in custodial accounts held abroad, it would raise the yield on the **10-year Treasury** note by as little as 0.3 percentage point.

The most likely way for China to retaliate against U.S. tariffs without raising trade levies of its own would be to tighten regulations and increase inspections of U.S. businesses operating in China, making the climate less hospitable, several analysts said.

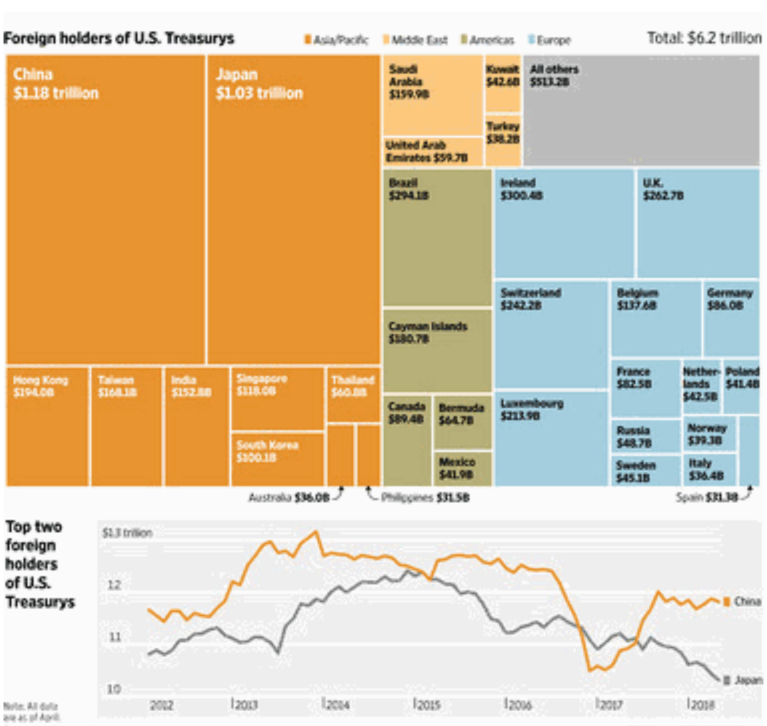
The Defense Department assessed the national-security risks posed by China's bondholdings in 2012 and found the threat of the country dumping Treasurys not credible.

Many analysts believe China would prefer to see the value of its currency against the dollar remain stable. While a weaker currency could help shore up the economy's export sector, it could also raise the risk of capital flight.

Between 2014 and 2016, Chinese currency reserves declined as investors moved money offshore. Officials sold roughly $200 billion of Treasurys to help support the value of its currency. During that period, Treasurys rallied and yields fell.

There would also be a longer-term risk for China, several analysts said. The use of the country's bondholdings and currency in a trade fight could hurt China's push to have the yuan adopted by large central banks as a global reserve currency.

Such a move could damage whatever trust investors have begun to place in the currency as a long-term store of value, Mr. McCormick said. "This is something the U.S. understands, which is why they're probably pushing the envelope a little" and making such large threats about tariffs, he added.



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Economy

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English

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WSJ: How has your forecast for the economy changed since earlier this year?

JAMES BULLARD: Things are looking very good. I would say it's a temporary blip in growth in 2018 and then it will slow down in 2019 and 2020, and I think that's something we should keep in mind. If you look at the [Federal Open Market Committee's Summary of Economic Projections], everyone has growth slowing next year. And professional forecasters, too. They all do the same thing. They've all said it will slow down next year. So I have the concern that we not raise rates permanently in response to something in growth that we think is temporary. That's one consideration to think about at this stage.

But as far as the first half of this year, the second quarter in particular is looking pretty good.

WSJ: And so how does that inform your view of how many more [interest] rate increases are needed this year?

MR. BULLARD: We're already basically at a neutral [federal-funds] rate. I would put the upper end of the neutral zone, considering confidence bounds around various quantities, to be about 2%. For the [federal-funds] rate, I think we're very close now. It wouldn't matter very much if we were a little below or a little above 2%, but I would be leery about going a lot higher from here given that market-based inflation expectations remain slightly on the soft side of 2%. And that suggests that markets are not really expecting too much inflation pressure going forward.

So let me just flesh that out a little bit. I like to look at market-based measures of inflation expectations because they are sensitive to incoming data. And for headline [inflation measured by the consumer-price index] they have a component that's tied to **oil prices**, so you have to factor that in a little bit. But markets are basically saying that over the next five years…the market expects [personal-consumption expenditures] inflation to be below target over the next 5 years—slightly below target.

So I like that because the market-based inflation expectations factor in everything that's going on in the U.S. economy, including trade policy, including fiscal policy changes, tax cuts, government spending changes, and including Fed policy. But their future expectations of Fed policy tend to be somewhat more dovish than the committee puts out in the SEP (Summary of Economic Projections). So the market is saying we're going to miss our inflation target on the low side and we're going to be more dovish than what we are saying we're going to be. And so I take from those kinds of assessments that we're in pretty good shape for monetary policy. We actually don't have to plan a lot of rate increases going forward.

WSJ: So does in your view, the neutral policy rate, real policy rate, that would be zero?

MR. BULLARD: Yes. So on the real rate, I did give this talk on this called "R-Star Wars: The Phantom Menace" a couple months ago. So if you want to see a long, detailed assessment of what I said, you can look there. But I'll give you the short version here.

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Let's say it's negative. Let's say it's zero. I think it's unreasonable to suddenly expect those long-term trends that have been going on for three decades to suddenly turn around and suddenly start to revert to mean. I don't think that's a reasonable assumption on which to make policy. Instead, I think you should say these are long-run trends; they are unlikely to turn around anytime soon. We'll certainly keep an eye out for it, but we really don't expect much change in this because these are driven by productivity growth, by demographic factors, and above all by the demand for safe assets globally, which has been extraordinary and expanding over the last 30 years.

So I think you should think of this short-term safe real rate as being possibly in negative territory, but possibly zero. And zero is kind of the upper bound of where that is. And if you add 2% to that, you would get 2% on the funds rate as kind of pretty close to neutral. So that's my argument about why we're close to neutral today and why I don't think it's reasonable to make policy on the basis of going quite a bit higher from where we're at today.

WSJ: We've seen inflation kind of inch up. You don't think it's going to go up, potentially?

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So I think the most reasonable strategy right now would be to slow down the pace of [rate] increases or do what I'm suggesting and not project any future increases. And then let these inflation expectations creep up a little bit more so that they're more consistent with our target over the next five years and the five years after that, so that we can expect to hit our inflation target on a PCE basis over the next five to 10 years.

WSJ: And you don't buy the argument that these things can move very quickly, that expectations on inflation could start to move up.

MR. BULLARD: It could, but we can also move quickly. My argument is, we do not need to be preemptive in this regard. I think the history of monetary policy, and certainly me being involved since 1990, in a lot of situations we did need to be preemptive because we needed to get ahead of cyclical movements in inflation or to keep inflation expectations under control. Certainly, even in the 1990s you had residual runover from the '80s and earlier periods that we had to keep that under control. And one way to keep that under control is to move ahead faster than what the market would have otherwise anticipated.

But not in this environment. This environment is one where we've been—inflation has been below target for—since 2012. I've lost track of how many years. I guess that's six-and-a-half years now. And it's only just now coming to target on a PCE basis. And you've got low inflation globally; so also Europe, also Japan much of the rest of the world as well. So you've got a very low inflationary environment, which I would attribute to high-quality inflation targeting since the 1990s. And because of that, you have, generally speaking, well-anchored inflation expectations, and if anything, inflation expectations which are somewhat subdued or too low compared to where we'd like them to be. And so I think that's the backdrop against which we have to make monetary policy, not the 1980s or '70s backdrop.

WSJ: So what, then, do you say to colleagues of yours who are concerned about potential financial instability, who look at the last two expansions ending because of bubbles?

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WSJ: Right. A number of people have said that they don't think that monetary policy is a particularly effective tool, even if you had concluded that there were some kind of imbalances.

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WSJ: Separately, I know it's very hard to know what is going to happen on trade policy right now, but I wonder how you're watching the developments. How would a ratcheting up of international trade disputes change your outlook for the growth story this year or next?

MR. BULLARD: Uncertainty about trade policy is certainly on the rise. When I talk contact people in the 8th District and across the U.S. and globally, [they] are worried about this issue. Policy makers are worried about this issue. So there's certainly a lot more uncertainty around trade policy than there was, that's for sure.

Uncertainty by itself could possibly feed into decisions about capital allocation and other issues. So I would say if that's happening, we're only on the cusp of that happening. It could be that agreements are reached in relatively short order, and this pressure goes down. I am concerned also about global supply chains, which I think are far more complicated than they once were, and a new system of tariffs would scramble the global supply chain and cause a lot of transition costs, even though the final state might not be all that different from the original state.

But in the meantime, you have to move the production from one place to another. And you have to change transportation routes. And those are a bunch of fixed costs that you wouldn't otherwise have to pay. So I think that's probably the main risk, is that there are unintended side effects and scrambling with the global supply chain beyond just what the tariff would cost and how it would change actual trade patterns.

WSJ: A few of your colleagues have spoken about their concerns raising rates to the degree that it would invert—that they would knowingly invert the yield curve. And I'm curious to get your view about this signal from the yield curve right now. It's flattened out quite a bit.

MR. BULLARD: Yeah. Well, I gave a speech on this in Little Rock about six months ago. And I wanted to get the debate going on this issue before we actually got to the inverted yield curve. And I think we have had a robust debate about it, both in **financial markets** and also in public comments by committee members. A lot of people have commented on it. I think it is a serious concern. And so let me just talk about it for a minute. The theories about yield curve inversion are not that clear. But the empirics are very clear. The empirics say when the yield curve inverts in the U.S. you get a recession every time. And there's only one false positive. That was in the 1960s. And even there, there was a slowdown that didn't turn into a recession.

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MR. BULLARD: Yeah, almost had a recession. So it seems to be a very robust indicator for the U.S. And I think we should respect that, even if it's not part of our theories. I guess my main point is: I just don't think monetary policy has to push so hard to invert the yield curve and test out the idea of whether this time is different or not. We don't really have to do that in this environment. A simple idea about what the yield curve is telling us is that the short end is controlled by the central bank, but the long end is more of a market signal about where the market thinks the economy is going, especially with respect to inflation. And the market just don't see that much inflation pressure going forward, even though they think the Fed is going to be more dovish than we say we're going to be.

So I would respect this signal. I would say that it's telling us that we can take it easy for now. We certainly want to keep an eye on things and don't want to take anything for granted, but I would not push so hard to invert the yield curve. And we're getting very close now, I think. I'm not sure what it's trading at today but it's about 35 [basis points].

It's very flat. Banking stocks have been hurt by this because the earnings are expected to fall…. But my whole point is I just don't think we have to press that hard in this environment. There's no reason to test that those waters in this circumstance.

WSJ: So in this world of low unemployment and low inflation where inflation expectations may be playing a very strong role in anchoring actual rates of inflation, what is the Fed, in this stage of the cycle, the Fed shouldn't be raising interest rates too much more. What is the Fed's kind of main goal?

MR. BULLARD: So we've already been preemptive. We've already, before inflation even got up to target, we started normalizing the policy rate. We started reducing the size of the balance sheet by allowing a balance sheet runoff. So we've already gotten ahead of the curve. We've already been preemptive. We were ready for this situation already, and now we got to not quite to a 2% funds rate, which, in this world, is pretty high and, plus, you've got the balance sheet running off. So I think that's what's already kept inflation expectations under control.

If we were still back two years ago and we hadn't done anything and we were—we were in this situation, it would be—might be too late and I might be more open to the idea that we're behind the curve. But I don't think that's what we've done. I think we've played it quite well and now that's why we're in such a good position today and that's why we've kept inflation expectations in check up to now, and that's why we don't have to do that much more, going forward, depending on what happens in the economy.

WSJ: What do you think the biggest risks to the economy are right now and in the next couple of years?

MR. BULLARD: I think there is a risk that we'll go too far, too fast as a committee…

WSJ: In raising rates?

MR. BULLARD: Yeah—given my view that you can stay at a pretty what is historically low level of a policy rate, but in this environment is actually a high or neutral rate—policy rate. That kind of a misinterpretation of where we are is a distinct possibility. That's why I'm trying to push against faster rate hikes.

I think this financial bubble issue, of course, is ever present, and you know, could be a major concern.

I think the trade issue, with China especially—to the extent you see China as an economy that could be fragile and is export-based, if the trade war really heats up, it could change the Chinese model in an important way and disrupt Asian growth in a way that we haven't seen in the last 15 years. So I see that as a possibility. I don't put high probability on that, but it is a possibility.

Europe, I think, is again in renewed political disarray with the new government in Italy and the possible erosion of support for [Chancellor Angela] Merkel in Germany. I would see Merkel as being a stabilizing force in Europe over the last decade and a very able politician, but it's not clear now if she can survive or not. I don't have any better insight on this than anyone else, but Europe has to regain its positive momentum for the European project by convincing the countries that are in and the countries that are out of the eurozone and in and out of the [European Monetary Union] that they've got the right formula going forward so that they can have a strong economy, and continue to be a great partner of the U.S. going forward. So they've got real challenges, I would say, on their own side.

WSJ: Just real quick, just kind of struck by your answer to Paul's question about the biggest risk. The first thing you said is it was essentially your own colleagues. (Laughter.)

MR. BULLARD: Well, I'm kind of out on the edge here about saying that we don't need to charge ahead quite as hard as we've kind of projected. I think so far we've been OK. We've gone gradually. I have been a little worried that we're going on a calendar basis and we're not really considering data; we're just kind of sort of doing this on a calendar basis. That, to me, does not smell like an optimal monetary policy.

I think we got in trouble with it in 2004 to 2006, when we moved 17 meetings in a row, one-quarter basis point in each meeting. I think during that time we were all congratulating each other about how smoothly the process had gone, but it all kind of blew up on us. So I think it requires more art than a mechanical increase in interest rates, I think.

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MR. BULLARD: Yeah, almost had a recession. So it seems to be a very robust indicator for the U.S. And I think we should respect that, even if it's not part of our theories. I guess my main point is: I just don't think monetary policy has to push so hard to invert the yield curve and test out the idea of whether this time is different or not. We don't really have to do that in this environment. A simple idea about what the yield curve is telling us is that the short end is controlled by the central bank, but the long end is more of a market signal about where the market thinks the economy is going, especially with respect to inflation. And the market just don't see that much inflation pressure going forward, even though they think the Fed is going to be more dovish than we say we're going to be.

So I would respect this signal. I would say that it's telling us that we can take it easy for now. We certainly want to keep an eye on things and don't want to take anything for granted, but I would not push so hard to invert the yield curve. And we're getting very close now, I think. I'm not sure what it's trading at today but it's about 35 [basis points].

It's very flat. Banking stocks have been hurt by this because the earnings are expected to fall…. But my whole point is I just don't think we have to press that hard in this environment. There's no reason to test that those waters in this circumstance.

WSJ: So in this world of low unemployment and low inflation where inflation expectations may be playing a very strong role in anchoring actual rates of inflation, what is the Fed, in this stage of the cycle, the Fed shouldn't be raising interest rates too much more. What is the Fed's kind of main goal?

MR. BULLARD: So we've already been preemptive. We've already, before inflation even got up to target, we started normalizing the policy rate. We started reducing the size of the balance sheet by allowing a balance sheet runoff. So we've already gotten ahead of the curve. We've already been preemptive. We were ready for this situation already, and now we got to not quite to a 2% funds rate, which, in this world, is pretty high and, plus, you've got the balance sheet running off. So I think that's what's already kept inflation expectations under control.

If we were still back two years ago and we hadn't done anything and we were—we were in this situation, it would be—might be too late and I might be more open to the idea that we're behind the curve. But I don't think that's what we've done. I think we've played it quite well and now that's why we're in such a good position today and that's why we've kept inflation expectations in check up to now, and that's why we don't have to do that much more, going forward, depending on what happens in the economy.

WSJ: What do you think the biggest risks to the economy are right now and in the next couple of years?

MR. BULLARD: I think there is a risk that we'll go too far, too fast as a committee…

WSJ: In raising rates?

MR. BULLARD: Yeah—given my view that you can stay at a pretty what is historically low level of a policy rate, but in this environment is actually a high or neutral rate—policy rate. That kind of a misinterpretation of where we are is a distinct possibility. That's why I'm trying to push against faster rate hikes.

I think this financial bubble issue, of course, is ever present, and you know, could be a major concern.

I think the trade issue, with China especially—to the extent you see China as an economy that could be fragile and is export-based, if the trade war really heats up, it could change the Chinese model in an important way and disrupt Asian growth in a way that we haven't seen in the last 15 years. So I see that as a possibility. I don't put high probability on that, but it is a possibility.

Europe, I think, is again in renewed political disarray with the new government in Italy and the possible erosion of support for [Chancellor Angela] Merkel in Germany. I would see Merkel as being a stabilizing force in Europe over the last decade and a very able politician, but it's not clear now if she can survive or not. I don't have any better insight on this than anyone else, but Europe has to regain its positive momentum for the European project by convincing the countries that are in and the countries that are out of the eurozone and in and out of the [European Monetary Union] that they've got the right formula going forward so that they can have a strong economy, and continue to be a great partner of the U.S. going forward. So they've got real challenges, I would say, on their own side.

WSJ: Just real quick, just kind of struck by your answer to Paul's question about the biggest risk. The first thing you said is it was essentially your own colleagues. (Laughter.)

MR. BULLARD: Well, I'm kind of out on the edge here about saying that we don't need to charge ahead quite as hard as we've kind of projected. I think so far we've been OK. We've gone gradually. I have been a little worried that we're going on a calendar basis and we're not really considering data; we're just kind of sort of doing this on a calendar basis. That, to me, does not smell like an optimal monetary policy.

I think we got in trouble with it in 2004 to 2006, when we moved 17 meetings in a row, one-quarter basis point in each meeting. I think during that time we were all congratulating each other about how smoothly the process had gone, but it all kind of blew up on us. So I think it requires more art than a mechanical increase in interest rates, I think.

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The New York Times

Business/Financial Desk; SECTB

President Backs Off On Limits To China

By ANA SWANSON, ALAN RAPPEPORT and JIM TANKERSLEY; Eileen Sullivan contributed reporting.
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WASHINGTON -- The Trump administration has backed off a plan to impose aggressive new restrictions on Chinese investment in the United States, opting instead to support a congressional effort that would expand the types of foreign deals that are subject to review.

President Trump said Wednesday that he supported a bipartisan push in Congress to broaden the authority of a government body that reviews foreign investments for security threats. The legislation would give the United States power to squelch a wider variety of investments from China, including minority stakes in American firms, joint ventures, and real estate transactions near military bases or other national security facilities.

It would also allow the United States to consider risks beyond national security when rejecting transactions -- for instance, whether a deal could undercut America's dominance in a particular field, like wireless technology or artificial intelligence.

Mr. Trump said the expansion of the Committee on Foreign Investment in the United States , or Cfius , would achieve his goal of combating China's ''predatory investment practices'' of buying stakes in American companies to acquire valuable technology and trade secrets.

[Read more about an expanded Cfius .]

The decision will forestall more draconian curbs on Chinese investment that the White House had been considering, such as limiting investment in technology and manufacturing industries by declaring an economic emergency. That could help defuse tensions between the world's two largest economies, at least somewhat.

But it is unlikely to avert a rapidly approaching trade clash that threatens to derail global stock markets and multinational supply chains. China is still far from offering to make the type of substantial changes to its economy that the Trump administration has pushed for, and no official talks appear to be scheduled in the next week.

The Trump administration is scheduled to put levies on $34 billion worth of Chinese products on July 6, with the president threatening to impose tariffs on as much as $450 billion of Chinese goods as punishment for Chinese trade practices. Beijing has countered with its own threat of tariffs on American products.

''Our objective is not to single out China or treat them differently, but that we have the necessary tools to protect U.S. investments,'' Steven Mnuchin , the Treasury secretary, said Wednesday. ''I'm not going to make specific comments on where we are in dialogue, but if China wants to come to the table with free and fair trade and treating American companies fairly and reducing the trade deficit, we're always willing to listen.''

Additional curbs could still be coming. Administration officials said Wednesday that Mr. Trump would direct the heads of the Commerce Department and other federal agencies to review the nation's export controls and recommend any needed changes. That could have a more significant effect on American companies than restrictions on Chinese investment, since it could limit their ability to sell products to China. The targeted industries that the White House wants to prevent China from dominating include robotics, artificial intelligence and new-energy vehicles.

Eswar Prasad , a professor of international trade at Cornell University, said the president's announcement suggested ''a brief lull in the economic hostilities against China.''

"For now, at least, the momentum within the administration has swung back in favor of Mnuchin and others who favor a less confrontational approach to the economic relationship with China," Mr. Prasad said. "However, with the imposition of tariffs against China just a few days away, this apparent respite in economic hostilities could prove to be all too fleeting."

The announcement appeared to be a narrow and unlikely victory for more moderate advisers in the White House. While expanding Cfius would most likely curb Chinese investment, the White House had drafted an executive order that would have put more stringent investment restrictions into effect, according to people familiar with the plans.

That garnered the support of more hard-line trade advisers -- among them Peter Navarro ; Robert E. Lighthizer , the United States trade representative; and Commerce Secretary Wilbur Ross -- as well as the national security adviser, John R. Bolton .

But Mr. Mnuchin convinced Mr. Trump that the president could be blamed for triggering a drop in the **stock market** and for creating additional layers of bureaucracy necessary to review investments. Mr. Mnuchin and top Republican lawmakers made the case that the legislation winding its way through Congress provided a viable bipartisan alternative.

Justice Department and State Department officials had also warned that investment restrictions emanating from the White House could trigger a wave of lawsuits.

The potential investment restrictions were part of the White House's effort to punish China for what it says are years of unfair trade practices, including cyber espionage and a pattern of pressuring American technology companies to hand over valuable trade secrets.

Among the actions that the United States has targeted are what it describes as the "theft" of corporate secrets and China's strategy to dominate cutting-edge industries, known as Made in China 2025. Data released this week from Public Citizen , a liberal advocacy group and think tank, showed that 56 percent of Chinese investments in the United States last year were in industries that Beijing defines as "strategic," such as aviation, biotechnology and new-energy vehicles -- up from 25 percent in 2016.

In a meeting last week with China's president, Xi Jinping , American corporate executives urged him to send one of his most trusted advisers, Wang Qishan, to the United States for talks. But with the United States and China so far from a compromise, such a visit appears unlikely in the near term, people familiar with the deliberations said.

On Wednesday, Larry Kudlow , the White House's chief economic adviser, said that Mr. Trump and Mr. Xi "work well together," but that the president was unsatisfied with the Chinese response on trade talks.

"The ball is in their court," Mr. Kudlow said.

Administration officials who outlined the decision in an early-morning briefing said that Mr. Trump had been pleased with the evolution of the legislation to expand Cfius and that he viewed it as an "extremely powerful tool" to safeguard national security. The overhaul would allow Cfius to review investments from a list of "countries of special concern" but stops short of specifically naming China as the target.

The Senate and House have passed different versions of the legislation, which must be reconciled and sent back for a final vote. While final approval appears likely in the coming weeks, it is not guaranteed. Mr. Trump said he would be prepared to "deploy new tools, developed under existing authorities," if lawmakers did not act to "protect the crown jewels of American technology and intellectual property from transfers and acquisitions that threaten our national security -- and future economic prosperity."

The decision could help repair ties with Republican lawmakers, who have been at odds with Mr. Trump over his approach to trade, including his tariffs on the European Union , Canada and Mexico and his decision to rescue the Chinese telecommunications company ZTE.

Mr. Trump has also threatened to put 20 percent tariffs on autos imported into the United States. A handful of Republican senators have introduced legislation to limit the president's ability to impose such tariffs, but they have faced opposition from Republican leadership.

Lawmakers have worked for months on the Cfius legislation, seeing it, rather than punitive new restrictions, as the best path to curtail risky investments from China.

Senator John Cornyn , a Texas Republican who has sponsored the bill, said in a statement that he appreciated the president's support for the legislation, which ''takes a carefully tailored approach to updating the review process without limiting our ability to meaningfully engage in trade with partners around the world.''

Mr. Mnuchin insisted on Wednesday that the Trump administration was not pursuing a protectionist approach and was actually trying to prod other countries, including China, to lower their trade barriers.

The president wants to curtail foreign access to American tech. (PHOTOGRAPH BY WU HONG/EPA, VIA SHUTTERSTOCK)

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The New York Times

Contributing Op-Ed Writer
Opinion
The Coming Tech Battle With China

By Ruchir Sharma
1,585 words
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Arriving in Beijing last month, I knew I would not be able to connect to Google, Facebook or Uber. As strange as it was to go without these staples of online life in the West, it was even stranger to find that local Chinese didn't seem to feel deprived at all. They search through Baidu, get their social media fix on WeChat, hail rides on Didi, curate news through sites like Toutiao. And while they know Beijing is watching, they accept this surveillance as normal.

The Chinese government has carved out an alternative internet universe with its own brands, rules and culture, in which privacy doesn't exist. But its real ambition is to break out of this parallel universe and dominate not just the internet but the technology industry worldwide. To contain Beijing, the United States and its allies are fighting back with a campaign of technoprotectionism, opening a perilous new front in the global trade battles.

President Trump is the unlikely leader of the fight against Chinese tech dominance. Widely seen as a champion of rust belt industries, he recently slapped heavy tariffs on all the leading aluminum and steel exporters, drawing fierce protests not only from China but also from American allies like Germany and Canada. But steel is a side show compared with the emerging tech battle with China.

Technology will decide which country emerges as the world's dominant economic power in the long run. While about 20 percent of per-capita gross domestic product growth is driven by labor and capital, the remaining 80 percent is determined by how rapidly an economy is developing and applying new technology to increase production. China's ambition to catch up to Western living standards thus depends largely on how rapidly it can match or surpass Western technology.

Even allies miffed by Mr. Trump's steel tariffs remained largely supportive when he imposed $50 billion in tariffs on China — and only China — in response to its predatory tech trade practices, then threatened another $200 billion if Beijing followed through on a promise to retaliate. This week, Mr. Trump endorsed intensified review of Chinese investment in American technology and of American tech exports to China.

Mr. Trump is both accelerating and expanding trade battles that began before he took office. Following the global financial crisis of 2008, countries around the world began to restrict cross-border flows of trade, capital and migrants. Globalization's champions predicted that borders would continue to fall in at least one area — digital tech and the internet — but China has shown that a determined government can build walls in the virtual sphere, too.

The president's tough stand on trade with China may be more popular than he is. The overwhelming consensus in the West is that Beijing is catching up illegitimately, by forcing companies that invest in China to share their best technology, or dispatching hackers to steal it. Though borrowing from the leading tech power is a standard development strategy — think of 19th-century America copying British industrial technology and Japan's great success replicating American technology — the scale and organization of China's campaign makes the threat feel new.

Beijing has banned some foreign competitors like Google and Facebook outright, and regulated others so heavily that they have been compelled to sell themselves to Chinese rivals (Uber) or forced to consider pulling out of China (Amazon). In essence, China has created domestic internet monopolies that are generating enough cash in their vast local market to finance aggressive expansion abroad. I have been told, for example, that Toutiao already sells its novel content curating service to one in 10 Japanese.

Last year Beijing rebranded the manufacturing centers of the Pearl River delta as the "Greater Bay Area" and began urging the main cities there — Shenzhen, Guangzhou and Hong Kong — to cooperate to become China's rival to Silicon Valley, which the Chinese would like to make the lesser Bay Area.

In Beijing, the buzz was about how "Created in China" is replacing "Made in China," with some claiming that Shenzhen is now more innovative than Silicon Valley in key industries. Instead of just assembling simple goods from parts built elsewhere, China is now increasingly seen as a cutting-edge designer and developer of artificial intelligence, drones and other advanced technologies.

Among the world's 20 largest internet companies by market capitalization, 11 are American and nine are Chinese, and the Chinese giants are proliferating fast, up from two just five years ago. Currently, they are limited largely to Chinese turf. Tencent and Alibaba get more than 90 percent of their traffic from within their home country, compared with roughly 10 percent for Google and Facebook, but they all have plans to expand.

The Trump administration has moved to restrict Chinese tech expansion in several ways. An executive branch committee that reviews investments for security threats recently blocked attempts by a Chinese company to buy MoneyGram, a money-transfer company. In another case, that same committee's concerns about potential Chinese influence over global mobile networks helped scuttle Broadcom's proposed takeover of the chip maker Qualcomm. When the Trump administration banned exports to a major Chinese smartphone manufacturer, ZTE, it forced the company to largely shut down for lack of access to key American technology.

Mr. Trump was willing to lift the ban on ZTE after the company paid a $1 billion fine and fired its top executives, but Congress was not. The Senate voted to reinstate the ban, which is likely to fuel trade battles to come. When I was in Beijing, many Chinese were talking about how the humiliation of ZTE was inspiring an official push to reduce China's dependence on the United States for semiconductors, software and other critical tech imports.

The next salvo from the Trump administration is expected to focus on sensitive sectors like financial technology and artificial intelligence, and to impose new controls not only on American tech exports to China, but also on American investments in China. Many Western allies have already taken similar steps. Germany is tightening investment rules for Chinese companies and protesting the restrictions German companies face in China. Australia is reportedly considering banning Chinese firms from working on its 5G rollout because of national security concerns.

The European Union recently imposed new data protection rules written largely to give consumers more control of information now in the hands of corporate giants like Facebook, but also to guard against the spread of a China-like surveillance state. The European Union is also pondering a new digital single market, in part to give European companies a market in which they have a chance to grow as large as Chinese rivals.

Meanwhile, many countries are going the opposite way, copying elements of China's external barriers and internal surveillance tools: Russia, Brazil and other countries are requiring foreign internet companies to put servers on those countries, where they are easier for the government to monitor and control. Qatar, Iran and the United Arab Emirates, among others, have banned foreign services like WhatsApp and Viber. These moves may be motivated by a desire to control political discussion more than trade, but nonetheless they invite retaliation.

This is how a digitally interconnected world could die by a thousand cuts, and technoprotectionism may get a further push during the next global downturn. From the United States to Europe and Japan, public debts are high and deficits are rising, which means these governments are poorly positioned to spend their way out of any slowdown. Central banks can't help much, either, since interest rates are still very low, with little room or reason to drop further right now. In this environment, governments may see protectionism as the only lever they have left to pull.

For most of the postwar era, the consensus in support of free trade was so strong that governments rarely resorted to raising tariffs even when times were tough. The trade wars that broke out after 2008 have involved mainly nontariff or "stealth" trade barriers, including cheap state loans and subsidies for favored industries. But in the last two years, the rise of Mr. Trump and other antiglobal populists has given new currency to protectionism in all its forms, including technoprotectionism.

The global **financial markets** had largely ignored the brewing trade battles, until recently. As the tariff threats grow in scale, and the battleground shifts from rust belt industries to new technologies, the markets are growing more skittish. So far, stocks have been hit harder in China than in the United States, but there will be no winners. The latest surveys of American investors and manufacturers show that their biggest concern is the threat of a trade war.

The risks from deglobalization are growing. If the current skirmishes turn into a full-blown trade war, blame will fall heavily on the thousandth cut. But the real fault will lie with the 999 that came before.

Ruchir Sharma, author of “The Rise and Fall of Nations: Forces of Change in the Post-Crisis World,” is the chief global strategist at Morgan Stanley Investment Management and a contributing opinion writer.

* Trump Tariffs Threaten National Security

* Why China Is Confident It Can Beat Trump in a Trade War

* China Moves to Shore Up Economy as Slowdown and Trade Fight Loom

Crowds near China’s Huawei Technologies stand at the Mobile World Conference in Shanghai on Wednesday. | Agence France-Presse — Getty Images

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WSJ PRO FINANCIAL REGULATION

Markets
SEC Moves to Streamline Exchange-Traded Fund Launches; Riskier ETFs will still receive additional scrutiny

By Asjylyn Loder and Gabriel T. Rubin
893 words
28 June 2018
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RSTPROFR
English

The exchange-traded-fund market is getting a regulatory overhaul that is likely to grease the wheels for the approval of new products.

On Thursday, the Securities and Exchange Commission proposed rules for the fast-growing $3.5 trillion ETF industry to replace a system that currently relies on narrow exemptions to rules written nearly 80 years ago. Market participants hope industrywide guidelines, once they are in place, will make it easier for companies to offer new ETF products to investors.

Since ETFs were introduced in the 1990s, the industry has relied on individual exemptions to securities laws for approval of new products, a makeshift process that has given older participants advantages over newer entrants.

"Governing the space by exception has worked well enough for almost 30 years, but it's time to put a stop to it," said Ben Johnson, head of global ETF research for Morningstar Inc.

Under the proposed process, common ETF products, such as an **S&P 500 index** ETF, would receive streamlined SEC approval. The rule would apply only to ETFs that disclose full portfolio holdings each day, and doesn't cover funds that use leverage to amplify gains and losses.

The proposed rules wouldn't open the floodgates to esoteric and potentially riskier products that have long received additional scrutiny, such as proposed funds with stock-picking strategies that don't disclose their holdings or, perhaps, a cryptocurrency ETF, SEC officials said.

The industry has been a regulatory orphan, wedged in as an exemption to rules written in 1940 for investment companies such as mutual funds, since State Street Corp. in 1993 launched the first fund that packaged every stock in the **S&P 500** into a single, easily-traded share.

It is common for new types of investment products to receive SEC approval through an exemption process, but the agency usually moves to write industry-specific rules after a handful of exemptions have been granted, said Ed Baer, an attorney with Ropes & Gray. There have been hundreds of exceptions for ETFs so far, and they still don't have a regulatory framework of their own, he said.

The SEC first proposed an ETF rule a decade ago, but deliberations were derailed by the financial crisis. Since then, the industry has grown from a financial backwater with less than $1 trillion in assets into a behemoth with more than 2,000 products that invest in everything from Argentine debt to derivatives on Wall Street's fear gauge.

The decades of tailor-made exceptions have given some industry participants a competitive edge, specifically when it comes to portfolio management. Most investors never notice these behind-the-scenes mechanics, but it is an important part of how the ETF market works.

ETFs are open-ended funds, and professional market participants can create or retire large blocks of shares of the fund in exchange for a basket of the underlying securities, such as the 500 stocks in the **S&P 500**. This in-kind trade process helps ETFs avoid taxable gains, making them more attractive to investors.

Newer ETF issuers must swap ETF shares for the exact mix of stocks or bonds owned by the fund, while older firms such as State Street and BlackRock Inc. have more flexibility. That latitude is especially helpful when managing ETFs that own securities that don't trade often and can be hard to find, such as corporate bonds or some small emerging market stocks.

"You have this odd situation where some sponsors can run an ETF one way, and others are restricted from doing that," said Noel Archard, global head of product for State Street's ETF business.

Under the proposal, all companies would be given the same flexibility to manage the ETF's portfolio, as long as they act in the best interests of investors, SEC officials said. This is meant to prevent big institutional players from dumping troubled securities onto unsuspecting ETF customers, or cherry-picking the best stocks and bonds when trading in ETF shares.

The rule won't cover ETFs that are share classes of mutual funds, such as some Vanguard Group funds. Also excluded are unit investment trusts, a legal structure more common to older funds, including the $262 billion SPDR **S&P 500** ETF Trust, the first and still largest ETF on the market. Those funds would continue to operate under the legacy exemptive orders.

The proposal will soon open for a 60-day public comment period, after which the SEC will consider a final rule.

The SEC also approved a final rule to spare mutual funds from having to tell shareholders how they score the liquidity of their holdings. The rule is a rollback of a 2016 rule that obligated mutual funds to report detailed information about their portfolio investments, including how easily each position could be sold to meet redemption requests.

The new rule requires funds to share a narrative disclosure with their shareholders describing the fund's approach to managing liquidity risk.

Both Democratic commissioners on the five-member commission opposed the rule, criticizing it as a bow to industry pressure.

Write to Asjylyn Loder at asjylyn.loder@wsj.com and Gabriel T. Rubin at gabriel.rubin@wsj.com

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THE WALL STREET JOURNAL.

Markets

U.S. Treasury Yields Inch Higher After Data on Jobs, Growth; Data on unemployment and economic growth are weaker than expected

By Orla McCaffrey
347 words
28 June 2018
04:32 PM
The Wall Street Journal Online
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U.S. government**bond prices** fell Thursday as stocks rose and concerns over trade tensions eased.

The yield on the benchmark 10-year U.S. Treasury note rose to 2.849% compared with 2.827% Tuesday. Yields rise as **bond prices** fall.

"The move is consistent with the idea that things might take a turn for the better on the trade front," said Ian Lyngen, head of U.S. government bond strategy at BMO Capital Markets. "But volumes are relatively low, so there's a limited amount of conviction behind the move."

Major U.S. indexes began rising midway through the session, with the **Dow Jones Industrial Average** gaining 0.4% and the **S&P 500** adding 0.6%.

Thursday's move came a day after concerns about trade tensions between the U.S. and China helped send yields to their lowest level since May 31.

Yields edged higher to start the day after weaker-than-expected unemployment and economic growth data were reported. They continued to climb after the Treasury Department auctioned $30 billion of seven-year notes to demand that was in line with recent averages.

The number of Americans filing new claims for unemployment benefits rose more than expected last week, according to data released Thursday, but remained in line with the trend of a tightening labor market. Also Thursday, revised data on gross domestic product showed economic growth was slower at the start of 2018 than previously reported.

The bond market will continue paying attention to the direction of currencies, specifically the Chinese yuan and others from emerging markets after their recent slips against the dollar, said John Briggs, head of strategy for Americas at RBS Securities.

"The bond market is looking at protectionism and trade risks and their potential spillover through the currency lens," Mr. Briggs said. "Markets are torn between which element—firm economic data or the risks emanating from U.S. protectionism—is going to rule the day."

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THE WALL STREET JOURNAL.

U.S. Markets
Markets

Gains in Technology, Financial Shares Help Lift Indexes; Some investors see talk of tariffs as mostly a war of words for now

By Akane Otani
560 words
28 June 2018
07:07 PM
The Wall Street Journal Online
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English

Corrections & Amplifications

Gilles Pradère is a fund manager at RAM Active Investments. An earlier version of this article incorrectly identified the business as RAM Active Investment. (June 28)

U.S. stocks rebounded in a broad afternoon rally Thursday, chipping away at their midweek losses.

Major indexes wobbled out of the gate as investors struggled to gauge the direction of trade policy between the world's two biggest economies, but they then regained ground in the last hour of the session.

The moves lifted all but two of the **S&P 500**'s 11 sectors for the day, helping major indexes pare steep declines accrued earlier in the week.

Stocks have struggled for direction as the U.S. government has taken a more aggressive stance toward China, imposing tariffs on its exports and suggesting it may impose new restrictions on Chinese investment.

Some investors and analysts fear that escalating tensions could lead to restrictive trade policies across the world that dent global growth.

Still, others maintain that much of the back-and-forth between Washington and Beijing appears to be posturing for now—and that the odds of a full trade war breaking out remain slim. U.S. growth still looks strong, especially compared with economic growth elsewhere, something that should help support further gains in the nine-year **bull market**, analysts say.

"For the most part we think a lot of what we've seen has been noise," said Bruce Bittles, chief investment strategist at Robert W. Baird & Co. He added that he is more concerned about other risks like tightening monetary policy and potential headwinds from a strengthening dollar.

The **Dow Jones Industrial Average** added 98.46 points, or 0.4%, to 24216.05, reversing course after sliding as many as 120 points earlier in the trading session. The **S&P 500** added 16.68 points, or 0.6%, to 2716.31 and the **Nasdaq Composite** advanced 58.60 points, or 0.8%, to 7503.68.

Technology stocks bounced back from their Wednesday losses, helping lead major indexes higher. Accenture jumped $9.16, or 5.9%, to $164.50 while Take-Two Interactive added 4.10, or 3.6%, to 118.06.

Financial stocks rose as the yield on the benchmark 10-year U.S. Treasury note edged up to 2.849% from 2.827% Wednesday. Higher rates tend to boost banks' net interest margins, a key measure of lending profitability.

Morgan Stanley added 1.10, or 2.3%, to 48.29 and Citigroup added 1.42, or 2.2%, to 66.88.

Pharmacies and package-delivery firms were pressured by Amazon.com's latest ventures into the shipping and health-care industries.

The e-commerce giant said Thursday that it is buying online pharmacyPillPack, as well as encouraging entrepreneurs to form small delivery companies to carry packages to consumers' doors.

CVS Health shed 4.27, or 6.1%, to 65.78, while United Parcel Service and FedEx fell more than 1% apiece.

Elsewhere, the Stoxx Europe 600 slid 0.8%, weighed down by declines in the technology sector. The Shanghai Composite closed at its lowest level in more than two years, while South Korea's Kospi Composite Index fell to its lowest level since May 2017.

Jon Sindreu

contributed to this article

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* Energy Topples Tech as Top Sector

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THE WALL STREET JOURNAL.

World

Trump's Bid to Weaken Iran Is Strengthening the Saudi Economy; Kingdom ramps up oil production as prices rise and sanctions pressure Tehran

By Summer Said and Michael Amon
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The Trump administration's effort to drive Iranian oil exports down to "zero" is boosting the fortunes of Tehran's rival, Saudi Arabia, and putting the U.S. ally on a stronger footing for a showdown across the Persian Gulf.

Saudi Crown Prince Mohammed bin Salman's government is planning to increase oil production to a record high of nearly 11 million barrels a day by next month to replace Iranian crude expected to be lost because of U.S. sanctions, people close to the Saudi oil ministry said.

After years of austerity measures following the 2014 **oil-price** crash, increased oil revenue could allow Prince Mohammed to expand military spending and economic and social reforms.

The benefits for the kingdom highlight the central place Saudi Arabia holds in President Donald Trump's confrontation of Iran over its nuclear program and military posture in the region.

Saudi Arabia is "an essential linchpin" of the Trump administration's strategy against Iran, said Helima Croft, managing director and global head of commodity strategy at RBC Capital Markets. "A better economy is a big win for MbS," she said, using a common nickname for the 32-year-old prince.

Mr. Trump pulled the U.S. from a 2015 multination deal that lifted sanctions in exchange for curbs on Iran's nuclear activity, and vowed to reimpose wide-reaching sanctions on Tehran by November—a course advocated by Saudi Arabia, Israel and other Iran foes in the region.

In addition to seeking to force Iran to abandon weapons programs, the U.S. is working to force Iran to pull back its support for military proxies such as Hezbollah, which threatens Israel in Lebanon, and the Houthis, who are fighting a Saudi-led coalition for control of Yemen and have terrorized Riyadh with rockets.

Prince Mohammed told The Wall Street Journal in March that the world needed to put economic pressure on Iran to avoid a direct military confrontation.

U.S. pressure has already begun rippling through Iran. The National Iranian Oil Co. has ordered affiliates to be ready for a reduction in oil production of 200,000 to 500,000 barrels a day, Iranian oil contractors said.

President Hassan Rouhani on Wednesday urged his people to stay strong as the U.S. tries to isolate their country. Protesters shut down Tehran's Grand Bazaar this week over the country's depreciating currency.

At the same time, the Saudis are planning for a rare moment in the oil market when they can ramp up petroleum production and still benefit from a crude-price rally. Saudi oil production is likely to hit 10.8 million to 10.9 million barrels a day in July, up from around 10.6 million in June and 10.03 million in May, according to the people close to the oil ministry. That May-July increase would mean nearly $25 billion a year in additional revenue, at $75 a barrel.

On Thursday, Brent crude, the international benchmark, was up over 4% since a senior State Department official said Tuesday that the U.S. would try to force all Iranian oil buyers to stop their purchases.

"If [the Saudis] are looking to facilitate regime change or force internal changes in Iran, quite frankly, this puts them in a very strong position," said Hootan Yazhari, head of the Middle East North Africa and global frontier markets research at Bank of America Merrill Lynch. Saudi officials don't publicly advocate for regime change in Iran but are calling for policy changes that Tehran is unlikely to support, such as giving up backing of Hezbollah.

A fiscal bump could help at what is period of uncertainty for the Saudi economy. The unemployment rate for Saudi citizens remains above 12%. Consumer spending slowed this year after the government introduced a 5% value-added tax in January and cut energy subsidies, making essentials like gasoline and electricity more expensive.

"Business is not like before, that's for sure," said Abu Ahmad, who owns a spice and nut shop at a traditional Arab market in Riyadh. "My profit margins are reduced."

Prince Mohammed would likely use at least some revenue from oil sales to press ahead with initiatives aimed at developing new non-oil industries and avoiding "politically unpopular austerity measures," said Ms. Croft.

A stronger Saudi economy would remove some of the fiscal pressure as the kingdom fights rebels in Yemen who they say are supplied by Iran. A Saudi-led coalition is in the middle of an offensive to take back the strategic port of Hodeidah, a potential turning point in the war. Iran denies that it is supporting the Houthi rebels.

As U.S. sanctions give Saudi Arabia an economic boost and leverage over its biggest rival, Ms. Croft said, Mr. Trump could use help from the Saudis on Middle East initiatives such as an Israeli-Palestinian peace plan, winding down the Syrian war and weapons deals.

The Saudis are working to shield oil consumers from the recipe for higher prices underlying the oil market today: robust demand coupled with supply outages from Iran to Venezuela to Canada. Production increases could prevent an **oil-price** spike in the middle of the summer driving season in the U.S.

"While they will never admit to this publicly, Saudi Arabia is clearly trying to stabilize prices around $70," consultancy Energy Aspects said in a note this week.

In the longer term, higher **oil prices** should be unappealing to the Saudis because they could cause global economic damage, said Robin Mills, chief executive of consultant Qamar Energy in Dubai.

The International Monetary Fund has warned that Saudi Arabia shouldn't let higher **oil prices** distract it from economic changes such as cutting subsidies and privatizing state-run businesses. Mr. Mills said it was likely, though, that the Saudi government would use some of the extra oil revenue to help citizens weather subsidy reductions.

"This does raise the concern that higher oil revenues weaken the impetus for economic reform," he said.

Donna Abdulaziz and Benoit Faucon contributed to this article.

Write to Summer Said at summer.said@wsj.com and Michael Amon at michael.amon@wsj.com

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THE WALL STREET JOURNAL.

Opinion
Go for Growth, Fellow Dems; To counter Trump, become the party of inclusive prosperity.

By Tony James
871 words
28 June 2018
06:49 PM
The Wall Street Journal Online
WSJO
English

We Democrats assumed a Trump presidency would be disastrous for the economy. But despite a disorderly administration and confusion in Washington, the economy is on a roll and the **stock market** has soared. Whether we view President Trump as a nightmare to be endured or a foe to be battled, Democrats should hear a wake-up call.

Economic growth, hourly wages, consumer confidence and personal spending are accelerating. Unemployment is the lowest in two decades. For the first time, job openings exceed the number of unemployed. Some of the current expansion is built on the foundation laid by the Obama administration. And although Mr. Trump's lack of fiscal discipline risks ballooning deficits, Democrats cannot dismiss the critical importance of new policies that have helped propel the economy.

Many Trump voters—high-school-educated Americans battered by globalization—are our natural constituents. We need to win them back. If Democrats are going to return to power, we need a strong pro-prosperity platform that includes pragmatic and economically inclusive policies that drive growth.

Let's look at regulation. The attitude that regulation is fundamentally good—and any attempt to reduce it bad—is far too prevalent among Democrats. In 2012 and again in 2016 the U.S. Supreme Court unanimously held that landowners could sue to challenge Environmental Protection Agency decisions to protect wetlands. No one at the EPA seems to have asked if its regulations were actually the best way to preserve wetlands. Regulation of the wrong sort hurts economic growth and diminishes U.S. competitiveness.

The new tax bill is also instructive. Let me state something that is heresy with some Democrats: Cutting the corporate tax rate was good for the economy. It levels the playing field with other countries, keeps thousands of jobs at home, and makes billions of dollars available for reinvestment, especially in smaller companies with limited access to capital markets.

A recent Morgan Stanley survey showed that companies expect to reinvest the bulk of the tax savings in higher wages, increased capital expenditures and research and development. The companies surveyed anticipated passing only a quarter to shareholders in dividends and buybacks. That squares with the plans of the companies our firm has invested in, and is corroborated by the significant jump in capital expenditures—24%—by **S&P 500** companies last quarter.

Many think corporate tax reform was not the appropriate national priority. It certainly didn't do enough to help struggling Americans, and the personal tax cuts were insufficiently progressive. But heated rhetoric from Democrats often dismisses tax reform altogether. From the results, it appears that these policies have given the economy a significant boost. As Democrats, what blinded us? Did our overriding disdain of all things Trump mean we failed to recognize that some of his policies make economic sense?

It is time we built a closer partnership with business, and prioritize ideas over criticisms. One example is infrastructure. Investment in infrastructure would provide fiscal stimulus, create high-paying jobs, improve safety, and increase productivity. Over the longer term, fixing aging infrastructure can add 0.5% to annual economic growth.

Another driver of economic expansion is growth in our labor force. That means we need immigrants—skilled and unskilled. Tech businesses struggle with the deficit of workers trained in science, technology, engineering and math. Agriculture suffers from a lack of seasonal workers. A more accommodating immigration policy would be embraced by business, unleashing further economic growth and expanding the tax rolls.

Addressing trade inequities would also help U.S. producers protect jobs at home. The U.S. has effective tariffs of 9%; China, 27%. Beyond tariffs, China also appears to have benefited disproportionately from current trading rules and has not taken sufficient steps to open its own economy. The result for the U.S. is a trade deficit of $375 billion a year.

Contrary to the prevailing views of most corporate executives, economic evidence shows that a higher minimum wage would benefit business because the added demand more than offsets the added cost. It doesn't help anyone to have consumers at the poverty line. By engaging constructively with business leaders, Democrats should be able to build consensus on this issue.

There are other areas where Democrats' priorities and business goals should align: What business executive wouldn't favor more-efficient health care for everyone, an effective retirement system, better education for more talented employees, and federal support for technological innovation?

Embracing business doesn't mean turning a blind eye to its flaws. Sensible regulation is vital to a vibrant market economy. More fundamentally, Americans have to feel that the economic system is fair and can work for everyone.

But if we want voters to hand us back the reins of government, we must be able to help the economy grow. That means establishing a constructive partnership with private business. As Democrats, we have already conceded faith, family and freedom to the Republican Party. We need to be the party of inclusive prosperity. Let's not also concede that to the Republicans.

Mr. James is executive vice chairman of Blackstone and author of "Rescuing Retirement."

Document WSJO000020180628ee6s007n6

WSJ PRO CENTRAL BANKING

Economy

U.S. Economy Was Weaker Last Quarter Than We Thought; Consumers spent less, and the housing market continued to weigh on growth

By Sharon Nunn
839 words
28 June 2018
10:00 AM
WSJ Pro Central Banking
RSTPROCB
English

WASHINGTON—Economic growth was slower at the beginning of this year than the government previously reported, as consumers pulled back spending and the housing market weighed down output.

Gross domestic product, a broad measure of the goods and services produced across the U.S., expanded at a seasonally and inflation-adjusted annual rate of 2% in the first quarter, the Commerce Department reported Thursday. That was weaker than an earlier estimate of 2.2% growth.

Consumers spent less on services than previously thought. Health-care purchases by nonprofits and spending on finance and insurance services were all weaker than the government previously reported. The economy also saw less private inventory investment, chiefly in retail inventories.

Still, investment outside of the housing market, such as computer software and research and development, was stronger than earlier thought, growing by the fastest pace in about three years.

"Although GDP growth in the first quarter was revised lower, and was softer than in the last three quarters of 2017 when growth averaged 2.7%, the economy is in much better shape than the headline number would indicate," said PNC chief economist Gus Faucher.

One potential issue: First-quarter growth has been weaker compared with other quarters in recent years because of issues with the way the government seasonally adjusts economic data. In the longer term, the economy grew 2.8% in the first quarter from a year earlier.

Analysis suggests growth has picked up in the second quarter. Forecasting firm Macroeconomic Advisers on Wednesday projected GDP growth would hit a 5.3% annual rate in the second quarter while the Federal Reserve Bank of Atlanta's GDPNow model projected output would grow 4.5%. The Commerce Department will release second-quarter growth data at the end of July, along with comprehensive revisions of historical data.

Economists think growth will remain robust throughout 2018, buoyed by an ultralow unemployment rate and steady job and wage growth. At the same time, the late-2017 tax overhaul could encourage spending by businesses and consumers.

A gauge of company earnings, profits after tax without inventory valuation and capital consumption adjustments, rose a seasonally adjusted 10.6% in the first quarter, above the previous reading that showed a 7.8% increase. This could signal the newly lowered federal corporate tax rate, which was cut to 21% from 35%, and other tax-law changes may have affected businesses' bottom lines substantially.

The first quarter saw residential investment weigh on growth. Home building and renovations declined at a revised annual rate of 1.1%. This could reverse in the second quarter. U.S. housing starts rebounded last month to the highest level since 2007.

Meanwhile, consumer spending, which accounts for more than two-thirds of total U.S. economic output, increased at a 0.9% annual pace last quarter. This signals pullback from more robust spending notched during the second half of 2017, which saw a strong holiday buying season and a swell of hurricane-related purchases, like replacement cars. A particularly harsh winter has also been blamed for part of the weaker purchasing in the first quarter.

"The slowdown in consumer spending in particular may raise an eyebrow, but the softer result should be viewed with a healthy dose of skepticism," said Jim Baird, chief investment officer at Plante Moran Financial Advisors. "Growth in the second quarter is largely believed to have regathered momentum."

Personal-consumption expenditures, a measure of household spending, increased a seasonally adjusted 0.6% in April from the prior month, according to the Commerce Department. That was the largest increase in five months, signaling a rebound in spending.

Francesca's Holdings Corp., which sells women's apparel, accessories and home goods, saw net sales for the first quarter decline, largely because of lower foot traffic in stores and fewer customers actually making purchases when they did walk through the door. Still, the company saw the decline moderate heading into the spring.

"I know there's been various reports out there, weather impact on business in [the first quarter]," Steven Lawrence, Francesca's chief executive, said on a recent earnings call. "But clearly, you could see it in the seasonal categories. We did definitely see the apparel trends pick up as we got deeper into that April time period and the weather warmed up."

The report also showed government spending grew at a 1.3% annual pace last quarter, with federal and state spending slowing from stronger spending seen at the end of last year.

Net exports docked 0.04 percentage point from the overall GDP growth rate in the first quarter. Change in private inventories subtracted 0.01 percentage point. Both categories tend to be **volatile** from quarter to quarter.

Write to Sharon Nunn at sharon.nunn@wsj.com

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* Fed's Bullard: Inverting Yield Curve ‘Key Near-Term Risk'

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THE WALL STREET JOURNAL.

Economy

Fed's Bullard: Inverting Yield Curve 'Key Near-Term Risk'; Officials have been split over how to interpret shift, which has often signaled short-term economic worry

By David Harrison
390 words
28 June 2018
03:59 PM
The Wall Street Journal Online
WSJO
English

Federal Reserve Bank of St. Louis President James Bullard said Thursday he is watching the flattening of the yield curve with concern and said the Fed should slow its rate increases to keep it from turning negative.

Speaking in St. Louis, Mr. Bullard noted that an inverted yield curve has been a reliable recession signal in the past.

The yield curve is a measure of the gap between short-term and long-term government debt, usually two-year Treasury notes and **10-year Treasury** notes. When the yield on two-year debt exceeds the yield on 10-year debt, it can be a sign that investors are more worried about the short-term economic outlook.

"I would see the yield curve inversion as a key near-term risk for the Fed," he said.

Fed officials have been split over how to interpret the flattening yield curve. On one side are officials such as New York Fed President John Williams who sees it as a normal development in a Fed tightening cycle. On the other are officials such as Mr. Bullard and Atlanta Fed President Raphael Bostic, who are more concerned.

Mr. Bullard said he was "very leery" of the view that the signal sent by the yield curve is different now than in the past. His experience, he said, has taught him to be "very respectful" of the risk of an inverted curve.

Rising short-term rates are primarily driven by the Fed, Mr. Bullard said, while falling long-term rates are primarily driven by markets. When they move in opposite directions, it is a sign of a risky mismatch between policy makers and investors, he said.

The way to resolve that mismatch, he argued, is to slow the pace of rate increases.

"The Fed does not have to be so aggressive," Mr. Bullard said.

The St. Louis boss has been one of the Fed's most outspoken advocates for a slower pace of rate increases. Mr. Bullard said Thursday he would prefer to see officials raise rates in response to incoming economic data rather than on a path.

Write to David Harrison at david.harrison@wsj.com

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THE WALL STREET JOURNAL.
U.S. EDITION

Life & Arts -- The Middle Seat: This Fee Exists for No Apparent Reason --- Beware 'carrier-imposed fees' on international flights when searching for frequent-flier award tickets; why hide a fare as a fee?

By Scott McCartney
1,246 words
28 June 2018
The Wall Street Journal
J
A11
English

Corrections & Amplifications

United Airlines doesn't add cash surcharges to frequent-flier-award tickets on partner airlines. The Middle Seat column Thursday about carrier-imposed fees incorrectly said United was among U.S. airlines that pass partner-airline surcharges on to customers buying award tickets with miles.

(WSJ June 29, 2018)

(END)

Of all the maneuvers airlines make with ticket pricing, this one may be the most devious.

On international tickets, many carriers break their price into "base fare" and "carrier-imposed fees," lumping the fee with government taxes and fees. The carrier fees began as fuel surcharges a decade ago. But now they appear truly arbitrary.

They aren't tied to distance traveled -- fees are often the same for flights from Europe to New York and Los Angeles. They vary wildly by direction of travel. Business-class tickets on British Airways between New York and London have a $1,006 carrier-imposed charge if the round-trip begins in New York, but only $381 if the round trip originates in London.

The surcharge can be much bigger than the fare itself. A $638 Virgin Atlantic round trip between New York and London breaks down to a fare of only $93, a carrier-imposed surcharge of $320 and government taxes of $225. A British Airways basic economy ticket lists the fare at $13 and "taxes, fees and carrier charges" at $545 for a total of $558.

And sometimes they fluctuate just like fares. Lufthansa recently told a customer its fee can waver from day to day on the same flight. A spokesman says that's based on fluctuating ticket prices, exchange rates, "market-specific conditions" and special offers.

Since regulators told airlines they could no longer call the fees fuel surcharges, the industry has been reticent to discuss what the charges are really for and why airlines adopt the unusual pricing structure. Some carriers have said the surcharges partially cover costs beyond the company's control. But base fares do that, too.

Breaking out a significant chunk of the fare and calling it a fee lumped with taxes makes the tax bite look far bigger on tickets. A curious traveler has to drill down to see the breakdown between airline charges and government or airport assessments. It's not always obvious that an "international surcharge" goes to the airline.

Surcharges typically don't change how much tax a traveler pays on cash tickets. And it doesn't impact how many frequent-flier miles you collect for a flight on an airline that pays out miles by price instead of distance. Those carriers give out miles based on total fare. The shiftiness can change how big a discount corporations get from negotiated fares if the discount comes off base fare only, though most companies make sure they're getting discounts on the total airline portion of the fare.

The most significant impact is on frequent-flier awards. Many airlines charge the fee on frequent-flier award tickets along with required government taxes and fees. The "free" ticket you buy with miles may require an additional $400, $500 or more -- most of that pocketed by the airline. The British Airways website says its highest taxes, fees and carrier charges amount across all routes round trip has been $910 in economy class.

Sometimes you can pay the surcharges in miles. Lufthansa allows you to spend an extra 15,000 miles to cover all taxes, fees and surcharges.

Airlines don't publish any sort of chart or schedule of their international fees. And they're reluctant to talk about the fare structure as well.

British Airways declined a request to discuss the charges but offered a statement saying all prices customers see include all charges and the carrier-imposed charge is clearly identified during the booking process on its website. (You have to click on "fare breakdown.")

Lufthansa also declined to talk about the charges but responded to emailed questions. Asked why the surcharge is lumped with government taxes and airport fees instead of with the airline's fare, Lufthansa said it displays a "transparent breakdown." (You click on a link and see International/Domestic Surcharge on a list of taxes in the same font, followed by Customs User Fee.) "Customers are made aware that the breakdown does not only include government taxes and fees but also airline surcharges," the airline said.

When European carriers introduced the charges in about 2008, as **oil prices** jumped, Scott Nason, then a pricing executive at American Airlines, recalls discussing the idea and rejecting it as unethical. "We made a firm decision not to go there," he says. "It is a mechanism that the European carriers devised to charge cash on 'free tickets,' " says Mr. Nason, president of SDN TT&H Consulting, based in the Dallas area.

American, United and Delta have all refrained from adding a cash price to most international award tickets beyond real taxes and government fees, but all three collect when their partners impose a surcharge.

The U.S. restraint is shifting, however. Delta has started adding its carrier-imposed international surcharge on frequent-flier trips that originate outside the U.S., though not on trips that begin from the U.S. You can get a coach frequent-flier award ticket from Atlanta to Paris round trip on Delta for 70,000 miles plus $84.11 in government taxes and fees. But Paris to Atlanta round-trip on Delta flights costs the miles plus $420 in taxes and fees. Almost $300 of that $420 goes to the airline, not any government.

Delta says it began adding the surcharge several years ago, but won't say why. Delta responded to questions with a statement noting that the all-in price for a booking is always displayed. "Surcharges may be driven by competitive factors in the marketplace, which differ in the U.S., Europe and all around the globe," Delta said.

The fees make cashing in miles for international trips tricky. One of the benefits of global alliances is the ability to redeem miles on partner airlines. But the price of a trip can vary significantly depending on which airline is actually doing the flying.

Consider a trip from San Jose, Calif., to London using American AAdvantage miles. Book it using American flights -- a connection in Chicago or Dallas will get you there -- and you'll spend 60,000 miles plus $189.81 in government taxes and fees. Book nonstops on British Airways using your AAdvantage miles and it's 60,000 miles plus $545.31. British Airways collects $320.

"I look upon these as loyalty killers. They grease the bottom line, but they have a chilling effect on loyalty," says Jay Sorensen, a frequent-flier program consultant and president of Wisconsin-based IdeaWorks Co., who has studied carrier-imposed charges.

Carrier-Imposed Confusion

Many airlines add cash surcharges to international frequent-flier award tickets, called 'carrier-imposed fees.' But the prices are all over the map:

Distance Isn't an Issue

New York-Frankfurt on Lufthansa: $320 in coach

Los Angeles-Frankfurt on Lufthansa: $320 in coach

Where you begin your trip does matter

New York to Venice round-trip on Delta: $0

Venice to New York round-trip on Delta: $282 in coach

Which airline is actually doing the flying matters

London to New York round-trip on American Flights 101 and 100: $0

London to New York round-trip on American Flights 6138 and 6141 (operated by British Airways): $269

Note: All fares from June 20 searches.

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The New York Times

Business Day

Trump's Trade Threats Hit China's Stock Market and Currency

By Keith Bradsher
1,023 words
28 June 2018
12:19 PM
NYTimes.com Feed
NYTFEED
English

SHANGHAI — Months of struggling with economic problems at home and bickering with President Trump over trade are starting to take their toll on China's financial health.

China's **stock market** has now fallen close to levels not seen since a crash shocked global investors three years ago. An elite Chinese think tank affiliated with the government warned this week that the chances of a financial panic had risen significantly, shaking markets even more.

Chinese officials are trying to help factories deal with American tariffs by weakening the value of the country's currency. That makes Chinese goods more competitive abroad, but it also gives investors inside and outside China a reason to take their money out of the country. And it offers Mr. Trump an opportunity to criticize Beijing — in the past, he has railed against the country for weakening its currency.

The chances of a financial collapse that could shake the world are slim. The Chinese government has vast sums of money it can tap in the event of a crisis. And there are steep financial barriers to keep money from fleeing the country. While investors have ways around the barriers, they limit the possibility that such a flight could bring one of the world's most important growth engines to a halt.

Nevertheless, China faces some increasingly serious economic challenges. It is trying to tackle its considerable debt problems without starving its economy of the money that keeps growth chugging along. The president's tariffs so far have been quite small in the grand scheme of things, but they add to China's troubles. The next wave of tariffs, set at 25 percent, threatens to cover at least a tenth of China's exports to the United States, and more could follow.

China's stock markets reflect the uncertainty. The Chinese **stock market** as of this week is down more than 20 percent from its January peak, making it a **bear market**. The country's main **stock index** lost nearly 1 percent on Thursday.

"You don't know what Trump is going to do next," said Hong Hao, the chief market strategist in the international unit of the Bank of Communications, one of China's biggest banks. "Normally at this level, there should be a technical rebound."

China's moves with its currency reflect its difficult balancing act. The Chinese central bank has guided the currency steadily lower against the dollar, particularly in the past two weeks, as the likelihood of further American tariffs on Chinese goods has increased. The currency is down more than 5 percent from its peak in February.

One indication of investor sentiment about China is the small amount of China's currency that is traded outside its borders. China keeps the value of its currency in an iron grip, but investors in places like Hong Kong can trade it more freely.

The value of the renminbi has fallen somewhat faster lately in the less-regulated Hong Kong market than in Shanghai trading. A widening gap between the two markets has long been a sign that investors are worried about the currency.

China faces still more obstacles. The United States Federal Reserve has begun raising short-term interest rates. That increases the cost of borrowing money for Americans and, given the vast influence of the American economy, for the rest of the world. Such rate increases have caused unpleasant economic surprises worldwide in the past, which could hurt China if growth slows in the markets where it sells its goods.

As if investors did not already have enough to worry about in China, a deeply pessimistic internal government analysis has widely circulated on social media this week. The analysis was written by the chairman of the National Institution of Finance and Development, a Beijing-based research group, and by three other economists.

A person who picked up the phone at the think tank said that the document was genuine and that its release had not been intended.

The document said that with “the Federal Reserve’s interest rate hikes and the long-term and highly uncertain trade conflicts between China and the United States, we believe that in China there is currently a high probability of financial panic.”

Other economists cautioned that the analysis should not necessarily be treated as representing a consensus view within the Chinese government.

Mr. Li has a reputation as being more **bearish** during financial crises than other Chinese government economists. He has also used periods of financial stress in China to oppose economic reformers who seek the opening up of the country’s financial system to greater competition and more international flows of money, Mr. Hong said.

The document leaked this week said that the way to prevent a financial panic was to create a separate stabilization fund to prop up the currency, rather than selling dollars and shrinking the money supply. Such a move could help insulate China’s economy, because reducing the money supply makes it harder for families and businesses to borrow for purchases and investments, from buying an apartment to building a factory.

By contrast, many economic reformers say that China would benefit from more openness. The closed Chinese financial system tends to steer money to state-owned enterprises instead of smaller and more entrepreneurial private sector businesses.

Predictions by the report’s authors aren’t gospel, said Qian Qimin, the director of wealth management research at Shenwan Securities, a Shanghai brokerage.

“They consider problems from a theoretical perspective and they look forward and alert government to the worst consequences, which is understandable,” he said.

Follow Keith Bradsher on Twitter: @KeithBradsher. Ailin Tang contributed research.

* China Moves to Shore Up Economy as Slowdown and Trade Fight Loom

* As Trump Escalates Trade Fight, China Can Take the Hit

* As China Curbs Borrowing, Growth Shows Signs of Faltering

On the display boards at securities brokerages in Beijing, red means a rising stock and green a falling stock. Lately, for many investors, there has been too much green. | Wu Hong/EPA, via Shutterstock

Document NYTFEED020180628ee6s005k1

THE WALL STREET JOURNAL.

Business

Walgreens to Buy Back $10 Billion in Shares, Raises Dividend; Drugstore chain becomes the latest company to return additional capital to investors following new U.S. tax law

By Austen Hufford
497 words
28 June 2018
05:55 PM
The Wall Street Journal Online
WSJO
English

Walgreens Boots Alliance Inc. plans to repurchase as much as $10 billion of its shares and raised its dividend by 10%, as the drugstore chain and newest Dow component became the latest company to return additional capital to investors following the new U.S. tax law.

However, Walgreens shares fell 9.9% to $59.70 in Thursday trading after Amazon.com Inc. said it was buying online pharmacy PillPack Inc., a move that sent shares of pharmacy and medical-distributor companies tumbling.

Walgreens Chief Executive Stefano Pessina said on an analyst call Thursday that the company doesn't see "any reason to be worried" about the deal.

Walgreens, which reported stronger sales and profits in its third quarter, said its effective tax rate was 7.6%, compared with 12.4% in the same quarter a year before.

Walgreens financial chief James Kehoe said on a call with analysts Thursday that the company would first use extra resources to invest in the business, then would consider mergers and partnerships and lastly would use capital for increasing dividends and share repurchases.

U.S. companies have been buying back their shares at an aggressive pace, raising questions about the way that the new corporate tax cuts are being used.

For Walgreens, comparable pharmacy-sales growth in the U.S. was flat in its latest quarter, as higher prices on branded drugs were offset by reimbursement pressures and the impact of generic drugs. Comparable pharmacy sales decreased 1.7% abroad.

Comparable retail sales fell 3.8% in the U.S. and 1.3% on a constant-currency basis internationally.

Walgreens, which replaced General Electric Co. in the **Dow Jones Industrial Average** this week, has expanded in recent years by merging with European drug wholesaler Alliance Boots and buying up stores from rival Rite Aid Corp. The company, whose roots date back to 1901, has more than 13,200 stores across 11 countries.

Walgreens raised its quarterly dividend to 44 cents from 40 cents, a larger increase than those the company has implemented in recent years.

The company also increased the low end of its earnings guidance for the year by 5 cents a share. It now expects per-share earnings of $5.90 to $6.05.

For the third quarter, Walgreens posted a profit of $1.34 billion, or $1.35 a share, compared with a profit of $1.16 billion, or $1.07 a share, in the year-ago period. On an adjusted basis, earnings per share came in at $1.53, above the $1.48 expected by analysts polled by FactSet.

Bolstered by the acquisition of Rite Aid stores, sales rose 14% to $34.33 billion. Analysts had expected the company to report $34.1 billion in sales.

Write to Austen Hufford at austen.hufford@wsj.com

Document WSJO000020180628ee6s00232

THE WALL STREET JOURNAL.

Markets

Copper Falls to 2018 Low After Weak Chinese Data; Contracts for July fell 1%, reaching the lowest point since early December

By Ben St. Clair and David Hodari
419 words
28 June 2018
02:34 PM
The Wall Street Journal Online
WSJO
English

Copper prices slipped to a six-month low Thursday amid jitters about economic growth in China, the world's dominant consumer of the metal.

Contracts for July fell 1% to $2.9535 a pound at the Comex division of the New York Mercantile Exchange, closing at the lowest point since December 7.

The release of weak Chinese economic data provided fresh signals of slowing growth in the country. Chinese power-grid investment and property completions dropped 21% and 10% in May, respectively, according to John Meyer, mining analyst at SP Angel.

Some analysts were already forecasting that economic growth in China will slow in the second half of the year, particularly in the metal-intensive sectors of infrastructure and housing.

"We think that this is the start of it really," said Caroline Bain, chief commodities economist at Capital Economics.

The release of those figures added fresh pressure to copper prices during a week in which investor fears around a U.S.-China trade spat have persisted. However, those concerns appeared to be fading Thursday after the White House backed away from plans to create tough restrictions on Chinese investments in the U.S. and U.S. technology exports to China.

Still, market participants remain **bearish** on the short-term outlook for copper prices.

With uncertainty still surrounding both trade relations and China's economic growth, "we do not see the current weakness in the metal markets as a buying opportunity," said Carsten Menke, commodities research analyst at Julius Baer.

Worries about supply disruption out of South America were also receding. Observers began 2018 with predictions of strikes in Chilean copper mines, but wage negotiations at the BHP Billiton-run copper mine at Escondida, the world's largest, appeared to be progressing well. That eased fears that workers would repeat the 44-day strike that disrupted supply there last year.

Gold prices also traded at a six-month low, with the July contract falling 0.4% to $1,247.80 a troy ounce. The recent strength in the U.S. dollar has weighed down gold prices, offsetting its usual role as a haven asset that rises when traders look to shield themselves from geopolitical uncertainty.

Benjamin Parkin contributed to this article.

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THE WALL STREET JOURNAL.

Politics

White House Retreats From Plans for Strict Limits on Chinese Investment; Administration opts for less confrontational approach with the U.S. economic rival and closer cooperation with Congress

By Bob Davis, Peter Nicholas in Washington and Lingling Wei in Beijing
1,381 words
27 June 2018
11:31 PM
The Wall Street Journal Online
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English

President Donald Trump backed away from plans to create tough new restrictions on Chinese investments in the U.S. and U.S. technology exports to China, defusing one fight with Beijing as American business officials try to head off a looming battle over tariffs.

The White House opted for a less confrontational approach with the U.S. economic rival and closer cooperation with Congress. The strategy was hotly debated within the administration for several days leading up to the decision, said administration officials.

Among the factors in Mr. Trump's decision: his own reservations about discouraging investment in the U.S. and his pique with a Wall Street Journal article reporting that the administration was moving toward a crackdown on China, the officials said.

China experts say the White House decision to back away from a fight on investments and U.S. exports could provide an opening for renewed negotiations. With a July 6 deadline for tariffs approaching, prominent U.S. business executives are trying to ease the way for new discussions between Treasury Secretary Steven Mnuchin and China's top economic envoy, Liu He.

Among those urging talks is former Treasury Secretary Henry Paulson, who used to be Mr. Mnuchin's boss at Goldman Sachs Group Inc. and meets regularly with Mr. Liu. Blackstone Group Chief Executive Stephen Schwarzman is also acting as a back channel between the two governments, said people familiar with the discussions.

For now, no negotiations are planned before the deadline when the White House will impose the first round of tariffs on $34 billion of Chinese imports. Beijing says it will retaliate dollar for dollar.

Chinese President Xi Jinping has instructed various levels of government to prepare for a trade war, said Chinese officials. Northeastern provinces of Heilongjiang and Jilin, for instance, are stepping up efforts to encourage farmers to grow more soybeans—one of the biggest U.S. exports to China that would be subject to punitive Chinese levies.

The Trump administration has complained that Beijing is forcing U.S. companies to transfer technology to Chinese firms. It has tried to use trade and investment measures to prevent China from advancing its goal of becoming a world leader in industries such as information technology, aerospace, electric vehicles and biotechnology.

The White House said on May 29 it would go through with twin plans to use new investment restrictions and U.S. export controls against China and Mr. Trump's advisers were preparing to move forward with the policies. But Mr. Mnuchin prevailed in a decision this week to rely on existing authorities to restrain Chinese investment into U.S. high-tech industries.

Mr. Trump was angered by news stories, particularly a Wall Street Journal article on Sunday, saying the administration was moving ahead with separate investment restrictions aimed at China. The article was based on interviews with administration officials from agencies taking differing views on the investment question, but some in the administration say Mr. Mnuchin viewed it as a leak aimed at pressuring Mr. Trump to make a decision Mr. Mnuchin opposed.

On Monday, Mr. Trump told Mr. Mnuchin to "push back" on the reports and that he wasn't "leaning in that direction," according to a White House official.

In a subsequent tweet, Mr. Mnuchin called the articles "fake news." During the day, the **stock market** fell sharply, providing additional impetus to ease off on China, said individuals familiar with the administration's thinking. "Those leaks were not helpful to the markets or not helpful to the process," Mr. Mnuchin said on CNBC.

Instead of creating new investment restrictions, the White House said it will continue to rely on an interagency group, the Committee on Foreign Investment in the U.S., or CFIUS, which screens foreign investments to see if they endanger national security. As part of this, the administration is throwing its support behind plans in Congress to widen the powers of CFIUS.

Mr. Trump punted as well on toughening export controls on Beijing. The White House had planned to announce new policies by Saturday. Instead, the White House asked the Commerce Department to study "issues related to the transfer of export of critical technologies," with no date to report its findings.

Mr. Mnuchin sought to play down U.S. tensions with China. "Our objective is not to single out China or treat them differently," Mr. Mnuchin said at a Treasury briefing. "We have the necessary tools to protect U.S. investments, on the one hand, to encourage an open investment system."

The reversal was greeted with relief in Beijing, said Chinese officials, who said they saw no immediate need to respond.

Two weeks ago, administration officials met privately in the White House's Situation Room to consider options. Discussions broke down along familiar lines, with hard-line trade hawks, including White House trade adviser Peter Navarro, calling for a tough approach on investments, and others calling for a softer approach. Mr. Mnuchin tried to steer the advisers toward a consensus recommendation that aides could take to the president.

One problem with the hard-line approach was that the investment restriction plan called for using the International Emergency Economic Powers Act of 1977, or IEEPA, which gives the president broad authority in the case of an "unusual and extraordinary threat," said people familiar with the internal debate.

The law has been widely used for sanctions over terrorist acts and using it in a trade dispute could be seen as overkill.

It also was difficult to figure out how to apply the law to broad areas of business like artificial intelligence or biotechnology without hitting products that are far from the cutting edge.

"There's a clear challenge," an official said. "There's not a way to design a system without another series of loopholes that are easy to exploit."

Mr. Trump had qualms about striking China too hard with investment restrictions, for fear it could dampen overall investment into the U.S. and might be hard to implement, U.S. officials said.

The White House also faced pressure from lawmakers not to strike with aggressive investment curbs. With a bill to strengthen CFIUS making its way through Congress, lawmakers lobbied the administration against creating an entirely separate structure for blocking investments.

"I've been talking to Secretary Mnuchin about this for quite some time," said Senate Majority Whip John Cornyn, a Texas Republican. "It might be confusing to people to do both."

The White House has been dealing with a rebellion among lawmakers on other trade issues. On June 19, the Senate rebuffed Mr. Trump by voting, 85-10, to reinstate a ban on selling U.S. parts to Chinese telecommunications company ZTE Corp. Lawmakers also have been pouring on criticism of Mr. Trump's tariffs on steel imports from Canada the European Union and other allies, which prompted counter-retaliation from those nations.

Rather than fight with Congress, Mr. Trump decided to embrace a strengthened CFIUS, which would apply to China and other nations.

Shortly before he made his decision in a White House meeting on Tuesday, the House voted 400-2 for the CFIUS bill.

The fight over China policy is far from settled. Democratic Minority Leader Chuck Schumer said the investment-restriction decision showed Mr. Trump didn't have the stomach for a China fight.

"Once again the president blinked and President Xi is outfoxing him," said the New York Democrat.

Mr. Trump's advisers say one thing that can get Mr. Trump to change direction and take a tougher approach is being seen as weak on China.

Siobhan Hughes contributed to this article.

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WSJ PRO CENTRAL BANKING

Economy
Layoffs Jump After Declining Steadily at the End of Spring; Economists surveyed by The Wall Street Journal had predicted claims would settle at 220,000

By Josh Mitchell and Sharon Nunn
395 words
28 June 2018
10:33 AM
WSJ Pro Central Banking
RSTPROCB
English

U.S. employers increased the number of workers they laid off last week, though the level hovered near multidecade lows.

Initial jobless claims, reflecting how many Americans applied for unemployment benefits, rose 9,000 to a seasonally adjusted 227,000 in the week ended June 23, the Labor Department said Thursday. Economists surveyed by The Wall Street Journal had predicted claims would settle at 220,000.

"This is the highest reading in five weeks, but the increase is well within the usual range of variation, and it's very unlikely to mark the start of a sustained increase," Ian Shepherdson, chief economist at Pantheon Macroeconomics, said in a note to clients.

Such estimates are **volatile** and are often revised later as more data becomes available. Over the past month, claims grew by an average of 1,000. That measure, known as the four-week moving average, suggests claims remain exceptionally low, providing additional evidence of a strong labor market.

The persistently low level of layoffs means employers are keeping payrolls steady as workers become harder and harder to find. Unemployment, at 3.8%, is historically low. Hiring remains steady.

"[Unless] we pull a lot of people into the labor force, the unemployment rate will go down further," Federal Reserve Bank of Boston president Eric Rosengren said in an interview with The Wall Street Journal. But, he said, "there is a point at which the unemployment rate gets so low that you can't be expecting payroll employment growth to be growing very rapidly."

Those factors, along with modest inflation, have led the Federal Reserve to boost a key interest rate twice this year. The central bank has indicated it will raise rates two more times in 2018 if the labor market remains tight and inflation continues to show signs of firming.

Thursday's report also showed the number of continuing unemployment benefit claims—those drawn by workers for more than a week—fell 21,000 to 1,705,000 in the week ended June 16. Continuing claims are reported with a one-week lag.

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THE WALL STREET JOURNAL.
U.S. EDITION

Heard on the Street
This Frozen-Foods Deal Is Hot

By Aaron Back
425 words
28 June 2018
The Wall Street Journal
J
B12
English

[Financial Analysis and Commentary]

Conagra Brands and Pinnacle Foods, with plenty of encouragement from their friends, are finally tying the knot. It looks like a good match.

The $8.2 billion deal unites two frozen-food specialists amid a resurgence of sales growth in the frozen aisle.

The merger had long been rumored and appeared to be nudged along by activist fund Jana Partners, which said in April that it had taken a stake of around 9% in Pinnacle Foods and that it intended to have discussions about a possible sale.

At $68 a share, Conagra is paying essentially no premium to Pinnacle's share price. But Pinnacle shares already were up 23% since the Jana filing, so some deal premium was priced in.

Jana has a positive history with Conagra, having built a stake in the company in 2015 and pushed for changes that contributed to a striking turnaround. Conagra's latest quarterly results, unveiled Wednesday, showed comparable sales in its refrigerated and frozen business rising 5.2% from a year earlier.

Pinnacle Foods also has a rapidly growing frozen business with brands like Birds Eye vegetables. Putting the two together will create a frozen-foods giant with market share second only to Nestle.

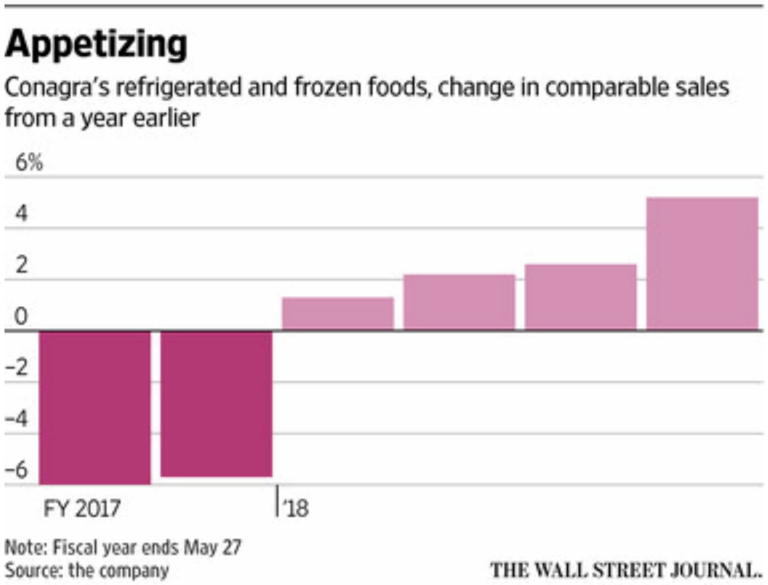
Producing and shipping frozen foods is expensive, leading analysts to believe there would be substantial cost synergies from a merger. Against these expectations, Conagra's announced target of $215 million in cost synergies by 2022 appears conservative.

Perhaps Conagra is understating the savings, but **bullish** analysts may also have gotten ahead of themselves. On a conference call, Conagra Chief Executive Sean Connolly explained that facilities for freezing fresh vegetables -- as Pinnacle does -- are different from those that produce frozen meals like Conagra's, so the overlap is more limited than many analysts expected.

Nonetheless, the advantages of the tie-up could be substantial. Creating a frozen-foods juggernaut will help drive better deals with distributors and retailers.

Finally, the multiple that Conagra is paying looks reasonable, even without assuming any synergies, at 16.5 times trailing earnings before interest, taxes, depreciation and amortization. That compares with multiples of around 20 times for Campbell's acquisition of Snyder's-Lance and Hershey's purchase of Amplify Snack Brands.

Conagra and Pinnacle are already standout performers. Together they will be a formidable competitor to the biggest global brands like Kraft Heinz and Nestle. Others should follow their example before they fall further behind.



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THE WALL STREET JOURNAL.
U.S. EDITION

Oil Soars As Supply Worries Increase

By Benjamin Parkin and Stephanie Yang
270 words
28 June 2018
The Wall Street Journal
J
B1
English

Oil prices reached the highest level in more than three years Wednesday, as threats to global supply loomed large even as major oil exporters increased production.

West Texas Intermediate futures rose 3.2% to $72.76 a barrel on the New York Mercantile Exchange, the highest close since November 2014. Brent crude, the global benchmark, rose 1.7% to $77.62.

Prices have notched fresh highs as traders fear that global crude supply could decline faster than expected, driven by harsh rhetoric from the U.S. government on Iran sanctions and a surprising drop in U.S. crude inventories.

On Tuesday, a senior State Department official said the U.S. expects countries to cut all oil imports from Iran by Nov. 4, boosting crude prices by more than 3%. The rally continued on Wednesday after the U.S. Energy Information Administration reported crude stockpiles declined by 9.9 million barrels last week, the biggest weekly reduction since 2016 and more than triple the amount that analysts had predicted.

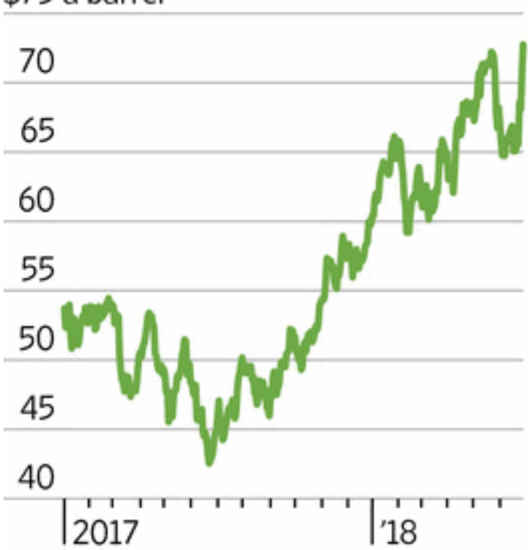
An agreement last week by the Organization of the Petroleum Exporting Countries to increase production by about 600,000 barrels a day did little to assuage concerns over supply risks. Prices retreated last week ahead of the gathering between OPEC and other major producers like Russia but jumped nearly 5% after the group decided to raise production by less than many had expected.

"It's like the OPEC meeting never happened," said Michael Cohen, head of energy markets research at Barclays PLC.

Barreling Ahead

Signs of falling crude supplies have sent oil prices back to multiyear highs.

$75 a barrel



Source: SIX

THE WALL STREET JOURNAL.

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THE WALL STREET JOURNAL.

Heard on the Street
Markets

Facebook Investors May Be Too Quick to Forgive; Social network's stock price has risen sharply since Cambridge Analytica scandal even though more questions have surfaced

By Dan Gallagher
452 words
28 June 2018
05:30 AM
The Wall Street Journal Online
WSJO
English

Investors have been quick to forgive Facebook for its lapses regarding the safekeeping of user data. Perhaps too quick.

The scandal involving a British political research firm called Cambridge Analytica took nearly $100 billion off the social network's market value at one point earlier this year. But the stock has now fully recovered—and them some. Facebook's share price has jumped 29% since bottoming three months ago, just ahead of CEO Mark Zuckerberg's memorable visit to Congress. That is well ahead of most large-cap internet peers for the same period, save for Netflix. Amazon.com and Google-parent Alphabet Inc. are up 10%-11%, respectively.

That sort of recovery reflects a belief that Facebook's business is immune to further blowback from the company's previously lax handling of user data, along with questions about the role it plays in elections and in wider society. And Facebook's first-quarter results backed that up. The company added 48 million daily active users during the period—an acceleration from the previous quarter—and grew advertising revenue by 50% year over year to $11.8 billion.

But investors should not be so sanguine. Many questions about Facebook's past data practices have continued to creep up in the wake of the Cambridge affair. The Wall Street Journal reported earlier this month about special deals that gave certain partners access to Facebook user data even after the company changed its data policies in 2015. And Facebook is still struggling to assess the exposure caused by its earlier practices. Some of the entities that had access to large amounts of user data are no longer in business and thus not easily tracked down. That raises the distinct possibility that new, even-worse scandals could still emerge.

A drumbeat of negative news could still make advertisers reassess how they make use of the platform. Also still unclear is how Facebook's planned increase in security spending this year, as well as new privacy rules enacted in Europe and under development in California, will affect the company's relatively fat bottom line.

None of this matters if Facebook's earnings continue to expand so rapidly. That has helped moderate the stock's valuation, which currently sits at 25 times forward earnings. And its ownership of the mega-popular Instagram certainly helps offset some of the risks faced by its flagship platform.

Facebook is an investment with unusual risks and investors should be unusually careful.

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

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Economy

Fed Should Raise Capital Buffer | Bullard Warns on Going Too Far | Quarles Defends Global Bodies | Tariffs to Factor Into BOC Decision | Fairless's Take: Lower Rates and Rising Debts; The Wall Street Journal's central banking newsletter for Thursday, June 28, 2018

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Fairless's Take: Lower Rates and Rising Debts

Fed Should Raise Banks' Capital Buffer, Now at Zero, Official Says

Fed Official Warns on Going Too Far, Too Fast With Rate Increases

Fed's Quarles Defends Global Regulatory Bodies

Tariffs to Factor Into Bank of Canada's Next Rate Decision

Lower Rates and Rising Debts

Can the world economy sustain higher levels of debt?

Governments have borrowed heavily over the past decade to guide advanced economies out of recession, while private companies and households have made little headway in paying down debts accumulated before 2008. That has raised questions about the vulnerability of these economies to any new downturn.

But former U.S. Treasury Secretary Lawrence Summers suggested last week that higher debt levels may in fact be sustainable because inflation-adjusted interest rates are lower than in the past.

Economists attribute a general decline in real interest rates since the 1980s to waning productivity growth and labor-force participation rates. Demand for government bonds has also risen since the financial crisis, driven by new rules requiring financial institutions to hold more safe assets to insulate themselves against losses. That increased demand has pushed down government borrowing costs.

Those trends mean that the cost of servicing debt across the public and private sectors has fallen.

Speaking at the European Central Bank's annual economic policy forum in Sintra, Portugal, Mr. Summers suggested that the European Union might need to revisit guidelines that restrict government debt to 60% of economic output. More than half of the EU's 28 member countries were in breach of those rules last year, according to data from the European Commission, the EU's executive arm.

However, rising debt levels also impact inflation-adjusted interest rates: Increasing the supply of government bonds, while demand is constant, tends to push down **bond prices** and push up governments' borrowing costs.

Crucially, lower interest rates partly reflect lower rates of economic growth. And less growth makes it harder for companies and governments to escape from under a mountain of debt.

Key Developments Around the World

Fed Should Raise Banks' Capital Buffer, Now at Zero, Official Says

The Federal Reserve should toughen banks' capital requirements to reduce the risks of a credit crunch in the next downturn, Boston Fed President Eric Rosengren said in an interview Wednesday. He said the Fed should start requiring banks to increase their levels of loss-absorbing capital, using a rule known as the countercyclical capital buffer. Raising the requirement, currently set at zero, would force banks to boost their capacity to absorb losses during good times, so they are less likely to pull back from lending when a recession begins. "You can't reduce something that's at zero. This would be the appropriate time to be building it up," Mr. Rosengren said. "That should be a nonzero number right now," he added. Mr. Rosengren noted that regulators in Europe and Hong Kong have raised similar capital buffers.

Fed Official Warns on Going Too Far, Too Fast With Rate Increases

St. Louis Fed President James Bullard said one big risk to the U.S. economy in coming years might be his Fed colleagues raising interest rates to a level he believes would restrict growth. "I think there is a risk that we'll go too far, too fast as a committee," Mr. Bullard said Wednesday in an interview with The Wall Street Journal, replying to a question about risks to the economic outlook. One reason for the risk, he said, is central bankers' uncertainty about the so-called neutral level of the Fed's benchmark rate, the point at which it neither spurs nor slows growth. The problem is, economists have no way of knowing for sure exactly where that point lies. "A misinterpretation of where we are is a distinct possibility," Mr. Bullard said. "That's why I'm trying to push against faster rate hikes." Fed officials' median projection for the neutral benchmark rate is 2.9%. But the span of their views is wide. Some officials believe it is as high as 3.5%, but Mr. Bullard said Wednesday he believes it could be at 2%, meaning the Fed is already nearly there.

Fed's Quarles Defends Global Regulatory Bodies

The Fed's point man on financial regulation defended U.S. participation in global committees that agree to set minimum financial rules, pushing back against Republican criticism of the panels. "Our consumers and businesses are more secure and prosperous because" the Financial Stability Board, an international committee of regulators, "helps make sure that all countries are doing their share in promoting financial stability and not gaining an unfair advantage," Fed Vice Chairman for Supervision Randal Quarles said Wednesday to a conference held by the Utah Bankers Association. His remarks contrasted with concerns raised by some other Republicans who worry that international regulatory discussions have unduly influenced U.S. rules.

5 things to watch for in the 2018 bank stress tests

Tariffs to Factor Into Bank of Canada's Next Rate Decision

U.S. metal tariffs and tighter mortgage-financing rules will be key considerations for the Bank of Canada ahead of its next policy announcement in July, Gov. Stephen Poloz said Wednesday. Mr. Poloz told an audience in Victoria, British Columbia, that the central bank will incorporate recent tariff announcements into its economic projections, including U.S. tariffs on steel and aluminum and retaliatory tariffs by Canada and others. The Bank of Canada is also working to understand how new mortgage rules, which require prospective home buyers to prove they can handle rising interest rates, are affecting the housing market and individual Canadians' mortgage renewals, Mr. Poloz said.

Czech National Bank Raises Interest Rates

The Czech National Bank on Wednesday raised its key interest rate for the fourth time in less than a year, cementing its position as the most aggressive of Europe's central banks in following the U.S. Federal Reserve's reversal of crisis-era stimulus measures. In an unexpected move, the CNB increased its two-week repo rate to 1.0% from 0.75%, and its Lombard rate to 2.0% from 1.5%, citing a weaker-than-expected currency and rising **oil prices**. "Higher-than-forecasted domestic inflation and stronger-than-forecasted inflationary pressures from abroad, linked mainly with **oil prices**... speak in favor of an interest rate increase," it said in a statement.

New Zealand's Central Bank Leaves Interest Rates on Hold

The Reserve Bank of New Zealand held the official cash rate steady at a record-low 1.75% as expected and kept a neutral view of the outlook as it waits to see if government spending reignites economic growth. "The best contribution we can make to maximising sustainable employment, and maintaining low and stable inflation, is to ensure the Official Cash Rate is at an expansionary level for a considerable period," said Gov. Adrian Orr in a statement.

Bank Indonesia Expected to Raise Rates Again on Renewed Rupiah Weakness

Bank Indonesia is widely expected to raise interest rates on Friday for the third time in about a month to ensure stability of the rupiah, amid fears the continuing US-China trade dispute could lead to more U.S. dollar strengthening against other currencies. Nine out of 12 economists surveyed by The Wall Street Journal predict

Bank Indonesia will raise the 7-day reverse repo rate by another quarter point to 5.0% from 4.75%, while three of them expect it to wait until the second half of the year.

Thursday

9:30 a.m. EDT

Bank of England's Haldane speaks

10:45 a.m. EDT

St. Louis Fed's Bullard speaks

Friday

4 a.m. EDT

Bank of Japan releases July Japanese government bond purchases plan

5 a.m. EDT

The European Union's statistics agency release June inflation figures for the eurozone

8:30 a.m. EDT

U.S. Commerce Department releases May PCE

An Output Gap Measure for the Euro Area: Exploiting Country-Level and Cross-Sectional Data Heterogeneity

Manuel Gonzalez-Astudillo proposes a new methodology for estimating the euro-area output gap and finds "because of negative shocks to trend output during the global financial crisis, output remained slightly above potential in that period." But, he writes in a Federal Reserve paper, "an output gap of about negative 3 1⁄2 percent emerged during the European debt crisis. At the end of the sample period, output is estimated to be about 1 percent above potential."

Erdogan Election Honeymoon Fades Fast for Turkey's Assets

"What troubles analysts are concerns that [Turkey's president Recep Tayyip] Erdogan will" destabilize Turkey's economy, which is "already showing signs of overheating. Inflation is running above 12 percent — more than twice the central bank's target — while the current account deficit has widened markedly in a sign of economic imbalances," Adam Samson writes for the Financial Times. "The broader emerging market environment has also turned **bearish**. High **oil prices** and the removal of stimulus from developed market central banks are weighing heavily on economies such as Turkey's. These factors have hit the lira this year, sending it slumping 18 per cent on the U.S. dollar. The Borsa Istanbul 100 stock gauge is also down a similar margin since the end of 2017."

Business investment in equipment is showing no signs of accelerating six months after lawmakers in Washington overhauled the tax system with the intent to spark such spending.

Economists are raising their estimates of second-quarter U.S. growth after new government figures showed a smaller-than-expected trade deficit for May.

Businesses across the eurozone remained upbeat about their prospects in June, even as new tariffs were imposed on trade between the European Union and the U.S., with fears that more will follow.

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/Financial Desk; SECTB
Markets Dip Over Trade Tensions, but Energy Sector Gains

By THE ASSOCIATED PRESS
696 words
28 June 2018
The New York Times
NYTF
Late Edition - Final
3
English

Global stock markets on Wednesday shifted course again as investors chased mixed signals on global trade tensions, and the **Standard & Poor's 500**-**stockindex** erased an early-morning jump to drop to its lowest closing level in nearly a month.

One of the day's few market certainties was oil's continued rise, and benchmark United States crude hit its highest price since 2014. That helped lift energy stocks, but other areas of the market zigged, zagged and zigged again as the day progressed.

Early on, Asian stocks slumped on concerns about the heated talk on trade between the United States and its partners. European stocks later flipped from losses to gains on hopes that a move by the Trump administration indicated a less combative stance with China. United States stocks opened higher, but the gains evaporated after a White House adviser said the move did not necessarily signal a softer stance.

By the end of the day, the **S**.**&**.**P 500** fell 23.43 points, or 0.9 percent, to 2,699.63 after being up as much as 0.8 percent. The **Dow Jonesindustrial average** lost 165.52, or 0.7 percent, to 24,117.59; the **Nasdaq composite** gave up 116.54, or 1.5 percent, to 7,445.09; and the Russell 2000 index of small-cap stocks fell 28.07, or 1.7 percent, to 1,640.45.

Stocks have swung in recent weeks, even by the hour, on worries about global trade. Investors were feeling less nervous about it in the morning after the Trump administration indicated it was shifting away from a plan to impose limits on Chinese investment in American technology companies and high-tech exports to China. Instead, the administration is calling on Congress to enhance an existing review process.

Markets took it as a positive sign, but the gains vanished in the afternoon after Larry Kudlow, director of the National Economic Council, said told Fox Business that it should not necessarily be seen as a softer stance.

In another pressure point on the market, the Federal Reserve is raising interest rates. More important, according to Barry Bannister, head of institutional equity strategy at Stifel, interest rates after accounting for inflation are set to cross important thresholds. That is putting pressure on stock prices, and he said the **bull market** that began in 2009 may end by the first quarter of 2020.

In the United States market, Conagra Brands had the biggest loss among stocks in the **S**.**&P**. **500** after it agreed to buy Pinnacle Foods, the company behind Duncan Hines and Hungry-Man, in a deal that would create a frozen-food giant. Conagra dropped $2.78, or 7.3 percent, to $35.45.

The market's strongest area was the energy sector. Crude jumped after a report showed that United States oil inventories dropped more sharply last week. Crude's rise helped drive energy stocks in the **S**.**&P**. **500** up 1.3 percent, more than double the gain for any of the other 10 sectors that make up the index.

Concho Resources, which looks for oil and gas in New Mexico and west Texas, jumped $6.09, or 4.6 percent, to $137.78 for the biggest gain in the **S**.**&P**. **500**. Benchmark United States crude rose $2.23 to settle at $72.76 per barrel. Brent crude, the global standard, rose $1.31 to $77.62 a barrel.

The dollar edged up to 110.25 Japanese yen from 110.11 yen Tuesday, and the euro fell to $1.1552 from $1.1642. Gold fell $3.80 to $1,252.80 per ounce.

The yield on the **10**-**year Treasury** dropped to 2.83 percent from 2.88 percent late Tuesday.

This is a more complete version of the story than the one that appeared in print.

CHARTS: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Wednesday. (Source: Reuters); Durable Goods Orders: Manufacturers' total new orders for durable goods, seasonally adjusted. (Source: Commerce Department)

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THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: U.S. Retreats on New China Curbs

By Bob Davis and Peter Nicholas in Washington, and Lingling Wei in Beijing
695 words
28 June 2018
The Wall Street Journal
J
A3
English

President Donald Trump backed away from plans to create tough new restrictions on Chinese investments in the U.S. and U.S. technology exports to China, defusing one fight with Beijing as American business officials try to head off a looming battle over tariffs.

The White House opted for a less-confrontational approach with the U.S. economic rival and closer cooperation with Congress. The strategy was hotly debated within the administration for several days leading up to the decision, administration officials said.

Among the factors in Mr. Trump's decision: his own reservations about discouraging investment in the U.S. and his pique with a Wall Street Journal article reporting that the administration was moving toward a crackdown on China, the officials said.

China experts say the White House decision to back away from a fight on investments and U.S. exports could provide an opening for renewed negotiations. With a July 6 deadline for tariffs approaching, prominent U.S. business executives are trying to ease the way for new discussions between Treasury Secretary Steven Mnuchin and China's top economic envoy, Liu He.

Among those urging talks is former Treasury Secretary Henry Paulson, who used to be Mr. Mnuchin's boss at Goldman Sachs Group Inc. and meets regularly with Mr. Liu. Blackstone Group Chief Executive Stephen Schwarzman is also acting as a back channel between the two governments, people familiar with the discussions said.

For now, no negotiations are planned before the deadline when the White House will impose the first round of tariffs on $34 billion of Chinese imports. Beijing says it will retaliate dollar for dollar.

Chinese President Xi Jinping has instructed various levels of government to prepare for a trade war, Chinese officials said. Northeastern provinces of Heilongjiang and Jilin, for instance, are stepping up efforts to encourage farmers to grow more soybeans -- one of the biggest U.S. exports to China that would be subject to Chinese levies.

The Trump administration has complained that Beijing is forcing U.S. companies to transfer technology to Chinese firms. It has tried to use trade and investment measures to prevent China from advancing its goal of becoming a world leader in industries such as information technology.

The White House said on May 29 it would go through with twin plans to use new investment restrictions and U.S. export controls against China and Mr. Trump's advisers were preparing to move forward with the policies. But Mr. Mnuchin prevailed in a decision this week to rely on existing authorities to restrain Chinese investment into U.S. high-tech industries.

Mr. Trump was angered by news stories, particularly a Journal article earlier this week, saying the administration was moving ahead with separate investment restrictions aimed at China. The article was based on interviews with administration officials, but some in the administration say Mr. Mnuchin viewed it as a "leak" aimed at pressuring Mr. Trump to make a decision Mr. Mnuchin opposed.

On Monday, Mr. Trump told Mr. Mnuchin to "push back" on the reports and that he wasn't "leaning in that direction," according to a White House official.

In a subsequent tweet, Mr. Mnuchin called the articles "fake news." During the day, the **stock market** fell sharply, providing additional impetus to ease off on China, said individuals familiar with the administration's thinking. "Those leaks were not helpful to the markets or not helpful to the process," Mr. Mnuchin said on CNBC.

Instead of creating new investment restrictions, the White House said it will continue to rely on an interagency group, the Committee on Foreign Investment in the U.S., which screens foreign investments to see if they endanger national security.

Mr. Trump punted as well on toughening export controls on Beijing. The White House had planned to announce new policies by Saturday. Instead, the White House asked the Commerce Department to study "issues related to the transfer of export of critical technologies," with no date to report its findings.

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THE WALL STREET JOURNAL.
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Manhattan Apartment Inventory Rises, as Sales Dip Persists

By Josh Barbanel
695 words
28 June 2018
The Wall Street Journal
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English

A slump in the Manhattan apartment market deepened during the second quarter, as sales slowed, inventory rose to levels not seen in years, and properties took longer to sell.

Fewer buyers were on the hunt and attendance fell at open houses, brokers said.

Overall, sales decreased by 10.8% compared with the second quarter in 2017, according to a Wall Street Journal analysis of city property records. "We are at the tail end of the great correction that began 18 to 24 months ago," said Leonard Steinberg, president of Compass brokerage.

Sales began to slide in the second half of 2016, a shift that many brokers and analysts attributed at the time to uncertainty over the presidential election. But the weakness has persisted, despite falling unemployment, a booming economy, a historically high **stock market** and strong Wall Street bonuses.

More recently, the slump has been attributed to modestly rising interest rates, and uncertainty about the impact of federal tax changes that reduce the deductibility of high state and local taxes, including the property tax in New York.

Now, many brokers are acknowledging that the Manhattan market has been in a prolonged correction as buyers push back against high prices that have risen year after year. The median price of an apartment rose by more than 40% between 2011 and 2017.

This year in the second quarter, the median price on a Manhattan apartment was down 9.2% from a record-high price set in the second quarter of 2017, though much of the decline was due to slower sales of the most expensive new luxury condominium developments.

The median price was $1.085 million in the second quarter, according to the Journal's analysis, the lowest median price since the fourth quarter of 2016. Prices slipped by 4.2% for resales of condos, and by 0.9% for co-ops, which include many lower-priced apartments.

The analysis is based on sales filed with the city's Department of Finance through June 25. The pace of sales includes all sales as of five days before the end of each quarter.

Contributing to the uncertainty is the rising number of unsold listings, which hit at least a six-year peak of 7,487 at the end of May, according UrbanDigs.com, a listing and real-estate data site. That was up 31.8% from May 31, 2017, and 40% from the same date in 2016.

Noah Rosenblatt, a broker and the founder of UrbanDigs, said sellers of more expensive apartments, priced between $5 million and $20 million, have reduced asking prices by 15%-20%. He said some buyers were spooked by the "negative perception" of the federal tax law changes and mortgage-rate increases, which may give other buyers an opportunity to swoop in and make favorable deals.

"I think we have already corrected," he said. "You are not paying peak prices, the market has already come down. You can negotiate and you do have options." But he said his data also showed a new weakness among lower-priced units, those listed under $2 million, a sector that has seen few effects of the slowdown because of a limited supply of apartments.

Another measure of the market's weakness is the increasing length of time it takes to sell a typical apartment at the current pace of sales.

A new report of listings by brokerage Brown Harris Stevens found that this metric, known as the absorption rate, rose to 8.2 months in Manhattan during May, up 30% from the same period in 2017. That was the highest rate since May 2012, said Gregory J. Heym, the chief economist at Brown Harris Stevens and Halstead.

Pamela Liebman, the president and chief executive of brokerage Corcoran, said many potential buyers are staying on the sidelines, some because of high prices and others who may be pausing to rethink the value of buying an expensive home.

Despite the buyer slowdown, many properly priced properties, including expensive ones, are selling, said Hall Willkie, a co-president at Brown Harris Stevens.

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WSJ PRO CENTRAL BANKING

Economy
Demand for Business Equipment Cools; Overall demand for long-lasting manufactured products fell for a second straight month

By Eric Morath
732 words
27 June 2018
12:25 PM
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English

Business investment in equipment is showing no signs of accelerating six months after lawmakers in Washington overhauled the tax system with the intent to spark such spending.

A proxy for such investment, new orders for nondefense capital goods excluding aircraft, decreased a seasonally adjusted 0.2% in May after a strong April increase, the Commerce Department said Wednesday. The capital-spending gauge has failed to increase for two straight months since August and September last year.

Soft business investment figures in May and a sharp decline in orders for motor vehicles and parts caused overall demand for long-lasting manufactured products to fall for a second straight month.

Orders for durable goods—products designed to last at least three years, such as washing machines and fighter jets— declined 0.6% in May from the prior month . Orders also fell 1% April, a narrower decline than the previous estimate of down 1.6%.

April orders for nondefense capital goods excluding aircraft were revised up to a 2.3% gain. From a year earlier, such orders were up 6.1%. While that is well ahead of the pace of consumer inflation, the year-over-year growth rate in the subset of capital-goods spending peaked in September at 13.3% and cooled since.

That's consistent with a separate measure of business investment on equipment, which showed such spending rose in the first three months of the year at the slowest pace in five quarters.

The new tax rules passed by Congress late last year were designed to incentivize businesses to increase capital investment. But so far demand for capital goods has decelerated somewhat from last year.

Growth in business equipment investment is "remaining much weaker than the growth rates seen in the second half of last year," said Andrew Hunter, economist at Capital Economics.

White House economists have said some businesses may have pulled ahead purchases of equipment into late 2017. The new law allowed firms to take bonus depreciation on purchases back to Sept. 27, 2017, and the tax break was more valuable last year when corporate rates were higher.

Spending on other forms of business investment, including building structures and research and development, did increase at a faster pace in the first quarter.

There are more factors than just tax laws affecting demand for capital equipment. Last year's run up in **oil prices** caused U.S. energy companies to invest in drills and other extraction equipment. Further increases in energy prices this year could spur additional investment. Meanwhile, shifting trade policies are becoming a worry for some manufacturers. Motorcycle maker Harley-Davidson Inc . said this week it plans to shift more production overseas to avoid European Union tariffs.

"The significant tailwind from corporate tax cuts is now being offset by other forces, most likely the uncertainties associated with the ongoing trade war," Deutsche Bank Securities Inc. economist Torsten Slok said.

Other measures of U.S. manufacturing are sending mixed signals. The Federal Reserve's measure of manufacturing output declined in May, in part due to a factory fire that idled production of Ford pickup trucks. But the Institute for Supply Management said U.S. factory activity picked up in May after a two-month slowdown. The trade group said demand remained high but did report worries over the effect of tariffs.

Wednesday's durable-goods report more broadly showed orders through the first five months of the year were up 9.9% from the same period in 2017. Durable-goods shipments fell 0.1% in May but were up 7% through the first five months of the year compared with the start of 2017.

Orders in the often **volatile** civilian-aircraft segment fell 7% in May. Orders for motor vehicles and parts declined 4.2% from the prior month. Excluding cars, planes and other transportation products, orders were down 0.3%.

Orders for defense capital goods, another choppy category, increased 15.1%. Excluding military demand, durable orders were down 1.5%.

Demand for U.S.-made primary metals, including steel and aluminum, decreased 0.4% on the month but was up 15.8% through the first five months of the year, compared with the same period last year.

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THE WALL STREET JOURNAL.

Economy
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By Eric Morath
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THE WALL STREET JOURNAL.

Markets

Why Investors Aren't Worried China Will Weaponize Its Treasurys Hoard; China holds $1.18 trillion in U.S. government bonds, but it's unlikely to dump them in response to rising trade tensions

By Daniel Kruger
895 words
27 June 2018
02:32 PM
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English

Intensifying trade tensions have U.S. investors parsing China's possible responses to the latest Trump administration salvos, concerned about everything from escalating tariffs to currency devaluation.

One thing nervous investors shouldn't worry about, some analysts say, is China dumping its $1.18 trillion of U.S. government bonds.

The nightmare scenario is that China, which owns about 8% of the U.S. government 's public debt, could drive down **bond prices** by unloading even part of its hoard of Treasurys. Such a move would likely send interest rates paid by the U.S. sharply higher.

Because Treasurys are a benchmark that help set rates for mortgages, business loans and consumer debt, such a move could drive up borrowing costs throughout the economy.

A decision by China to sell Treasurys could be the economic equivalent of "mutually assured destruction," said Mark McCormick, head of currency strategy at TD Securities .

So China would be loath to weaponize its financial assets, analysts say.

For starters, driving down prices on U.S. government bonds would erode the value of any securities China continues to hold. It could also damage the value of China's other extensive dollar-denominated holdings, such as corporate bonds and stocks.

The move could also prove counterproductive in other ways. Because China exported $505 billion of goods to the U.S. in 2017 and imported $130 billion, analysts have noted that U.S., President Trump has more targets for tariffs than Chinese President Xi Jinping .

So instead of imposing additional tariffs, some said China could respond by devaluing the yuan.

Indeed, China recently has allowed the yuan to trade lower against the dollar. On Wednesday the currency reached a six-month low.

Selling Treasurys would upend that plan. China has for years used dollars accumulated by running trade surpluses to purchase Treasurys. This is part of a strategy to prevent the yuan from appreciating, analysts and economists said.

That helps keep China's exports affordable to consumers around the world. Selling U.S. government debt and accumulating yuan could instead risk boosting the value of its currency, making China's exports relatively more expensive.

Such a move could also send unpredictable shock waves throughout the global economy, unleashing currency **volatility** that China's central bank could be unable to contain. While the yuan fell Wednesday, China's central bank could be unable to contain. While the yuan fell Wednesday, appeared to step in to keep the decline from getting out of control.

Escalating trade levies have the potential to slow global growth, one reason why the benchmark **10-year Treasury** note has slipped from an almost-seven-year high of 3.109% in May, said Jeff Klingelhofer , who manages bond portfolios at Thornburg Investment Management.

While he can't rule out the possibility China will sell Treasurys, "my level of concern is pretty low" he said. "It doesn't seem productive to them in any way, shape or form."

Selling dollar assets and repatriating yuan would add to China's trade problems and "help address U.S. trade problems" by hurting the value of the dollar and making U.S. exports cheaper, said Brad Setser , an economist at the Council on Foreign Relations .

Some argue that even if China wanted to sell its Treasury portfolio, it might not prove to be that effective a strategy. Mr. Setser, estimates that if China were to sell all of its $1.18 trillion of Treasurys, along with about $100 billion in custodial accounts held abroad, particularly in Belgium, it would raise the yield on the **10-year Treasury** note by as little as 0.3 percentage point.

The most likely way for China to retaliate against U.S. tariffs without raising trade levies of its own would be to tighten regulations and increase inspections of U.S. businesses operating in China, making the climate less hospitable, several analysts said.

The Department of Defense assessed the national security risks posed by China's bondholdings in 2012 and found the threat of the country dumping Treasurys not credible.

Many analysts believe China would prefer to see the value of its currency against the U.S. dollar remain stable. While a weaker currency could help shore up the economy's export sector, it could also raise the risk of capital flight.

Between 2014 and 2016, Chinese currency reserves declined as investors moved money offshore. Officials sold roughly $200 billion of Treasurys to help support the value of its currency. During that period, Treasurys rallied and yields fell.

There would also be a longer-term risk for China, several analysts said. The use of the country's bondholdings and currency in a trade fight could hurt China's push to have the yuan adopted by large central banks as a global reserve currency.

Such a move could damage whatever trust investors have begun to place in the currency as a long-term store of value, Mr. McCormick said. "This is something the U.S. understands, which is why they're probably pushing the envelope a little" and making such large threats about tariffs, he added.

Write to Daniel Kruger at Daniel.Kruger@wsj.com

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The New York Times

U.S.; Politics

Trump Backs Softer Restrictions on Chinese Investment

By Ana Swanson, Alan Rappeport and Jim Tankersley
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English

WASHINGTON — The Trump administration has backed off a plan to impose aggressive new restrictions on Chinese investment in the United States, opting instead to support a congressional effort that would expand the types of foreign deals that are subject to review.

President Trump said Wednesday that he supported a bipartisan push in Congress to broaden the authority of a government body that reviews foreign investments for security threats. The legislation would give the United States power to squelch a wider variety of investments from China, including minority stakes in American firms, joint ventures, and real estate transactions near military bases or other national security facilities.

It would also allow the United States to consider risks beyond national security when rejecting transactions — for instance, whether a deal could undercut America's dominance in a particular field, like wireless technology or artificial intelligence.

Mr. Trump said the expansion of the Committee on Foreign Investment in the United States , or Cfius , would achieve his goal of combating China's "predatory investment practices" of buying stakes in American companies to acquire valuable technology and trade secrets.

[Read more about an expanded Cfius .]

The decision will forestall more draconian curbs on Chinese investment that the White House had been considering, such as limiting investment in technology and manufacturing industries by declaring an economic emergency. That could help defuse tensions between the world's two largest economies, at least somewhat.

But it is unlikely to avert a rapidly approaching trade clash that threatens to derail global stock markets and multinational supply chains. China is still far from offering to make the type of substantial changes to its economy that the Trump administration has pushed for, and no official talks appear to be scheduled in the next week.

The Trump administration is scheduled to put levies on $34 billion worth of Chinese products on July 6, with the president threatening to impose tariffs on as much as $450 billion of Chinese goods as punishment for Chinese trade practices. Beijing has countered with its own threat of tariffs on American products.

"Our objective is not to single out China or treat them differently, but that we have the necessary tools to protect U.S. investments," Steven Mnuchin , the Treasury secretary, said Wednesday. "I'm not going to make specific comments on where we are in dialogue, but if China wants to come to the table with free and fair trade and treating American companies fairly and reducing the trade deficit, we're always willing to listen."

Additional curbs could still be coming. Administration officials said Wednesday that Mr. Trump would direct the heads of the Commerce Department and other federal agencies to review the nation's export controls and recommend any needed changes. That could have a more significant effect on American companies than restrictions on Chinese investment, since it could limit their ability to sell products to China. The targeted industries that the White House wants to prevent China from dominating include robotics, artificial intelligence and new-energy vehicles.

Eswar Prasad , a professor of international trade at Cornell University, said the president's announcement suggested "a brief lull in the economic hostilities against China."

“For now, at least, the momentum within the administration has swung back in favor of Mnuchin and others who favor a less confrontational approach to the economic relationship with China,” Mr. Prasad said. “However, with the imposition of tariffs against China just a few days away, this apparent respite in economic hostilities could prove to be all too fleeting.”

The announcement appeared to be a narrow and unlikely victory for more moderate advisers in the White House. While expanding Cfius would most likely curb Chinese investment, the White House had drafted an executive order that would have put more stringent investment restrictions into effect, according to people familiar with the plans.

That garnered the support of more hard-line trade advisers — among them Peter Navarro ; Robert E. Lighthizer , the United States trade representative; and Commerce Secretary Wilbur Ross — as well as the national security adviser, John R. Bolton .

But Mr. Mnuchin convinced Mr. Trump that the president could be blamed for triggering a drop in the **stock market** and for creating additional layers of bureaucracy necessary to review investments. Mr. Mnuchin and top Republican lawmakers made the case that the legislation winding its way through Congress provided a viable bipartisan alternative.

Justice Department and State Department officials had also warned that investment restrictions emanating from the White House could trigger a wave of lawsuits.

The potential investment restrictions were part of the White House’s effort to punish China for what it says are years of unfair trade practices, including cyber espionage and a pattern of pressuring American technology companies to hand over valuable trade secrets.

Among the actions that the United States has targeted are what it describes as the “theft” of corporate secrets and China’s strategy to dominate cutting-edge industries, known as Made in China 2025. Data released this week from Public Citizen , a liberal advocacy group and think tank, showed that 56 percent of Chinese investments in the United States last year were in industries that Beijing defines as “strategic,” such as aviation, biotechnology and new-energy vehicles — up from 25 percent in 2016.

In a meeting last week with China’s president, Xi Jinping , American corporate executives urged him to send one of his most trusted advisers, Wang Qishan, to the United States for talks. But with the United States and China so far from a compromise, such a visit appears unlikely in the near term, people familiar with the deliberations said.

On Wednesday, Larry Kudlow , the White House’s chief economic adviser, said that Mr. Trump and Mr. Xi “work well together,” but that the president was unsatisfied with the Chinese response on trade talks.

“The ball is in their court,” Mr. Kudlow said.

Administration officials who outlined the decision in an early-morning briefing said that Mr. Trump had been pleased with the evolution of the legislation to expand Cfius and that he viewed it as an “extremely powerful tool” to safeguard national security. The overhaul would allow Cfius to review investments from a list of “countries of special concern” but stops short of specifically naming China as the target.

The Senate and House have passed different versions of the legislation, which must be reconciled and sent back for a final vote. While final approval appears likely in the coming weeks, it is not guaranteed. Mr. Trump said he would be prepared to “deploy new tools, developed under existing authorities,” if lawmakers did not act to “protect the crown jewels of American technology and intellectual property from transfers and acquisitions that threaten our national security — and future economic prosperity.”

The decision could help repair ties with Republican lawmakers, who have been at odds with Mr. Trump over his approach to trade, including his tariffs on the European Union , Canada and Mexico and his decision to rescue the Chinese telecommunications company ZTE.

Mr. Trump has also threatened to put 20 percent tariffs on autos imported into the United States. A handful of Republican senators have introduced legislation to limit the president’s ability to impose such tariffs, but they have faced opposition from Republican leadership.

Lawmakers have worked for months on the Cfius legislation, seeing it, rather than punitive new restrictions, as the best path to curtail risky investments from China.

Senator John Cornyn , a Texas Republican who has sponsored the bill, said in a statement that he appreciated the president's support for the legislation, which "takes a carefully tailored approach to updating the review process without limiting our ability to meaningfully engage in trade with partners around the world."

Mr. Mnuchin insisted on Wednesday that the Trump administration was not pursuing a protectionist approach and was actually trying to prod other countries, including China, to lower their trade barriers.

Eileen Sullivan contributed reporting.

* Trump May Soften Sweeping Plan to Restrict Chinese Investments

A robot on display in Beijing last month. The White House has targeted specific products that it wants to prevent China from dominating, including robotics. | Wu Hong/EPA, via Shutterstock | Steven Mnuchin, the Treasury secretary, insisted on Wednesday that the Trump administration was not pursuing a protectionist approach toward other nations. | Doug Mills/The New York Times

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THE WALL STREET JOURNAL.

Business

People on Higher Floors of Buildings Tend to Take More Risks; One reason, researchers say, is that being higher up may lead people to feel more powerful

By Heidi Mitchell
723 words
26 June 2018
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The Wall Street Journal Online
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English

People apparently take the idea of the heights of power literally.

So says a group of researchers who found that being on the higher floors of a building tends to make people feel more powerful—which may lead them to take bigger financial risks.

"We know that people who are taller take more risks, and we have a sense that people who are risk takers gravitate toward high-elevation activities like skydiving, but I wanted to understand if the reverse is true in a controlled environment," says Sina Esteky, an assistant professor of marketing at the Farmer School of Business at Miami University in Ohio, and the lead researcher for the recent paper published in the Journal of Consumer Psychology.

In one of five studies that make up the paper, Dr. Esteky looked at investment and returns data from 3,147 hedge funds, as well as elevation from street level of their offices. He found that the higher the office location, the more risk the funds would take, as measured by their **volatility** across a one-year period. Still, he says, there was quite a bit of "noise" in the data. For example, Dr. Esteky says he didn't totally control for factors such as the relative experience of fund managers.

In the second study, a research assistant entered a glass elevator in a 73-story building with a stranger going all the way up or all the way down, and offered each person a choice: invest in a safer lottery with a 50-50 chance of winning $50 or $100, or in a riskier lottery with a 50-50 chance of winning either $20 or $130. "We found that people who were going up were twice as likely to choose the riskier lottery," Dr. Esteky says. A similar study Dr. Esteky conducted at a business school compared people on the ground floor versus the mezzanine level of the building and found that being even two floors off the ground led people to take more risks.

In a follow-up study, Dr. Esteky asked 260 participants in 22 states to take a picture of their views to confirm their elevation and sightlines. He then offered each of them $70 and asked if they wanted to keep it or bet it on an investment in which the chance of total loss was 66%. Those who had elevated views were more likely to choose the risky investment, while those in windowless spaces—regardless of which floor they were on—were more reluctant to do so. The results suggest "the elevation-risk affect only works when people have a view, and it is elevated," says Dr. Esteky.

Dr. Esteky sees a few practical applications for his research, which builds on previous studies demonstrating that people associate elevation with power and that a sense of power increases risk taking.

Marketers promoting ventures with perceived risk, like casinos, could use technology such as geo-tagging or location-based apps to target prospective consumers while they are at high elevations, he says. Urban planners, too, should consider elevation when determining where to put high-stakes decision makers such as judges, surgeons and financial planners, he says. "Architects should make sure that important decisions that affect people's money, lives or futures are made in as unbiased spaces as possible," he says. That may mean thinking twice about the top-floor executive suite with expansive views.

The United Nations says that by 2030, 60% of the world's population will live in cities—many working in skyscrapers. "If you have that many people working on the 70th floor, that is going to impact society long term," Dr. Esteky says, adding that the affect would be subtle and nuanced but ubiquitous nonetheless. "Urban planners need to be mindful of the design of these cities," he says.

Ms. Mitchell is a writer in Chicago. She can be reached at reports@wsj.com.

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THE WALL STREET JOURNAL.

U.S. Markets
Markets
U.S. Stocks Retreat, Led by Tech Shares; Investors are weighing mixed signals from the U.S. and China on trade

By Riva Gold and Danielle Chemtob
899 words
27 June 2018
05:28 PM
The Wall Street Journal Online
WSJO
English

U.S. stocks turned lower Wednesday as lingering trade tensions offset gains in shares of energy companies.

Investors have been weighing mixed signals this week from the U.S. and China about the future of their trading relationship, which some worry could hurt the outlook for global growth.

President Donald Trump suggested he would scrap plans for new restrictions on Chinese investment in U.S. technology and rely mainly on existing tools to guard against the purchase—and theft—of innovations vital to the U.S. economy.

Technology and internet stocks led the declines in Wednesday's session, which saw the **Dow Jones Industrial Average** swing 441 points from its high to low.

"There's still some anxiety in the marketplace that maybe the president or somebody in the government is still going to give some scrutiny over China," said Mohit Bajaj, director of ETF trading solutions at brokerage WallachBeth Capital.

"I just think people are going to continue to shave off risk as we go into the [July 4] holiday," he added.

Major indexes opened higher, and all 11 sectors of the broad **S&P 500** climbed earlier in the day, but just three—energy, utilities and telecommunications—ended the session with gains.

The blue-chip index lost 165.52 points, or 0.7%, to 24117.59, after earlier rising as much as 286 points. The **S&P 500** shed 23.43 points, or 0.9%, to 2699.63 as its technology sector fell 1.5%. The tech-heavy **Nasdaq Composite** lost 116.54 points, or 1.5%, to 7445.08.

Energy stocks in the **S&P 500** were a bright spot, rising 1.3%. U.S. crude added 3.2% to $72.76 a barrel, its highest settlement value in more than 3½ years. The gains added to Tuesday's 3.6% climb after the U.S. threatened to slap sanctions on countries that don't stop importing Iranian oil by early November.

Strong global demand coupled with restrained supply—even with last week's decision from major oil-exporting countries to increase global output—could propel the sector even more this year, said Jeff Schulze, investment strategist at ClearBridge Investments, which manages $140 billion in assets.

"There's a lot of positive reasons for energy to continue performing, and this is the beginning of a much bigger move higher," he said.

In company news, shares of Conagra Brands were among Wednesday's biggest decliners, tumbling $2.78, or 7.3%, to $35.45 after the company said it would buy Pinnacle Foods for $8.2 billion in cash and stock. Pinnacle dropped 2.91, or 4.3%, to 64.95.

The U.S. Justice Department approved Walt Disney's proposed $71 billion acquisition of 21st Century Fox assets Wednesday. Shares of Comcast, which is in competition with Disney to acquire the entertainment company, fell 49 cents, or 1.5%, to 32.29.

The dollar and U.S. government bonds—investors' favored haven assets of late—climbed as stocks slumped. The WSJ Dollar Index, which measures the greenback against a basket of peers, added 0.6%. And the yield on the benchmark 10-year U.S. Treasury note fell to 2.827% after settling at 2.882% Tuesday. Yields move inversely to prices.

The decline in bond yields pressured financial stocks in the **S&P 500**, which slipped 1.3%. Lower yields can weigh on banks' net interest margins, a key measure of lending profitability.

"Lately it's been extremely **volatile** because investors are nervous about every tweet," said David Marcus, CEO of Evermore Global Advisors. But Mr. Marcus said his firm is using the uncertainty as a buying opportunity.

China's Ministry of Commerce on Wednesday said it is closely watching potential U.S. moves to restrict Chinese investment amid signs of intensifying trade tensions between the two countries.

Separately, China's central bankguided the yuan to a six-month low against the U.S. dollar, sending the Chinese currency tumbling. The yuan's drop has accelerated since trade threats between China and the U.S. escalated in the middle of June.

The brewing trade tensions are the latest complication for the world's second-largest economy, where recent economic data point to signs of slowing growth.

"Throw on top of that they're in a trade war with the largest global economy, and it tends to damper things, especially for expectations that have gotten very ambitious for the start of the year," said Frank Rybinski, chief macro strategist at Aegon Asset Management.

Mark Stoeckle, senior portfolio manager of Adams Diversified Equity Fund, said the uncertainty is frustrating for investors trying to figure out how to respond.

"We've chosen to determine that the best thing for us to do is wait to get more facts," he said. "Reacting to unknowns is not a terribly good investment strategy."

Elsewhere, the Stoxx Europe 600 added 0.7% after recovering from earlier losses. Weakness in Asian stocks continued, with Hong Kong's Hang Seng falling 1.8% and the Shanghai Composite dropping 1.1% after entering a **bear market** Tuesday.

Amrith Ramkumar and Saumya Vaishampayan contributed to this article.

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THE WALL STREET JOURNAL.

Markets

U.S. Government Bonds Gain On Trade Concerns; Investors focused on the risk that rifts between trading partners could widen and slow global economic activity

By Daniel Kruger
349 words
27 June 2018
05:37 PM
The Wall Street Journal Online
WSJO
English

U.S. government**bond prices** rose Wednesday as investors focused on the risk that rifts between the largest global trading partners could widen, potentially slowing economic activity around the world.

The yield on the benchmark **10**-**year Treasury** note fell to 2.827%, the lowest closing level since May 31, from 2.882% Tuesday. Yields fall as **bond prices** rise.

Yields fell even as the Trump administration appeared to back away from imposing restrictions on Chinese investment in the U.S. as investors and analysts said it was likely that the move was more likely to reflect tactics than a substantive policy change.

The Trump administration has decided that relying on existing laws updated by Congress and dropping consideration of alternative approaches that would have allowed the White House to impose stricter limits on its own "is the best approach to protect U.S. technology," a senior administration official said Wednesday.

"We see decisions and policy reversals with some regularity," said Christopher Sullivan, chief investment officer at the United Nations Federal Credit Union. "This is disconcerting to markets."

The Treasury's auction of $36 billion of five-year notes Wednesday was met with strong demand, following Tuesday's sale of $34 billion of two-year notes which attracted investor demand in line with recent averages.

While investors and analysts have expressed concern with the rising size of U.S. government bond sales needed to fund last year's $1.5 trillion tax cut, "it's difficult to look at that as supply indigestion," said Ian Lyngen, head of U.S. government bond strategy at BMO Capital Markets.

Fed funds futures, which investors use to bet on the direction of central bank policy, place the odds of the Fed raising rates at least two more times this year at 44% late Wednesday, down from 52% a week ago, according to data from CME Group.

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THE WALL STREET JOURNAL.

Economy
Some Economists Boost Estimates for U.S. Growth; Newly released trade data for May prompt some forecasters to upgrade second-quarter growth estimates

By Ben Leubsdorf
505 words
27 June 2018
04:06 PM
The Wall Street Journal Online
WSJO
English

Economists are raising their estimates of second-quarter U.S. growth after new government figures showed a smaller-than-expected trade deficit for May.

The Commerce Department on Wednesday reported the trade deficit in goods narrowed 3.7% in May from the prior month, as exports climbed 2.1% and imports rose a more modest 0.2%. Export growth adds to the goods and services produced by a nation, boosting output growth, while import growth means more of what a nation consumes is produced abroad and isn't counted in domestic production.

"The nominal goods deficit has now narrowed for three straight months following seven consecutive months of widening," and as a result it appears trade "will make a significant contribution" to growth in the second quarter, JPMorgan Chase economist Daniel Silver said in a note to clients.

The recent narrowing in the trade gap reversed a widening that followed a series of powerful hurricanes last year, according to Pantheon Macroeconomics chief economist Ian Shepherdson. The storms late last summer disrupted port traffic and were followed by an imports surge as American companies restocked depleted inventory. That could mean the deficit won't continue to narrow.

Businesses also might be adapting to tariff threats that may eventually disrupt trade. May saw a 12.8% jump in U.S. exports of foods, feeds and beverages from the prior month, which "could reflect efforts by the private sector to book exports ahead of tariff increases," Barclays economists Michael Gapen and Pooja Sriram said in a note to clients.

Based on Wednesday's report, some forecasters upgraded their estimates for growth in the second quarter, which ends this weekend. Macroeconomic Advisers raised its second-quarter gross domestic product forecast to a 5.3% seasonally adjusted annual growth rate; as of Monday, the firm had been predicting a 4.6% growth rate.

If the latest forecast holds up, it would be the strongest quarterly growth reading since the third quarter of 2003, edging the 5.2% growth rate recorded in the third quarter of 2014.

The second-quarter pickup comes after a modest slowdown in the first quarter, when the Commerce Department reported 2.2% growth for economic output. The government on Thursday will release revised GDP data for the first quarter and put out its initial estimate for second-quarter output on July 27.

Growth rates can be **volatile** from quarter to quarter, and the springtime acceleration may prove temporary. Still, economists expect healthy economic growth in 2018 thanks in part to stimulus from recent tax cuts and increased government spending. Forecasters surveyed earlier this month by The Wall Street Journal on average predicted 2.9% GDP growth in the fourth quarter of 2018 from a year earlier, easing to 2.4% growth in 2019 and 1.9% growth in 2020.

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WSJ PRO CENTRAL BANKING

Economy

Fed Official Warns on Going Too Far, Too Fast With Rate Increases; St. Louis Fed President James Bullard says misinterpretation of neutral rate ‘a distinct possibility'

By Paul Kiernan
446 words
27 June 2018
03:21 PM
WSJ Pro Central Banking
RSTPROCB
English

WASHINGTON—St. Louis Fed President James Bullard said one big risk to the U.S. economy in coming years might be his Federal Reserve colleagues raising interest rates to a level he believes would restrict growth.

"I think there is a risk that we'll go too far, too fast as a committee," Mr. Bullard said Wednesday in an interview with The Wall Street Journal, replying to a question about risks to the economic outlook.

One reason for the risk, he said, is central bankers' uncertainty about the so-called neutral level of the Fed's benchmark rate, the point at which it neither spurs nor slows growth.

The problem is, economists have no way of knowing for sure exactly where that point lies.

"A misinterpretation of where we are is a distinct possibility," Mr. Bullard said. "That's why I'm trying to push against faster rate hikes."

Fed officials' median projection for the neutral benchmark rate is 2.9%. But the span of their views is wide. Some officials believe it is as high as 3.5%, but Mr. Bullard said Wednesday he believes it could be at 2%, meaning the Fed is already nearly there.

At their meeting two weeks ago, the policy makers lifted the benchmark rate to a range between 1.75% and 2% and penciled in two more increases this year, for a total of four moves in 2018.

Mr. Bullard says the Fed shouldn't raise the rate from its current level, partly because of uncertainty about its neutral level, but also because he believes long-term changes in the economy have reduced the odds of runaway inflation.

Other officials, however, support continued gradual rate increases, noting that inflation rose to hit the central bank's 2% target in March and April, amid other signs of accelerating economic growth in the second quarter.

Mr. Bullard pointed out that the inflation pickup has been driven in part by **volatile oil prices**, over which the Fed has little control. Faster economic growth, meantime, is being fueled by recent tax cuts and federal spending increases, effects he expects to fade in 2019 and 2020.

He said he sees no need to raise rates to pre-empt faster inflation, noting the Fed started raising interest rates while inflation was still well below target. "I think we've played it quite well, and that's why we're in such a good position today."

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THE WALL STREET JOURNAL.
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Stocks in China, Europe Caught in Crossfire

By Riva Gold and Shen Hong
937 words
27 June 2018
The Wall Street Journal
J
B1
English

China's main stock benchmark entered **bear-market** territory Tuesday as trade tensions continued to reverberate and investors grew more concerned about the world's second-largest economy.

A further lurch downward for the Shanghai Composite Index brought it 20.1% below a two-year high reached on Jan. 24, breaching the 20% level that defines a **bear market**. The move followed a tumultuous Monday for U.S. markets that had investors scrambling to decipher competing trade talk from the White House about a potential escalation of restrictions against China or possibly technology companies globally. Early Wednesday, the Shanghai benchmark was down slightly.

"The trade conflict between the U.S. and China has turned out to be more protracted and more fierce than we had expected," said Victoria Mio, Hong Kong-based chief investment officer for China at Robeco, a Dutch asset-management firm.

The scariest place to be in such a battle, though, may be stocks in Europe. In recent weeks, investors have withdrawn billions of dollars from European equity and bond funds, concerned trade frictions could dent an already fragile economic recovery in a region heavily exposed to international trade.

The result: While the U.S. has initiated the trade conflict, its markets are so far holding up better than those in China or Europe.

The **S&P 500** is up around 2% in the year to date, while the Stoxx Europe 600 is down around 3% and the Shanghai market has fallen by around 14%.

The U.S. tech sector continues to be a particular bright spot despite sudden worries it could be dragged into the fight. The tech-heavy **Nasdaq Composite** is up nearly 10% so far in 2018, even after stocks such as Netflix Inc., Facebook Inc. and Amazon.com Inc. took a drubbing Monday.

The market performance reflects a growing divergence in global economies and their exposure to trade.

Goods and services exports, for instance, make up 27% of the euro area's gross domestic product and 21% for China but just 12% for the U.S., according to data from the European Central Bank.

The U.S. economy continues to post strong growth and unemployment is at record-low levels.

In China, by contrast, there are worries growth is starting to weaken: Data for May showed a slowdown in areas ranging from investment to retail sales.

Over the weekend, the Chinese central bank took actions to encourage more bank lending by freeing up funds in the financial system. The yuan has been declining against the dollar, which some investors fear could add to trade tensions with Washington. Analysts said the currency's slide has damped overseas investors' interest in China's markets in recent weeks.

In Europe, the worry is that a U.S.-China fight could score a direct hit on a still-fragile economy. Both the U.S. and China make up Europe's biggest export markets and it has already been drawn directly into the confrontation.

The U.S. has placed tariffs on European steel and aluminum; the EU has retaliated by placing tariffs on many U.S. products such as Harley-Davidson motorcycles and bourbon.

Investors worry the next target could be cars, a key export of Germany. While initial trade tensions were more focused on narrow corners of the U.S. market, autos are much more global in nature and would likely hit Europe harder, said Barbara Reinhard, head of asset allocation at Voya Investment Management.

Even if Europe can avoid direct tariffs, the global supply chains that European companies rely upon for components could suffer.

"Europe is very sensitive to trade and to the global economy," said Thomas Costerg, economist at Pictet Wealth Management. "Europe is always caught in the crossfire," and always suffers more when there is a hit to global growth.

An unexpected profit warning from Daimler AG last week brought home to investors the direct risks to Europe. The German car manufacturer said Chinese retaliatory import duties on vehicles built in the U.S. would hit sales and profits. The European auto sector fell for eight straight sessions through Tuesday.

So far in June, shares of Italian-American Fiat Chrysler Automobiles, which generates 53% of its revenue in the U.S. according to FactSet, have fallen 15%, while Volkswagen AG has lost 10% and Bayerische Motoren Werke AG shed 8.1%. The auto sector makes up 14% of Germany's benchmark DAX index.

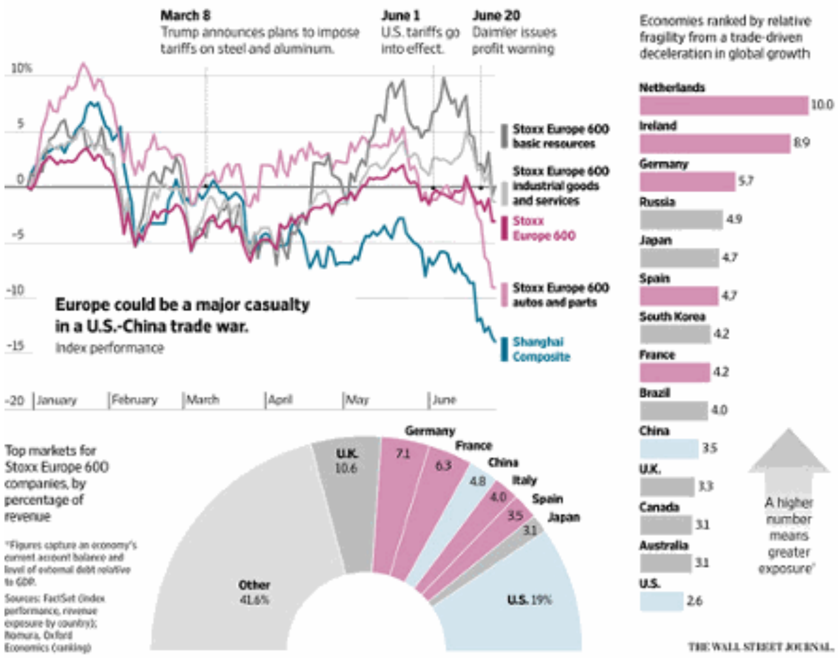
"We think that the warning from Daimler . . . is a line in the sand," Voya's Ms. Reinhard said.

Bank of America Merrill Lynch estimates U.S. car tariffs at 25% could lower euro-area GDP by at least 0.3%, excluding any second-round effects on investor confidence, business spending and changes in other export markets.

But it isn't only Europe's cars that have deep ties to the U.S. and China. Those two countries make up a combined 24% of the Stoxx Europe 600's revenue, according to FactSet, meaning the index is exposed to any slowdowns in their economies.

Investors are betting this could hurt the region's corporate profits. Fund managers withdrew around $17 billion from European equities in May and June and $8 billion from European bond funds, according to data from the Institute of International Finance and EPFR Global. U.S. assets now make up 58% of global fund portfolios, the highest since before the presidential election in 2016, according to the IIF data.

Mike Bird contributed to this article.



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THE WALL STREET JOURNAL.

Politics

Trump Eases Demand for New Tools to Limit Chinese Investment; President suggests he will rely on 1988 law being updated by Congress that lets U.S. review foreign investments

By Bob Davis
1,238 words
26 June 2018
10:39 PM
The Wall Street Journal Online
WSJO
English

WASHINGTON—President Donald Trump suggested he would scrap plans for new restrictions on Chinese investment in U.S. technology and rely mainly on existing tools that some of his advisers have labeled inadequate to guard against the purchase—and theft—of innovations vital to the U.S. economy.

"We have the greatest technology in the world. People come and steal it," he said in response to questions from reporters at the White House on Tuesday. "We have to protect that and that can be done through CFIUS," referring to an interagency group, the Committee on Foreign Investment in the U.S., which screens foreign investments to see whether they endanger national security.

He called a recent article in The Wall Street Journal that the administration was planning two further initiatives, in addition to CFIUS, to prevent Beijing from obtaining advanced U.S. technology "a bad leak…probably just made up."

As recently as Sunday, administration officials and others who work closely with the administration had said the plans for the restrictions were on track, though Mr. Trump hadn't yet approved them.

If Mr. Trump's decision holds, it would represent a significant easing of threats the president has made against China and a possible olive branch to Beijing before the July 6 imposition of the first tariffs on Chinese goods under the Trump administration's trade offensive. The new policy is planned for release on Wednesday, administration officials said.

"This suggests that some rationality might be returning to the approaches on trade and investment restrictions," said Cornell University economist Eswar Prasad, who speaks often with Chinese officials. "But it doesn't necessarily signal a pullback from [a] hard-line stance on China."

Investment restrictions in addition to CFIUS have long been part of the administration's planned efforts to keep China from moving ahead with plans outlined in its "Made in China 2025" report to become a global leader in 10 broad areas of technology, including information technology, aerospace, electric vehicles and biotechnology. A May 29 White House statement said the policies would be aimed at "Chinese persons and entities" that seek to acquire "industrially significant technology."

Lawmakers who have worked on a bill to overhaul CFIUS have also been arguing in administration meetings that additional investment restrictions weren't necessary. "The legislative change is "designed to deal with a narrow but important aspect of dual-use technology that's being compromised by strategic investments by countries like China," said Senate Majority Whip John Cornyn, a Texas Republican, in an interview.

A bill to strengthen CFIUS passed the House on Tuesday by a 400-2 margin. A similar measure has already passed the Senate and the two versions now need to be reconciled. It would assure CFIUS reviews of more transactions, particularly those involving state-owned firms. It would also create a new export-control system to review whether overseas joint ventures are improperly transferring critical technologies to foreign companies.

Industry lobbyists and China experts attribute Mr. Trump's shift to recent declines in the **stock market** and to U.S. companies getting battered by tariffs in U.S. trade battles with the European Union, Canada, Mexico and China.

Mr. Trump warned Harley-Davidson Inc. early Tuesday that moving production overseas would mark "the beginning of the end" of the iconic brand, a day after the manufacturer said it planned to make more motorcycles abroad to avoid EU tariffs.

People familiar with the Trump White House deliberations said the president wasn't reacting to the markets. Rather, the plans for restrictions had run up against a number of legal obstacles, among other problems, they said.

The **Dow Jones Industrial Average** edged higher on Tuesday to close at 24283.11.

Relying mainly on CFIUS—if that is the final decision—would be a big victory for Treasury Secretary Steven Mnuchin, National Economic Council Director Larry Kudlow and others who have tried to tamp down the burgeoning trade battle with China. Mr. Mnuchin has been concerned that the investment restrictions could be interpreted abroad as a first step to shutting down the U.S. market.

"The United States is one of the world's most open investment environments and will remain a leading destination for international investment," he told foreign investors in June.

The decision would also mark the end for now of the ascendancy of the so-called nationalist wing represented by White House trade adviser Peter Navarro and U.S. Trade Representative Robert Lighthizer. The two camps have jockeyed for power for months over the China issue and the battle is sure to continue.

Mr. Lighthizer, for instance, has seen the investment restrictions as an important part of the U.S. trade arsenal. CFIUS is "limited in terms of national security," he said on Fox Business Network in June. The new investment restrictions—now scrapped—would "have a broader definition of national security."

Matthew Goodman, an Asia expert at the Center for Strategic and International Studies who served in the Obama administration, said that a new form of investment restriction would be useful because CFIUS is supposed to focus solely on national security, not economic competitiveness. Scrapping the investment restriction plans seems "to be removing a useful tool for taking on what the administration has described as problematic Chinese practices."

Using CFIUS, the Obama and Trump administrations have largely halted Chinese efforts to buy U.S. semiconductor companies and helped put a big crimp on Chinese investment overall. According to Rhodium Group, a market-research firm, Chinese investments were down 92% in the first half of 2018 from a year earlier, to $1.8 billion, because of Chinese curbs on credit and U.S. scrutiny of Chinese deals.

And yet, Mr. Navarro, among others in the Trump administration, worry that CFIUS hadn't been effective at halting Chinese acquisition of biotechnology or small venture capital investments in companies that could spawn new technologies.

The shift on the investment restrictions still leaves the U.S. and China at loggerheads over trade. China has threatened to match the first U.S. tariffs of 25% on $50 billion of Chinese goods. Should China do that, Mr. Trump has threatened 10% tariffs on as much as $400 billion of Chinese imports.

Beijing has a multitude of ways to bring pressure on the U.S., including ramping up regulatory reviews of U.S. companies, handing out licenses to operate in China to U.S. competitors and organizing consumer boycotts of U.S. goods.

Mr. Prasad, the Cornell China expert, said Beijing will still be wary of trying to cut a deal with the U.S., given the ups and downs in U.S. decision making. "It might help the Chinese believe they should stay engaged with less protectionist forces [in the administration] to prevent rising tensions," he said. "But that will be a tough sell" in Beijing.

Siobhan Hughes contributed to this article.

Write to Bob Davis at bob.davis@wsj.com

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THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Rising Oil Prices Lift Small Towns --- Record output boosts standard of living in production regions; 'the money's here'

By Rebecca Elliott and Harriet Torry
841 words
27 June 2018
The Wall Street Journal
J
A3
English

HOBBS, N.M. -- Oil is booming again in the Permian Basin, and so are the fortunes of this sun-bleached town.

Job postings for truckers and electricians cover billboards and chain-link fences lining the highways. Hotels are full of oil-field workers. The civic coffers are recovering from the recent oil bust. Hobbs, population 38,000, was able to put up $25 million in cash for its share of a glitzy new $63.5 million community recreation center. It sports basketball courts, a turf soccer field, waterslides, a lazy river and a three-story jungle gym.

"The money's here," says Don Bryant, who was born in Hobbs 53 years ago and owns a company that makes tools to repair oil wells. He thought about uprooting for mountainous Colorado, but decided there was more opportunity in Hobbs, near the Texas border.

From Texas to North Dakota, oil-producing regions of the U.S. are surging now that America is pumping record volumes of crude -- 10.9 million barrels a day during the second week of June, according to the Energy Information Administration. The leap from 9.4 million barrels a day a year ago is helping lift the U.S. economy as a whole, redefining the sweet spot at which **oil prices** are a tailwind for the country.

The cost of a barrel of crude has risen roughly 60% in the past year, to about $71 a barrel, while gasoline prices have climbed roughly 27% over the same period. Yet the economy is still firing on all cylinders. The Organization of the Petroleum Exporting Countries agreed on Friday to boost production in an effort to keep prices from climbing still higher.

"Historically, America had a lot more consumers and a lot less producers, so on net it was bad for the American economy," Mark Wright, research director for the Federal Reserve Bank of Minneapolis, said of pricier oil. "Now, we have a lot more producers, so as a consequence it's a lot better."

Higher **oil prices** are a burden on consumers, who have to pay more at the pump, and feed through the broader economy as businesses raise prices to cover higher manufacturing and transportation costs. But current crude prices aren't especially high, historically speaking, and are far below a decade ago, when they topped out at a record $145 a barrel. Gasoline prices, averaging $2.85 a gallon, remain below the levels they averaged for most of the first half of this decade.

If gasoline prices stay at current levels, people in the bottom half of the income distribution would lose about half the extra income gains from the $1.5 trillion tax cut that President Donald Trump signed into law late last year to higher pump prices, according to an analysis by the Penn Wharton Budget Model.

Broadly speaking, more-expensive crude is far less of an economic drag than it once was.

"On net, is the U.S. economy still better off with lower **oil prices**? The answer is yes, though clearly not to the same extent we used to be," said Ryan Kellogg, a University of Chicago economist.

The upswing has helped spark an oil boom by making shale drilling profitable in more parts of the country. The U.S. exported a record amount of oil and fuel in April, $19.9 billion, which helped narrow the trade deficit, the Commerce Department said this month.

Texas has flourished, closing last year as the nation's fastest-growing economy, with fourth-quarter seasonally adjusted growth of 5.2%.

In New Mexico, which has struggled economically in recent years, the economy grew 0.8% last year after declining 0.1% in 2016, when **oil prices** slid below $30 a barrel. State revenue soared 14.5% through March, thanks to increased oil and gas activity, according to the state legislative finance committee.

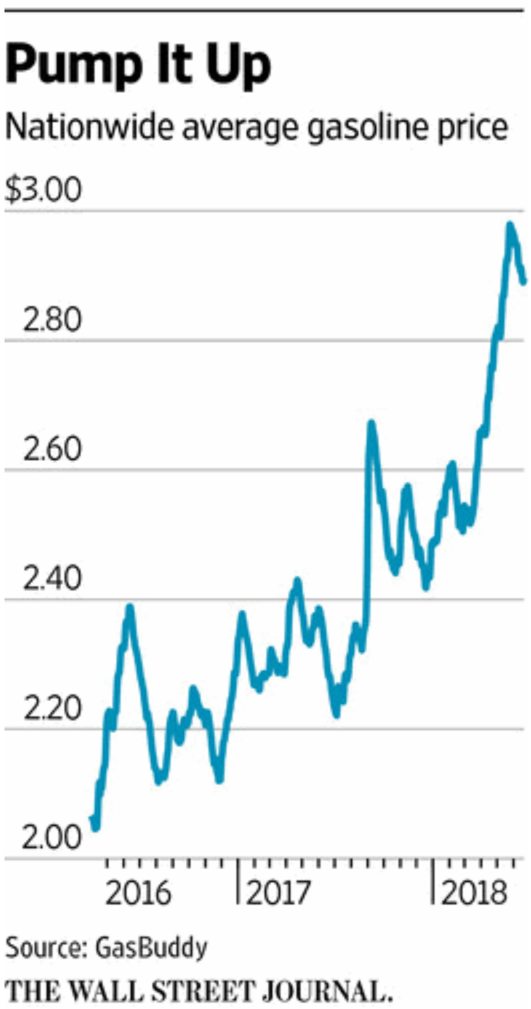
That is benefiting places like Hobbs, which long has ridden the booms and busts of oil.

More drilling in the Permian has meant more business for Mr. Bryant and his wife, Donna Bryant, who burned through all but $500 in personal savings during the recent downturn. They were able to begin saving about $1,500 a month again starting in January.

"We knew it would come back. We just didn't know when," said Ms. Bryant, 52.

Nabil Tapia's family moved to Hobbs in May after her husband, an electrician, was offered $30 an hour -- plus a per diem of $100 -- to work at a natural-gas plant. He was earning less than a third as much in South Texas.

"With what we're getting now, we can easily plan for what we want to do," said Ms. Tapia, 30. "There's no, 'Well, I can't get this because I don't have the money for it.'"



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THE WALL STREET JOURNAL.
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Fed Nears Dropping Grading of Big Banks

By Ryan Tracy
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27 June 2018
The Wall Street Journal
J
B1
English

WASHINGTON -- The Federal Reserve is moving toward eliminating passing and failing grades for its stress tests of the nation's largest banks, replacing them with a capital ratio that the lender must meet during the following year.

On Thursday, when the second round of stress-test results is released, there is still a chance a bank could fail the exam, which tests whether banks could continue lending during a severe recession. As soon as 2019, regulators are likely to turn to the ratio.

The changes, set in motion during the Obama administration and continuing under President Donald Trump, reflect the Fed's uneasiness with surprising bankers and **financial markets** with bad news, such as Citigroup Inc.'s unexpected stress-test failure in 2014.

The modifications also demonstrate how Fed officials have grown more comfortable with big banks' risk-management chops after the 2008 financial crisis exposed significant weaknesses. Last year, no banks failed, the first time that happened since the Fed began disclosing annual results in 2012.

For banks, the changes promise less risk to their reputations and less urgency to invest in passing the tests, which can cost companies hundreds of millions of dollars in compliance costs.

The Fed has been steering "a gradual course away from the potential for public shaming," said Michael Alix, a former Fed official who works as a consultant advising banks at PricewaterhouseCoopers LLP. Instead, he said, the Fed is moving back to the way it typically addressed risk-management issues in the past: privately.

Bank regulators historically have worried about bashing banks in public because it could fuel perceptions that a firm is in trouble, leading to the destabilizing "runs" on banks that regulators are trying to prevent.

Stress tests have been an exception. Officials created the tests during the crisis to increase public confidence in banks. The 2010 Dodd-Frank financial law made annual testing mandatory for large banks, and in 2012 regulators began disclosing individual bank results.

After Citigroup failed in 2014 -- along with four other firms -- Chief Executive Michael Corbat told colleagues, "If we don't get this right, we don't deserve to stay in business."

Citigroup passed the next year's test and Mr. Corbat kept his job.

The current Fed grading system has two parts: A quantitative exam estimates whether bank capital levels stay above regulatory requirements. A qualitative portion looks at more subjective questions, including the quality of a bank's internal data or board of directors.

A slip-up on either part means the bank fails, and it doesn't receive the Fed's approval to increase the profits it returns to shareholders through dividends or share buybacks. The bank can still make previously announced payouts.

The Fed in April proposed changing the first, quantitative part of future stress tests. Under the proposed process, if the Fed decides a bank's capital levels are low, the bank would face a higher capital requirement during the following year. To comply, bankers may have to limit shareholder payouts -- the same effect as failing the test today, but with a less explicit public rebuke.

The second piece of the Fed's pass-fail system also is fading. In 2017, the Fed stopped issuing qualitative grades to banks with less than $250 billion in total assets and less than $75 billion in assets in nonbank businesses. As a result, about half of the 35 firms taking this year's tests don't face the qualitative grade.

Fed officials haven't proposed scrapping the qualitative grade for the largest banks, including global behemoths such as Wells Fargo & Co. and Deutsche Bank AG, whose U.S. unit is subject to the stress tests. But they intend to do so.

Fed Chairman Jerome Powell said last year, before he took the central bank's helm, that banks have made progress and "we're getting to the point where qualitative supervision of risk management can no longer be part of the stress test." Fed Vice Chairman for Supervision Randal Quarles said in April this "is something we should consider."

Fed officials can still put pressure on banks; they just wouldn't do so as publicly.

The banking industry has praised some aspects of the proposed changes and criticized others.

Two former Fed economists at the Clearing House Association of large banks in May called the Fed's quantitative proposal "a clear improvement" that nevertheless "makes capital requirements very **volatile**," because the test results fluctuate from year to year.

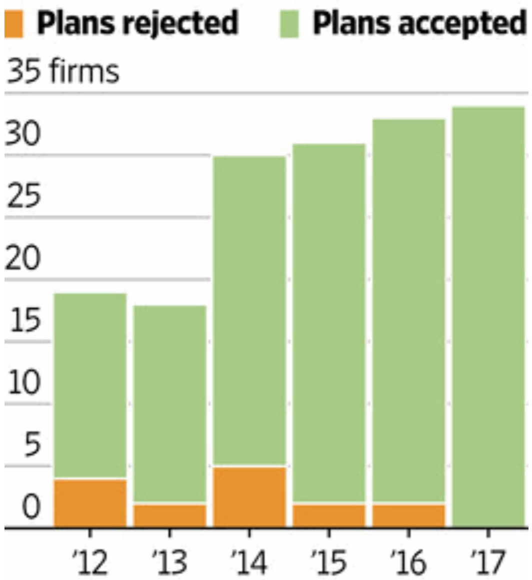
The Fed is reviewing public comments on the draft quantitative changes, which officials hope to implement for the 2019 exams. That would mean next year's tests include only pass-fail grades based on subjective factors, not banks' numerical scores.

Next year's tests may also include fewer firms with less than $250 billion in assets, as the Fed acts on new congressional authority to exempt those banks from the tests entirely.

That would leave the largest banks taking the 2019 tests, with the Fed still able to fail them for subjective reasons. Fed officials haven't said when they intend to stop issuing pass-fail grades to those firms.

Low Stress

Since 2014, when five of 30 banks failed, nearly all banks have passed the Fed's exams.



Source: Federal Reserve

THE WALL STREET JOURNAL.

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THE WALL STREET JOURNAL.
U.S. EDITION

U.S. Warns Countries To Stop Iran Oil Imports

By Ian Talley
914 words
27 June 2018
The Wall Street Journal
J
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English

WASHINGTON -- The U.S. threatened to slap sanctions on countries that don't cut oil imports from Iran to "zero" by Nov. 4, part of the Trump administration's push to further isolate Tehran both politically and economically, a senior U.S. State Department official said.

Buyers of Iranian crude had expected the U.S. would allow them time to reduce their oil imports over a much longer period, by issuing sanctions waivers for nations that made significant efforts to cut their purchases. That expectation was partly based on previous comments from top Trump officials, as well as the Obama administration's earlier effort to wean the world off Iranian oil over several years.

But the senior official said on Tuesday that President Donald Trump's administration doesn't plan to issue any waivers and would instead be asking other Middle Eastern crude exporters over the coming days to ensure oil supply to global markets.

The tactic is likely to further escalate geopolitical tensions between the U.S. and other nations as the Trump administration pits itself against allies and other major economies over its nearly unilateral policy toward Iran and a host of challenges on trade.

Oil prices immediately jumped on the news, with West Texas Intermediate crude for August delivery ending 3.6% higher at $70.53 a barrel on the New York Mercantile Exchange. That marked the highest level since May, when the White House said it would pull out of the 2015 Iran nuclear accord -- which the U.S. and other major countries reached with Tehran to curb its nuclear development -- and would reimpose crushing sanctions on one of the world's largest oil suppliers.

"We will certainly be requesting that their oil imports go to zero without question by Nov. 4th," the official said of other countries' purchases of Iranian oil. While the administration won't rule out issuing sanctions waivers in the future, the official said, its predisposition is: "No, we're not going to do waivers."

"We view this as one of our top national-security priorities," the official said.

The move is likely designed to spur greater global compliance with U.S. sanctions. Most major importers of Iranian crude have balked at Washington's new economic offensive against Tehran.

Two weeks ago, Andrew Peek, deputy assistant secretary of State for Iran and Iraq, said the U.S. was prepared to issue waivers if countries made major reductions in Iran oil imports. "It needs to be significant but will probably vary from country to country," he said then.

Top administration officials from the State and Treasury departments have jetted around the world in recent days to persuade other countries to cut use of Iranian crude and warn them that any companies, banks or traders that handle Iranian oil face U.S. penalties, including the risk of being frozen out of U.S. markets. The senior State Department official said allies in Europe and Asia already had been warned, and trips to China, India and Turkey were in the works.

Governments are being cautioned that Secretary of State Mike Pompeo and the White House "aren't kidding about this," the official said. China and India, two of the largest buyers of Iranian crude, "will be subject to the same sanctions that everybody else is if they engage in those sectors of the economy."

The Trump administration, in pulling out of the nuclear accord and reimposing sanctions on Iran that hit not just the oil sector, but also the banking, shipping, trade and insurance markets, said it wants to force Tehran to radically overhaul its nuclear and military posture in the region.

Banks' reluctance to deal with Iran is already taking its toll on Tehran's oil exports. Exports have fallen to an average of 2.2 million barrels a day this month, compared with 2.7 million barrels a day in May, according to data from London consulting firm Vortexa.

European refiners, which buy around a third of Iran's oil exports, are also dropping out. Italy's Saras is considering no longer buying Iranian oil because its banks don't want to finance such trades even before the Nov. 4 deadline, according to company officials. The company said last week it had made no final decision. European refiners say they have already started buying more oil from Saudi Arabia, Russia and Iraq to make up for upcoming reductions in Iranian oil.

Meanwhile, economic woes have triggered a new round of protests in Iran, posing a challenge to President Hassan Rouhani's government as it struggles to tackle persistent inflation and unemployment.

Mr. Pompeo warned last month that Tehran would face "the strongest sanctions in history" if it didn't yield to U.S. demands that it temper its nuclear and regional ambitions. He also suggested the Iranian public could take matters into its own hands.

The administration's more aggressive stance on sanctions could bolster its leverage over Tehran, but it also complicates the White House's other diplomatic and political priorities.

The move puts particular pressure on major trans-Atlantic allies that import hefty amounts of crude from Iran at a time when Mr. Trump is ratcheting up tensions with European nations over trade and seeking their support for his other foreign-policy goals.

Benoit Faucon, Laurence Norman and Michael R. Gordon contributed to this article.

Clamping Down

Iran's oil exports were beginning to recover after the lifting of sanctions under the 2015 nuclear deal. New U.S. sanctions, which include prohibitions on Iranian oil exports, could reverse those gains. Oil prices rose Tuesday on news the administration plans to ban all foreign purchases of Iranian crude in November.

*Includes condensates Sources: OPEC; U.S. Energy Information Administration; WSJ Market Data Group THE WALL STREET JOURNAL.

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WSJ PRO CENTRAL BANKING

Economy
CBO Sees Record Interest Costs | The Fed's Latest Challenge | Yuan at Six-Month Low | BOE Warns of Growing Risks | Hannon's Take: The ECB and Underlying Inflation; The Wall Street Journal's central banking newsletter for Wednesday, June 27, 2018

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Hannon's Take: The ECB and Underlying Inflation

CBO: Rising Interest Would Increasingly Pressure U.S. Government Finances

The Fed's Latest Challenge: Keeping Benchmark Rate in Check

China Sends Yuan to Six-Month Low Against Dollar

BOE Warns of Growing Risks to Global Debt Markets

The ECB and Underlying Inflation

If the forecasters are right, figures to be released Friday will show eurozone inflation is at or above the European Central Bank's target for the second straight month in June, the first time that has happened in over five years.

While undoubtedly a step in the right direction for policy makers, there is still some way to go before they can celebrate victory in their long struggle to first eliminate the threat of deflation and then fulfill their mandate.

Economists surveyed by The Wall Street Journal expect the European Union's statistics agency to report that consumer prices are 2% higher this month than a year earlier, following a jump in annual inflation to 1.9% in May from 1.2% in April.

The ECB aims to keep inflation close to, but just below 2%. The last time inflation was at or above the target for two straight months was back in early 2013. So on the face of it, policy makers have won.

Except that what they are really concerned about is inflation over the medium term, and not the month-to-month changes in a highly **volatile** measure that has mostly moved around because of **oil prices**, over which policy makers have negligible influence.

But while ECB President Mario Draghi never tires of referring to this "underlying inflation" in his speeches and news conferences, it isn't exactly clear what measure he is referring to.

ECB economists have published a guide to the various ways in which underlying inflation is understood by policy makers, concluding that none is clearly better than the others in all circumstances.

What they all have in common is a good deal of stability over the past few years, while the headline rate has shifted around. Whether it is the headline measure excluding energy, food, travel-related items, clothing and footwear; "Supercore"; or the so-called Persistent and Common Component of Inflation, not much has happened, or seems to be happening.

They are all hovering around 1%. Which is some way away from where the ECB wants them to be. This is what Mr. Draghi refers to when he says that measures of underlying inflation "remain generally muted."

What has yet to happen is what Mr. Draghi says he is increasingly confident will happen: a pickup in underlying inflation.

Key Developments Around the World

CBO: Rising Interest Would Increasingly Pressure U.S. Government Finances

Rising interest rates will push U.S. government interest payments to record levels in the coming decades, the Congressional Budget Office said Tuesday. In its annual long-term budget report, CBO said an improving economy and rising levels of federal debt would push debt payments from 1.6% of the gross domestic product in 2018 to 3.1% in 2028 and 6.3% in 2048, which would be the highest level ever. At that point, interest payments would equal spending on Social Security.

The Fed's Latest Challenge: Keeping Benchmark Rate in Check

The Federal Reserve recently tweaked how it sets short-term interest rates in an effort to keep them from drifting too high—but an increase in its benchmark raises questions about its ability to keep borrowing costs in check. The Fed's benchmark federal-funds rate, which sits in a target range of between 1.75% and 2%, is creeping closer to its ceiling despite an adjustment at the central bank's last meeting that was designed to keep it closer to the middle. The benchmark now sits at 1.92%, and the Fed would like to see it closer to its 1.875% midpoint.

China Sends Yuan to Six-Month Low Against Dollar

China's central bank guided the yuan to a six-month low against the U.S. dollar on Wednesday, sending the Chinese currency tumbling once trading began minutes later. The People's Bank of China set the dollar's reference rate at 6.5569 yuan, which meant the yuan was 0.6% lower than the day before—its biggest drop since Jan. 9, 2017. The so-called fix, which reflects the previous day's close and the movement of currencies overnight, put the yuan at its weakest level since Dec. 25.

BOE Warns of Growing Risks to Global Debt Markets

The Bank of Englandsounded an alarm Wednesday over global debt markets, saying it sees pockets of risk to the stability of the financial system in places ranging from U.S. corporate borrowing to risky loans in Britain to foreign-currency lending to emerging markets. The BOE's warning comes as the global economy faces multiple challenges, as major central banks led by the U.S. Federal Reservestep back from the easy-money policies of the past decade and as trade tensions escalate.

Banks Are Playing Chicken With Brexit

There is a serious game of chicken going on in European finance and each side just told the other they need to blink.The face-off is between banks and European authorities over how far banks should prepare for Brexit. It is a classic moral-hazard problem: Banks seem to be hoping that politicians will be forced to give them a pass because finance is too important to suffer major disruption. But the European Banking Authority, which writes the rules, and the European Central Bank's regulatory arm, which enforces them, both warned banks this week that time was running out.

Brazil's Central Bank Says May Truckers Strike Complicates Reading of Economy

Brazil's central bank said Tuesday it will monitor how the economy recovers from a disrupting truckers strike amid global trade tensions before deciding whether to raise rates in the near future. Last month's 10-day stoppage blocked highways and prevented deliveries of goods around the country, and its effects could still hurt June's economic growth, the bank said in minutes to last week's meeting, when it left its benchmark lending rate unchanged at 6.5%, a historic low. The bank's monetary-policy committee concluded that both the truckers strike and recent currency **volatility** are likely to fuel inflation, but said that for now rates should remain low as activity is below expectations.--Dow Jones Newswires

Wednesday

7 a.m. EDT

Czech National Bank releases policy statement

11 a.m. EDT

Federal Reserve's Quarles speaks

12:30 p.m. EDT

Boston Fed's Rosengren speaks

3:15 p.m. EDT

Bank of Canada's Poloz speaks

5 p.m. EDT

Reserve Bank of New Zealand releases policy statement

Thursday

N/A

Bank Indonesia releases policy statement

N/A

Federal Reserve releases individual firms' stress test results

N/A

Central Bank of Egypt releases policy statement

9:30 a.m. EDT

Bank of England's Haldane speaks

10:45 a.m. EDT

St. Louis Fed's Bullard speaks

Resolving "Too Big to Fail"

Nicola Cetorelli and James Traina find in a Federal Reserve Bank of New York report that ""living will" regulation increases a bank's annual cost of capital" by 10% of the bank's total funding cost. "This effect is stronger in banks that were measured as systemically important before the regulation's announcement. We interpret our findings as a reduction in "too big to fail" subsidies. The size of this effect is large: a back-of-the-envelope calculation implies a subsidy reduction of $42 billion annually," they write.

The Bank of England Future-Proofs Itself

The Bank of England "will now have an explicit target for its own capital, or what we should strictly call "equity" — the difference between its assets and its liabilities... If equity falls below the floor, the government will ensure that it is rapidly restored, possibly through a recapitalisation — in plain words, a transfer of taxpayer money," Martin Sandbu writes for the Financial Times. "It is a great paradox that when central banks worry about risk to their own balance sheet, they are led to act procyclically (or insufficiently countercyclically) and therefore reinforce risk (or fail to reduce it enough) in the economy as a whole. It is bad for financial and economic stability when central bankers think of themselves as just bankers. The BoE is far from alone in this; but it is a shame to have codified this error in an explicit policy framework."

An index measuring manufacturing activity across the central Atlantic region continued to expand in June, according to a report released Tuesday. The Federal Reserve Bank of Richmond's composite manufacturing index increased from 16 in May to 20 in June, its highest value so far this year, as shipments, new orders and employment all increased. There was also an increase in the backlog of orders.

Argentina President Mauricio Macri passed a big test with global investors after his policy responses helped stem the peso's slide and enabled the country to rejoin a popular emerging markets index, attracting foreign capital back to the market.

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

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The New York Times

Business/Financial Desk; SECTB
A Recession Signal Is Flashing Yellow

By MATT PHILLIPS
1,243 words
27 June 2018
The New York Times
NYTF
Late Edition - Final
1
English

You can try to play down a trade war with China. You can brush off the impact of rising **oil prices** on corporate earnings.

But if you're in the business of making economic predictions, it has become very difficult to disregard an important signal from the bond market.

The so-called yield curve is perilously close to predicting a recession -- something it has done before with surprising accuracy -- and it's become a big topic on Wall Street.

Terms like ''yield curve'' can be mind-numbing if you're not a bond trader, but the mechanics, practical impact and psychology of it are fairly straightforward. Here's what the fuss is all about.

First, the mechanics.

The yield curve is basically the difference between interest rates on short-term United States government bonds, say, two-year Treasury notes, and long-term government bonds, like **10**-**year Treasury** notes.

Typically, when an economy seems in good health, the rate on the longer-term bonds will be higher than short-term ones. The extra interest is to compensate, in part, for the risk that strong economic growth could set off a broad rise in prices, known as inflation. Lately, though, long-term bond yields have been stubbornly slow to rise -- which suggests traders are concerned about long-term growth -- even as the economy shows plenty of vitality.

At the same time, the Federal Reserve has been raising short-term rates, so the yield curve has been ''flattening.'' In other words, the gap between short-term interest rates and long-term rates is shrinking.

The gap between two-year and 10-year United States Treasury notes is roughly 0.34 percentage points. It was last at these levels in 2007 when the United States economy was heading into what was arguably the worst recession in almost 80 years.

As scary as references to the financial crisis sound, flattening alone does not mean that the United States is doomed to slip into another recession. But if it keeps moving in this direction, eventually long-term interest rates will fall below short-term rates.

When that happens, the yield curve has ''inverted.'' An inversion is seen as ''a powerful signal of recessions,'' as the president of the New York Fed, John Williams, said this year, and that's what everyone is watching for.

Every recession of the past 60 years has been preceded by an inverted yield curve, according to research from the San Francisco Fed. Curve inversions have ''correctly signaled all nine recessions since 1955 and had only one false positive, in the mid-1960s, when an inversion was followed by an economic slowdown but not an official recession,'' the bank's researchers wrote in March.

Even if it hasn't happened yet, the move in that direction has Wall Street's attention.

''For economists, of course it's always been traditionally a very good signal of directionality of the economy,'' said Sonja Gibbs, senior director of capital markets at the Institute of International Finance. ''That's why everyone is bemoaning the flattening of the yield curve.''

Recession? Really?

Sure, it seems like a strange time to be worried about recession. Unemployment is at an 18-year low, corporate investment is picking up steam, and consumer spending shows signs of rebounding.

Some economists on Wall Street think the economy could be growing at around a nearly 5 percent annualized clip this quarter. But if the current economic vigor is only reflecting a short-term stimulus coming from the Trump administration's tax cut, then some kind of slowdown is to be expected.

''It's very hard to see what's going to goose the economy further from these levels,'' Ms. Gibbs said.

And the **financial markets** can sometimes sniff out problems with the economy before they show up in the official economic snapshots published on G.D.P. and unemployment. Another notable yield curve inversion occurred in February 2000, just before the **stock market**'s dot-com bubble burst.

In that sense, the government bond market isn't alone. Stocks have been in a sideways struggle since the **Standard & Poor's 500-stockindex** last peaked on Jan. 26. Returns on corporate bonds are negative, as are some key commodities tied to industrial activity.

An important caveat to the predictive power of the yield curve is that it can't predict precisely when a recession will begin. In the past the recession has come in as little as six months, or as long as two years, after the inversion, the San Francisco Fed's researchers note.

In other words, there's a reason to look at the yield curve skeptically, despite its prowess at predicting recessions.

The new fear gauge.

As in all market moves, perceptions of its significance mean the yield curve can sometimes become a feedback loop.

If enough investors begin to grow concerned about a recession, they will most likely put more and more money into the safety of long-term government bonds. That buying binge would likely help flatten, or invert, the yield curve.

Then people will write articles about the curve's sending a stronger signal on recession. And that could, in turn, drive even more people to buy into long-term bonds. Rinse. Repeat.

There's also a practical impact.

But it's not just psychology. The yield curve helps determine some of the decisions that are the most crucial to the health of the American economy.

Specifically, the flattening yield curve makes banking, which is basically the business of borrowing money at short-term rates and lending it at long-term rates, less profitable. And if the yield curve inverts, it means lending money becomes a losing proposition.

Either way, the flow of lending is likely to be curtailed. And in the United States, where borrowed money is the lifeblood of economic activity, that can slam the brakes on economic growth.

The Fed's hand.

There is an argument to be made against reading too much into the yield curve's moves -- and it hangs on the idea that, rather than the free market, central banks have had a big influence on both the long-term and short-term rates.

Since the last recession, central banks bought trillions of dollars of government bonds as they tried to push long-term interest rates lower in order to lend a helping hand to the economy.

Even though they're reversing course now, central banks still own massive amounts of those bonds, and that may be keeping long-term interest rates lower than they would otherwise be.

Also, the Federal Reserve has been raising short-term interest rates since December 2015 and has indicated it will keep doing so this year.

So if long-term rates were pushed lower by central bank bond buying, and now short-term rates are being pushed higher as the Fed tightens its monetary policy, the yield curve has nowhere to go but flatter.

''In the current environment, I think it's a less reliable indicator than it has been in the past,'' said Matthew Luzzetti, a senior economist at Deutsche Bank.

CHARTS: Potentially Dire Signals: Economists and investors are watching the shrinking gap between interest rates on 2-year and 10-year U.S. government bonds -- known in the bond market as a flattening yield curve. (Source: Federal Reserve Bank of St. Louis)

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The New York Times

Business/Financial Desk; SECTB
Markets Inch Higher As Tech Companies Regain Their Footing

By THE ASSOCIATED PRESS
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27 June 2018
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5
English

U.S. stocks bobbed higher Tuesday as technology and consumer-focused companies regained a sliver of their losses from the day before. **Oil prices** and energy companies jumped as the United States pressed its allies to stop importing oil from Iran.

Coming off their worst loss since early April, stocks were on track for hefty gains Tuesday afternoon, but weakened late. Technology companies like Apple bounced back after abrupt losses on Monday. General Electric led industrial companies higher after it said it would shrink even further by spinning off its health care business and its oil service unit.

Banks and other financial companies took losses as bond yields and interest rates remained well off their highs from last month.

Julian Emanuel, chief equity and derivative strategist for the financial services firm BTIG, said the **stock market** will be **volatile** as long as investors concentrate on the trade disputes the United States is having with many of its biggest trading partners.

''The economy is strong as it stands now and earnings are great, but when all of the psychic energy and all of the focus is on the trade war, as it was in late March and early April, the market has responded accordingly,'' he said.

The **S**.**&P**. **500 index** gained 5.99 points, or 0.2 percent, to 2,723.06. The **Dow Jonesindustrial average** gained 30.31 points, or 0.1 percent, to 24,283.11. The **Nasdaq composite** added 29.62 points, or 0.4 percent, to 7,561.63. The Russell 2000 index picked up 11.02 points, or 0.7 percent, to 1,668.53.

Mr. Emanuel said investors' decision to shift money into smaller companies might lead to headaches later on because those stocks are more **volatile** than the larger and more multinational companies in the **S**.**&P**. **500**.

''This whole notion of small caps being a safe haven is really a head-scratcher,'' he said.

A senior State Department official said the Trump administration wants allies to stop importing oil from Iran. If they do, it would increase demand from other countries, which would likely produce more oil to pick up the slack. Benchmark U.S. crude added 3.6 percent to $70.53 a barrel in New York. Brent crude, used to price international oils, rose 2.1 percent to $76.31 per barrel in London.

President Trump withdrew the United States from the Iran nuclear deal in May, so sanctions on Iran's energy sector will kick in again in November. The State Department official said the United States is telling Asian and European governments that they should eliminate their oil imports from Iran before the grace period expires on Nov. 4.

Exxon Mobil jumped 1.1 percent to $80.64, and Chevron picked up 1.3 percent to $124.16.

Apple climbed 1.2 percent to $184.43 and Facebook gained 1.3 percent to $199. Technology stocks were hammered Monday as investors reacted to reports that the Trump administration might bar technology companies from selling certain high-tech products to China and other countries and limit investment in tech companies by Chinese firms. Stocks recovered some of those losses after a top U.S. trade adviser rebutted those reports.

Consumer-focused companies also rose. Amazon jumped 1.7 percent to $1,691.09 and Netflix rose 3.9 percent to $399.39 after they both dropped on Monday. The homebuilder Lennar climbed 4.9 percent to $51.61 after a strong quarterly report.

G.E. jumped 7.8 percent to $13.74 after the company said it will sell its two-thirds stake in Baker Hughes and also divest its health care business. Tuesday was the first day in 110 years that General Electric wasn't part of the **Dow Jonesindustrial average**.

Bond prices were little changed. The yield on the **10**-**year Treasury** note remained at 2.88 percent.

This is a more complete version of the story than the one that appeared in print.

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Tuesday. (Source: Reuters)

Document NYTF000020180627ee6r00059

The New York Times

Foreign Desk; SECTA
Roiling Markets, U.S. Insists World Must Stop Buying Iranian Oil

By GARDINER HARRIS and STANLEY REED; Gardiner Harris reported from Washington and Stanley Reed from London.
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The United States said on Tuesday that it will impose sanctions against all importers of Iranian oil by Nov. 4, a surprisingly tough position that roiled oil markets and is likely to further alienate allies and adversaries alike.

The policy shook **financial markets** that had become accustomed to waivers for American sanctions that in years past had been granted to companies in countries like India and China as long as they showed steady reductions in their imports of Iranian oil.

But a senior State Department official said Tuesday morning that such routine waivers were not likely to be issued by the Trump administration, although he did not rule them out entirely.

Oil prices immediately rose on the news. The United States benchmark increased nearly 4 percent to $70.68 a barrel, while the international benchmark, Brent crude, rose 2.3 percent to $76.46 a barrel.

The Trump administration may be signaling an unusually tough position to gain leverage ahead of the first official meeting in Vienna of the remaining signatories to the Iran nuclear deal since President Trump announced in May that he was leaving the accord.

American diplomats will not participate in the Vienna talks, set for next week, since the United States is no longer a party to the deal. But senior Trump administration officials will talk with European diplomats on the sidelines of the meeting about efforts to further restrain Iran.

Sanctions experts expressed a mixture of bafflement and scorn at Tuesday's announcement. They noted that countries like India and China never entirely ended their imports of Iranian crude even before Tehran agreed to the 2015 nuclear accord.

Following Washington's withdrawal from the deal, European allies vowed to resist reimposing of sanctions. And in the midst of an increasingly bitter trade war with China, the likelihood that Beijing will entirely end its imports of Iranian oil is dubious, analysts said.

''They're going to go after the Central Bank of China just before the midterms?'' said Daniel Fried, a top White House and State Department official in the administration of President George W. Bush. ''The next day's headline will be: 'Dow Drops 5,000 Points.'''

Peter Harrell, a former sanctions official in the State Department, dismissed the idea outright. ''I don't see China and India going to zero,'' he said.

Next week's meeting in Vienna will come just two days after President Hassan Rouhani of Iran is expected to visit the Austrian capital to discuss the nuclear deal.

This month, European leaders applied for waivers to the renewed American sanctions against Iran, saying that preserving the agreement was vital to the security of their respective nations. Few expected the waivers to be granted, but Tuesday's abrupt announcement, which largely ruled them out, could cause further strains.

Briefing reporters on condition of anonymity, a top State Department official said that he had yet to visit India or China to discuss the re-imposition of sanctions.

But he said that companies in both countries that continue to buy oil and other products from Iran after Nov. 4 will be barred from selling anything in the United States. The official acknowledged that other nations rarely want to voluntarily end imports but do so to preserve their relationships with the United States.

European diplomats spent months negotiating a side agreement to the Iran deal with Brian Hook, a top State Department official, hoping such an agreement would persuade Mr. Trump to stay in the accord. In April, President Emmanuel Macron of France told Mr. Trump in the Oval Office that negotiations with Mr. Hook were about to yield a strong agreement. ''Who's Brian Hook?'' Mr. Trump responded, according to a person with knowledge of the exchange.

The failure of the nuclear negotiations, Mr. Trump's unusually combative posture at the recent Group of 7 meeting in Canada and his recent imposition of trade tariffs have left European allies weighing how far they can and should go to defy the United States. A growing number of large European companies have announced, however, that they intend to abandon Iran.

Mr. Trump said this month that his decision to pull out of the nuclear deal had already led Tehran to curb its aggressive behavior in the Middle East, a claim analysts largely dismissed. But an economic crisis that began late last year has only deepened as the threat of sanctions loom, with growing signs of discontent among Iranians.

Robert A. Pape, director of the University of Chicago's Project on Security and Threats, said that sanctions only work when a country's military suppliers participate in the effort. With Russia and China likely to continue to supply Iran with sophisticated hardware despite the sanctions, the Trump administration's efforts are not likely to succeed, he said.

''This is big stick diplomacy, and that has a long history of failure,'' Mr. Pape said.

On Wall Street, analysts said the coming months could see a series of price spikes in what is an increasingly tight oil market.

Iran has been exporting over 2 million barrels a day. With Venezuelan output in decline and sporadic cutoffs occurring in Libya and elsewhere, analysts estimated that there is now only two to three million barrels a day of so-called spare capacity.

''The spare capacity cushion could become very thin, if you take Iranian exports out,'' said Bhushan Bahree, an oil analyst at IHS Markit, a research firm.

Big oil producers were jockeying to deal with the new realities of the oil market at meetings between the Organization of the Petroleum Exporting Countries and other producers, like Russia, over the weekend in Vienna. The meetings appeared to mark the effective end of the 18 months of production cuts that have drained the oil glut and more than doubled prices from their lows in early 2016.

Saudi Arabia and its allies -- like Kuwait and the United Arab Emirates -- pushed for production increases. Iran resisted, but the Saudis and their allies prevailed.

Khalid al-Falih, the Saudi oil minister, said on Saturday that Saudi Arabia was already ramping up exports substantially. But analysts still predicted further price rises if Iran is entirely excluded from the market.

Katherine Bauer, a former Treasury Department official, said that countries are likely to balk at the Trump administration's maximalist posture.

''The risk is that you push countries to look for ways around sanctions,'' she said.

An Iranian oil field in the Persian Gulf. Analysts questioned the timing of more U.S. sanctions. (PHOTOGRAPH BY ATTA KENARE/AGENCE FRANCE-PRESSE -- GETTY IMAGES)

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The New York Times

Business/Financial Desk; SECTB
A Trade War Could Sink Companies On the Edge

By PETER EAVIS
635 words
27 June 2018
The New York Times
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Late Edition - Final
2
English

The strength of the United States economy, the theory goes, gives it an edge in a trade war.

Harley-Davidson shows how this assumption might break down in practice.

The motorcycle maker said this week that it would bear the cost of tariffs the European Union imposed in response to the ones Trump administration placed on steel and aluminum. And when Harley-Davidson said it would shift some production out of the United States to avoid Europe's tariffs, President Trump was quick to criticize the company.

It's the sort of situation any company would want to avoid, but these challenges were the last thing Harley-Davidson, which has grappled with years of falling sales, needed. And it demonstrates how trade frictions could end up having an outsize effect on any other American company that was struggling before hostilities broke out.

Harley-Davidson is vulnerable on several fronts. The Trump administration's metals tariffs are pushing up its costs. The European Union's tariffs on American motorcycles, raised in retaliation last week to 31 percent from 6 percent, added on average $2,200 to the cost of a Harley sold in the bloc, the company said. For now, Harley-Davidson said it was going to bear the additional expense itself, which could cost the company as much as $100 million a year.

As if that were not enough, the company may now lose sales among supporters of Mr. Trump. The president did not hold back in his criticism of the company and even suggested that prospective buyers might now back away. ''Customers are already very angry at them,'' Mr. Trump wrote on Twitter.

If Mr. Trump's comments do drive down demand, it would only make Harley-Davidson's long-standing problems worse.

As tastes change, fewer people are buying Harley's motorcycles -- a trend that shows few signs of changing. Last year, Harley-Davidson sold 148,000 motorcycles in the United States, by far its biggest market, down more than 8 percent from 162,000 in 2016. To make up for falling domestic sales, the company has been trying to bolster its international business, with some success in recent years. But last year, overseas sales came in below the company's expectations, falling 4 percent from 2016. And those sales struggles have weighed on Harley's work force. The company expected to shed 800 jobs with the closure of a plant in Kansas City, Mo., while adding 450 at its main plant in York, Pa.

Harley's weakness is reflected in its **stock price**. With a quintessentially American brand and an important niche in the United States manufacturing sector, Harley might have been expected to participate in the **stock market** rally that took place after Mr. Trump was elected. But the company's stock is down 28 percent since then, compared with a 27 percent gain for the **Standard & Poor's 500**-**stockindex**.

Harley-Davidson may, of course, be citing the tariffs as a reason for moving more operations overseas when it was already planning to do so. Its foreign operations are still small compared with those in the United States, but they are a crucial part of its efforts to grow. Well before the European Union tariffs came into effect, Harley-Davidson was investing significantly overseas, most recently a plant in Thailand expected to begin production this year.

The buoyant **stock market**, rosy economic statistics and the earnings kick from the recent tax cuts all might give the impression that American companies can power through a trade war. But Harley shows why that might not always be the case.

This is a more complete version of the story than the one that appeared in print.

Document NYTF000020180627ee6r00046

THE WALL STREET JOURNAL.

CT-Markets
美國股市下挫，貿易戰擔憂擾動市場

Akane Otani
1,358 words
26 June 2018
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華爾街日報中文版 (繁體)
WSJCT
Chinese - Traditional

周一美國股市一度大幅下挫，但尾盤收復部分失地，
投資者在努力解讀白宮高級官員就中美貿易政策前景釋放出的相互矛盾的資訊。

美國主要股指早盤下挫，
因白宮與中國政府的最新一輪交鋒加劇了投資者對爆發全面貿易戰的擔憂。科技股跌幅尤其大，
納斯達克綜合指數一度跌近3%。

不過在交易的最後一個小時股市突然收復部分失地，此前白宮貿易顧問納瓦羅(Peter
Navarro)在接受CNBC採訪時表示，沒有對中國或其他國家立即實施投資限制的計劃。當天早些時候美國財政部長姆努欽(Steven
Mnuchin)發表推文，否認限制投資政策是針對中國，稱這些限制將針對所有企圖竊取美國技術的國家。

這種反覆令本就不安的投資者無所適從。

BMO Global Asset Management股票部門負責人Ernesto
Ramos稱，鑑於一些類股的估值水平和人們聽到的言論，
他認為不涉足市場中風險最高的一些領域將是審慎的。他還表示，他所在公司已經全面採取措施保護其持倉，
但將等待貿易政策實際發展的具體情況來確定如何對待具體股票。

道瓊斯指數周一盤中一度下跌約500點，之後收復部分失地，收盤跌328.09點，至24252.80點，跌幅1.3%。標普500指數跌37.81點，至2717.07點，跌幅1.4%。科技股為主的納斯達克綜合指數跌160.81點，至7532.01點，跌幅2.1%。標普500指數和納斯達克指數均創4月初以來最大單日跌幅。

有報道稱美國可能考慮限制外資對美國科技公司的投資，這加劇了投資者的不安，
擔心限制性貿易政策可能將不僅影響汽車製造商和工業企業。

周一之前，在工業和農業股大跌時，科技股表現相對堅挺。分析師稱，這反映出投資者押注，
面對中國和歐盟對美國加征的關稅，科技公司受到的衝擊將最小。

然而，周一的下跌表明了上述假設是不牢靠的。今年迄今取得巨大漲幅的一些科技股重挫：Netflix
(NFLX)跌6.5%，錄得2016年7月以來最大單日跌幅；Facebook (FB)跌2.7%；亞馬遜(Amazon.com Inc.,
AMZN)跌3.1%；英偉達(Nvidia co., NVDA)跌4.7%。

Ramos表示，長時間表現強於大盤後的科技股正面臨某種"完美風暴"。

科技行業海外銷售規模龐大同時依賴全球供應鏈,標普500指數科技成分公司約58%的收入來自海外。根據FactSet數據,這是該指數全部11個類股中最高的。

全球投資者對美中貿易戰全面爆發的前景感到不安。雖然到目前為止美國政府宣布徵收的關稅和中國的報復措還只施涉及一小部分商品,但分析師擔心緊張局勢可能會升級,並擴散到其它主要經濟體。

投資機構路博邁(Neuberger Berman)的股市首席投資長Joseph
Amato表示,貿易是投資者的主要關注點。但他補充說,市場對影響一小部分商品的關稅沒有那麼擔心,
更擔心的是中國採取的其它報復措施。

許多公司已對緊張貿易關係可能如何影響利潤發出警告。德國汽車生產商戴姆勒公司(Daimler AG)上周稱,中國對美國生產的進口汽車徵收報復性關稅將衝擊其銷售額和利潤。上周戴姆勒股價下跌近10%,追蹤汽車股的全球基金First Trust Nasdaq Global Auto Index Fund下跌7%。

其它公司對貿易關稅將如何影響利潤不是那麼清楚,但一些高管表示,任何限制措施都可能侵蝕利潤率並妨礙業務活動。

Pioneer Natural Resources Co.首席執行長Timothy Dove上周在一個會議上表示，鋼鐵關稅以及中國的報復威脅將大大推高該公司成本並抑制銷售。Dove之前曾表示，對事態的發展方向不是非常樂觀。

與此同時，英格索蘭公司(Ingersoll-Rand Company, IR)首席執行長Michael Lamach上周在瑞銀(UBS)的一個行業會議上表示，貿易格局正發生改變，客戶們已經開始詢問未來的遊戲規則將是什麼樣的。

周一的拋售拖累全球股指走低，歐洲斯托克600指數重挫2%，創下3月份以來最大單日跌幅。上證綜指創2016年6月以來最低收盤水平。香港恒生指數創去年12月以來最低收盤點位。

最近歐洲和中國出爐的數據顯示經濟增速較2018年初放緩，這進一步打擊了投資者信心。周一，Ifo商業經濟景氣指數顯示德國6月份企業信心進一步惡化。

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THE WALL STREET JOURNAL.

CN-Markets
美国股市下挫，贸易战担忧扰动市场

Akane Otani
1,358 words
26 June 2018
09:25 PM
华尔街日报中文版 (简体)
WSJCN
Chinese - Simplified

周一美国股市一度大幅下挫，但尾盘收复部分失地，投资者在努力解读白宫高级官员就中美贸易政策前景释放出的相互矛盾的信息。

美国主要股指早盘下挫，因白宫与中国政府的最新一轮交锋加剧了投资者对爆发全面贸易战的担忧。科技股跌幅尤其大，纳斯达克综合指数一度跌近3%。

不过在交易的最后一个小时股市突然收复部分失地，此前白宫贸易顾问纳瓦罗(Peter Navarro)在接受CNBC采访时表示，没有对中国或其他国家立即实施投资限制的计划。当天早些时候美国财政部长姆努钦(Steven Mnuchin)发表推文，否认限制投资政策是针对中国，称这些限制将针对所有企图窃取美国技术的国家。

这种反复令本就不安的投资者无所适从。

BMO Global Asset Management股票部门负责人Ernesto Ramos称，鉴于一些类股的估值水平和人们听到的言论，他认为不涉足市场中风险最高的一些领域将是审慎的。他还表示，他所在公司已经全面采取措施保护其持仓，但将等待贸易政策实际发展的具体情况来确定如何对待具体股票。

道琼斯指数周一盘中一度下跌约500点，之后收复部分失地，收盘跌328.09点，至24252.80点，跌幅1.3%。标普500指数跌37.81点，至2717.07点，跌幅1.4%。科技股为主的纳斯达克综合指数跌160.81点，至7532.01点，跌幅2.1%。标普500指数和纳斯达克指数均创4月初以来最大单日跌幅。

有报道称美国可能考虑限制外资对美国科技公司的投资，这加剧了投资者的不安，担心限制性贸易政策可能将不仅影响汽车制造商和工业企业。

周一之前，在工业和农业股大跌时，科技股表现相对坚挺。分析师称，这反映出投资者押注，面对中国和欧盟对美国加征的关税，科技公司受到的冲击将最小。

然而，周一的下跌表明了上述假设是不牢靠的。今年迄今取得巨大涨幅的一些科技股重挫：Netflix (NFLX)跌6.5%，录得2016年7月以来最大单日跌幅；Facebook (FB)跌2.7%；亚马逊(Amazon.com Inc., AMZN)跌3.1%；英伟达(Nvidia co., NVDA)跌4.7%。

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全球投资者对美中贸易战全面爆发的前景感到不安。虽然到目前为止美国政府宣布征收的关税和中国的报复措还只施涉及一小部分商品,但分析师担心紧张局势可能会升级,并扩散到其它主要经济体。

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许多公司已对紧张贸易关系可能如何影响利润发出警告。德国汽车生产商戴姆勒公司(Daimler AG)上周称,中国对美国生产的进口汽车征收报复性关税将冲击其销售额和利润。上周戴姆勒股价下跌近10%,追踪汽车股的全球基金First Trust Nasdaq Global Auto Index Fund下跌7%。

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与此同时，英格索兰公司(Ingersoll-Rand Company, IR)首席执行长Michael Lamach上周在瑞银(UBS)的一个行业会议上表示，贸易格局正发生改变，客户们已经开始询问未来的游戏规则将是什么样的。

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THE WALL STREET JOURNAL.

Markets
The Scariest Place for Investors in a Trade War; Investor concern rises as Europe risks getting caught in the crossfire of the U.S.-China spat

By Riva Gold
1,061 words
26 June 2018
10:41 AM
The Wall Street Journal Online
WSJO
English

As the U.S. and China risk a trade war, investors worry Europe could be a major casualty.

Global stocks have been whipsawed in recent sessions as investors grapple with conflicting signals from senior officials in the Trump administration on future trade policy between the world's two biggest economies.

Many investors have already started selling Europe, concerned that trade frictions could dent a fragile economic recovery in a region heavily exposed to international trade. In recent weeks, investors have withdrawn billions of dollars from European equity and bond funds. Export-intensive sectors have taken a drubbing, with the region's auto stocks down 11% over the past month—now standing within 1% of a **bear market**—while the wider Stoxx Europe 600 index has fallen 3.3%.

Europe is exposed to a series of direct and indirect trade costs, investors say. The U.S. has already placed tariffs on European steel and aluminum and investors worry the same could happen to cars, a key driver of Germany's export engine.

Even if Europe can avoid direct tariffs, the global supply chains that its companies rely upon for components could be hit as the U.S. and China target each other's products.

Goods and services exports make up 27% of the euro area's gross domestic product, compared with 12% for the U.S. and 21% for China, according to data from the European Central Bank.

If China and the U.S. do enter a trade war, any effect on their economies will be felt in Europe. Both make up Europe's biggest export markets.

"Europe is very sensitive to trade and to the global economy," said Thomas Costerg, economist at Pictet Wealth Management." Europe is always caught in the crossfire," and always suffers more when there is a hit to global growth, he said.

What appeared to start as a China-oriented U.S. trade agenda has already spilled into direct confrontation with Europe. After the Trump administration imposed metals tariffs in Europe and elsewhere, the EU retaliated by placing tariffs on many U.S. products such as Harley-Davidson motorcycles and bourbon.

For investors, an unexpected profit warning from Daimler AG last week really hit home the direct risks to Europe. The German car manufacturer said that Chinese retaliatory import duties on vehicles built in the U.S. would hit sales and profits. The European auto sector fell for seven straight sessions through Monday.

"We think that the warning from Daimler […] is a line in the sand," said Barbara Reinhard, head of asset allocation at Voya Investment Management. Initial trade tensions were more focused on narrow corners of the U.S. market, but autos are much more global in nature and would likely hit Europe harder, she said.

So far in June, shares of Italian-American Fiat Chrysler Automobiles, which generates 53% of its revenues in the U.S. according to FactSet, have fallen 15%, while Volkswagen AG and Bayerische Motoren Werke AG have each lost 8.7%. The auto sector makes up 14% of Germany's benchmark DAX index.

Bank of America Merrill Lynch estimates that U.S. car tariffs at 25% could lower euro area GDP by at least 0.3%, excluding any second-round effects on investor confidence, business spending and changes in other export markets.

But it isn't only Europe's cars that have deep ties to the U.S. and China. Those two countries make up a combined 24% of the Stoxx Europe 600's revenues according to FactSet, meaning the index is exposed to any slowdowns in their economies.

Investors are betting this could hurt the region's corporate profits. Fund managers withdrew around $17 billion from European equities in May and June and $8 billion from European bond funds, according to data from the Institute of International Finance and EPFR Global. U.S. assets now make up 58% of global fund portfolios- the highest since before the presidential election in 2016, according to the IIF data.

"A lot of the success of the European recovery has been based on strong export performance, particularly from Germany," said Chris Iggo, chief investment officer for fixed income at AXA Investment Managers.

"In Europe, one might expect some kind of bounce in [economic] activity, but that might not show through if firms are worried about the trade side and what that implies for investment and employment plans," he said.

Already, there are signs trade uncertainty is creeping into economic data. The eurozone's June manufacturing Purchasing Managers Index showed a decline for the export-reliant manufacturing sector to 55 from 55.5 in May, an 18-month low.

As expectations for growth and monetary policy diverge, the yield gap between 10-year German and U.S. government bonds last week closed at its highest since March 1989, according to Tradeweb and Thomson Reuters data.

To be sure, if the trade barbs remain squarely between the U.S. and elsewhere, some investors see opportunities for Europe to benefit.

If the EU takes a fairly neutral stance and remains free of punitive tariffs from both the U.S. and China, member states could benefit by substituting the two countries in each other's export markets, according to Alicia Garcia Herrero, chief economist for Asia Pacific at Natixis.

Companies exporting autos and chemical products in particular could benefit, she said.

But many investors are concerned the trade issues come at a time when the region's fractious politics make Europe more vulnerable and less able to unite in its response to increased trade tensions.

Simon Derrick, chief currency strategist at BNY Mellon, points to Germany's increasingly delicate coalition government, potential clashes between Brussels and Italy's new antiestablishment government and ongoing debates around Brexit.

"All this points to a far more fragile Europe," he said.

Write to Riva Gold at riva.gold@wsj.com

Related Reading

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* Daimler Issues Profit Warning as Chinese Tariffs Hit U.S.-Built SUVs

* Harley-Davidson to Shift Production

Document WSJO000020180626ee6q002jp

THE WALL STREET JOURNAL.

Markets

What a Summer Scorcher Means for Natural-Gas Prices; A hot June has pushed natural gas futures to their highest price since January

By Stephanie Yang
864 words
26 June 2018
06:44 PM
The Wall Street Journal Online
WSJO
English

Corrections & Amplifications

Teri Viswanath is managing director of natural gas analysis at S&P Global Platts. An earlier version of this article incorrectly said she works at PIRA Energy Group. (June 26, 2018)

Low supplies of natural gas could lead to higher prices this summer, as Americans begin to flip on their air-conditioning units, boosting demand for the energy source.

Stockpiles of natural gas—made plentiful by the U.S. shale boom—have become depleted after an extended winter this year increased demand for heating homes. Booming U.S. exports of gas also have absorbed excess inventories, and analysts say cheap prices have made it more popular for power generation, compared with more expensive sources like coal.

Natural gas consumption generally rises in the summer months as cooling needs drive energy demand. But this year, the amount of natural gas in storage started June at the lowest level since 2014 for that time of year, and the second lowest level in a decade.

Now, with weather forecasts into July showing hotter-than-average temperatures across the U.S., consumers could see a pop in prices. Already, a significantly hot month of June has pushed natural gas futures near the closely watched level of $3 a million British thermal units, recently hitting the highest price since January.

"As we get deep into summer months, we get **volatility**," said Nicholas Koutsoftas, a portfolio manager at Cohen & Steers. "Any deviation from the norm will cause big moves in the natural gas market."

Extreme cold in January led to record natural gas consumption and withdrawals from storage extended into April due to unseasonably cool weather. Now the amount of energy required to cool buildings in June is on track for its second highest level since 1981, according to Bespoke Weather Services.

It's a far cry from two years ago when the relentless growth of U.S. shale and mild weather produced a glut that sent gas prices tumbling to a 17-year low.

Traders are betting that the summer will end with significantly less natural gas in stock. On London's Intercontinental Exchange, EIA end-of-storage index futures indicate bets that October will end with about 3.525 trillion cubic feet of natural gas, which would be the lowest for that time since 2008, before shale flooded the U.S. with cheap energy.

"It's amazing what this market has absorbed to be here," said Jacob Meisel, chief weather analyst at Bespoke. "Temporarily, you could see weather exacerbate this further."

This comes as U.S. producers are churning out more natural gas than ever before. According to S&P Global Platts, U.S. dry gas production climbed to a record 78.2 billion cubic feet a day in May. The U.S. Energy Information Administration forecasts that number will rise even further to average 81.2 bcf/d in 2018.

One game-changer has been increasing demand overseas: U.S. companies are sending more natural gas abroad. Exports of liquefied natural gas nearly quadrupled last year to total more than 700 billion cubic feet, according to the EIA.

"U.S. producers are now relevant on the global stage and not just the local stage," said Dan Pickering, head of the asset-management arm of Tudor, Pickering, Holt & Co. "We've got a lot of supply, but we've got new demand sources."

As more export facilities start operations, traders are banking on growing shipments to help underpin the market. Earlier this year, natural gas prices for 2019 softened after Freeport LNG pushed back its expected start date, one illustration of how vital exports have become, analysts said.

"With the country now open to exports, you can't become too lean on these inventory levels," said Teri Viswanath, managing director of natural gas analysis at S&P Global Platts. "That certainly has caused the market to reconsider that laissez-faire attitude that traders took earlier in the season."

To be sure, a sustained rise in prices could reverse longer-term trends in consumption, and cooler-than-expected weather could also negate the need for additional power this summer.

And natural gas prices haven't surged higher because the market is still counting on producers to replenish stores ahead of another demand boost next winter. Shale drillers capitalizing on higher **oil prices** also could flood the market with more supply, as they produce more natural gas as a byproduct. Earlier this year, **volatility** in the natural gas market fell to a 22-year-low.

"There's a perception that supply growth will really help alleviate any constraints you may have seen with such low inventories," said Nina Fahy, head of North American natural gas at Energy Aspects.

As prices have stabilized near $3, some investors have regained confidence in U.S. natural gas producers. In the past three months, shares of companies Chesapeake Energy Corp. and Southwestern Energy Co. have gained 61% and 21%, respectively.

"There's a meaningful offset to the production growth that we're witnessing, and at some point the market's going to have to come to grips with this," said Zane Curry, an analyst at Mobius Risk Group.

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THE WALL STREET JOURNAL.

U.S. Markets
Markets

Dow Climbs, Powered by Oil Stocks; Sector gets lift from higher crude prices; GE rises 7.8%, biggest increase since 2015

By Gunjan Banerji
657 words
26 June 2018
07:36 PM
The Wall Street Journal Online
WSJO
English

Gains in shares of energy companies pushed U.S. stocks higher Tuesday.

Energy stocks rose with **oil prices** after a senior State Department official said the administration expects all countries to stop imports from Iran by November or risk sanctions.

The **Dow Jones Industrial Average** gained 30.31 points, or 0.1% to 24283.11. The **S&P 500** added 5.99 points, or 0.2%, to 2723.06 while the **Nasdaq Composite** rose 29.62 points, or 0.4%, to 7561.63.

Energy shares posted the biggest gains among the **S&P 500**'s 11 sectors, rising 1.4%. Chevron added $1.55, or 1.3%, to $124.16, while Exxon Mobil climbed 90 cents, or 1.1%, to 80.64 in the Dow industrials.

U.S. crude for August delivery climbed 3.6% to $70.53 a barrel, its highest close in more than a month.

Company-specific news also spurred stock moves Tuesday. General Electric climbed 99 cents, or 7.8%, to 13.74 in the wake of an announcement that it is to jettison its ownership in oil-services firm Baker Hughes and spin off its health-care unit in a strategy shift that will see it focus on power and aviation. It was the stock's biggest percentage increase since April 2015.

Shares of American Express lost 33 cents, or 0.3%, to 98.21 as the company said it was joining forces with Amazon.com to launch a credit card for small businesses.

Tuesday's moves marked a reprieve after trade concerns jolted markets Monday, dragging major U.S. indexes to their worst day in months.

Those worries eased following White House adviser Peter Navarro's Monday afternoon comments on CNBC that analysts said helped assuage fears of an all-out trade war.

Against that backdrop, Harley-Davidson announced plans late Monday to shift more production overseas to avoid European Union tariffs on motorcycles, imposed in response to Trump administration tariffs on European steel and aluminum. The motorcycle company's shares fell 25 cents, or 0.6%, to 41.32 Tuesday as President Donald Trump warned the company against the move, posting their fourth day of declines.

"Things coming out of Washington are causing the market to swing daily, if not hourly," said Randy Frederick, vice president of trading and derivatives at the Schwab Center for Financial Research.

Chinese President Xi Jinping recently remarked that his country would "punch back" against trade restrictions, further spooking investors already fearful of the prospect of a full-blown global trade war.

The Shanghai Composite Index entered a **bear market**, closing down 0.5% at a fresh two-year low.

The Chinese yuan declined 0.5% against the dollar, after hitting its weakest level this year Monday following remarks from the Chinese central bank that it would reduce the amount of cash it requires banks to hold in reserve, allowing them to boost lending.

The WSJ Dollar Index, which measures the U.S. currency against a basket of 16 others, rose 0.3%.

With the yuan under pressure in recent weeks, analysts have discussed the prospect of Beijing devaluing its currency in the event U.S. tariffs begin to squeeze the world's second-largest economy. Analysts were expecting the yuan to come under further pressure but weren't forecasting a repeat of 2016, when the currency fell 7% during the course of the year.

Some said the recent turbulence was here to stay, despite calmer markets on Tuesday.

"Protectionism and the dollar strength are driving the market right now," said Eddie Perkin, chief equity investment officer at Eaton Vance. "I think you might see a little bit of more **volatility**."

—Bob Davis and David Hodari contributed to this ar ticle.

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THE WALL STREET JOURNAL.

Markets

U.S. Treasury Yields Steady After Volatile Session; Investors worry escalating trade tensions could slow economic growth

By Danielle Chemtob
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26 June 2018
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The Wall Street Journal Online
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U.S. government bonds were little changed Tuesday as **financial markets** stabilized following a **volatile** session Monday.

The yield on the benchmark 10-year U.S. Treasury note settled at 2.882% compared with 2.875% Monday. Yields rise as **bond prices** fall.

Trading was muted after conflicting messages from within the Trump administration over trade policy jolted markets Monday, sending yields on short- and long term bonds lower and pressuring stocks around the world.

"The Treasury market isn't taking the day off, but it is just sort of trading quietly as it begins to think about the end of the quarter," said Jim Vogel, interest-rate strategist at FTN Financial.

Many investors and analysts are worried that an escalation in trade tensions could slow economic growth.

"Given that previous economic tailwinds appear to be fading and we now have trade-war-related headwinds building, I suspect that the market will quickly start to look through this part of the cycle and start to worry about what comes next," said Ian Lyngen, head of U.S. rate strategy at BMO Capital Markets.

Consumer confidence data released Tuesday could be one early sign that tighter trade policies may discourage spending, Mr. Lyngen said in a research note.

The Conference Board's index of consumer confidence fell in June, data showed Tuesday, due to a decline in its measure of expectations for the future. Economists surveyed by The Wall Street Journal had expected the index to rise in June.

The Treasury Department also auctioned $34 billion in two-year Treasury notes Tuesday, with investor demand near recent averages. The department will auction $36 billion in five-year notes Wednesday and $30 billion of seven-year notes Thursday.

Later this week, investors will be looking at economic reports including core personal-consumption expenditures, which measures inflation without the often **volatile** categories of food and energy prices.

Document WSJO000020180626ee6q00335

THE WALL STREET JOURNAL.

Metro Money
US

Want to Run a High-Flying Hedge Fund? Don't Be a Cheapskate; Whitney Tilson's successful hedge fund sputtered and closed. Now, he's teaching others how to avoid the mistakes he made

By Anne Kadet
932 words
26 June 2018
10:00 AM
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Last fall, after trailing the market for eight years, Whitney Tilson closed his once-highflying hedge fund. So what's he up to now? Teaching others how to start a hedge fund.

"I did it, and I screwed it up. So I can teach you both things. What to do, and what not to do," the 51-year-old recently told me.

His $2,000, one-day "How to Launch and Build an Investment Fund" seminar is pitched at stock pickers who didn't go to Harvard or intern at Goldman Sachs, said Mr. Tilson, who did go to Harvard and worked in the nonprofit sector before launching his fund, Kase Capital Management, from his Manhattan bedroom in 1999.

"There are super-talented investors who didn't come down that narrow track, and good luck getting a job in the hedge-fund industry if you didn't," he said.

His most recent seminar was held at the swanky New York Athletic Club on Central Park South in Manhattan. Most of the students on hand said they worked in finance, but their ranks included a fashion stylist, an aerospace engineer and a real-estate broker. There were 13 men and three women. Half were white.

"In 20 years of business, this is the most diverse room I've ever been in," Mr. Tilson said. "It's usually all guys who look like me!"

Mr. Tilson said he started his fund after enjoying success with his personal portfolio, including a big bet on AOL.

"I was a **bull-market** genius," he said. "I was so full of myself I decided to run other people's money."

He had several advantages: He was living rent-free in an apartment belonging to his wife's grandparents. And his wife, a lawyer, was earning six figures.

Don't try this at home, he advised, unless you have three years of living expenses in the bank.

Still, he noted, there are few barriers to starting a fund. He launched his own with $1.1 million raised from his parents and in-laws. He said he spent just $18,000 the first year on expenses such as a computer, cellphone and travel.

The morning's seminar presentation covered logistical issues such as how to choose a brokerage. When it comes to fees, Mr. Tilson recommended charging the usual 20% of returns plus a 1.5% management fee.

"It's an obscene and usurious fee structure, but it's the industry standard," he said. "Anything out of the norm and you waste half your time answering questions about your stupid-ass fees."

To raise one's profile, Mr. Tilson recommended taking informed but contrarian positions on hot topics. He made his name, in part, by predicting the housing bubble. CNBC called him "the Prophet."

He also made smart trades. Between 1999 and 2010, Kase Capital returned 184% compared with 2.6% for the **S&P 500**.

Investors came flocking. At his 2010 peak, Mr. Tilson had $200 million under management.

That performance should have attracted more business, he said. He regrets not hiring a marketing pro: "I was a stupid cheapskate in so many ways."

During the lunch break—chicken wraps, assorted salads, cookies—Bronx real-estate broker Ovan Morrison told me the seminar had inspired him to get serious about starting his own fund.

No one in his circle has $100,000 to invest, he said, but they likely would contribute smaller sums: "My mother will do it. My friends will do it."

"I feel like I've seen the promised land, being in this environment. And I can't turn back," Mr. Morrison said.

Student Eric Schleien said the class would have saved him a lot of effort had he attended before launching his own firm, Granite State Capital Management, three years ago.

"The investing aspect, I knew how to do that very well," he said. "But when it comes to operations, a lot was learning on the job."

No one shares the information Mr. Tilson presents, he said. "In this industry, they're very secretive."

After lunch, we got to the fun part: How to raise a billion dollars.

Start with friends and family, followed by high-net-worth individuals, Mr. Tilson said. The institutional money comes later.

Cultivate personal relationships with investors, he advised. Buy them gifts and bake them cookies. Give them your cellphone number.

Ugh. This business was sounding less fun by the minute.

The final topic was investor presentations and letters. Mr. Tilson showed examples of what not to do, including an investor update from a fund manager who went on for eight pages about his pet position. "If you're an obsessive lunatic, hide it from your investors," he advised.

I know what I'll be doing this summer: Not starting a hedge fund.

The father of three daughters, meanwhile, said he's happier these days, and is determined to avoid repeating his cheapskate mistakes with his new Manhattan-based venture, Kase Learning. He's hired three employees to manage and market his seminars, and has planned a global tour of 13 cities.

"I'm $700,000 in the hole right now, and burning," he said of his personal investment in his new business. "I hope I've got the tiger by the tail."

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THE WALL STREET JOURNAL.

Politics

Trump Steps Up Threats Against Harley-Davidson; Comments come after motorcycle maker said it plans to shift more production overseas

By Rebecca Ballhaus
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26 June 2018
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WASHINGTON—President Donald Trump warned Harley-Davidson Inc. that moving production overseas would mark "the beginning of the end" of the iconic brand, a day after the manufacturer said it planned to make more motorcycles abroad to avoid European Union tariffs.

"A Harley-Davidson should never be built in another country—never! Their employees and customers are already very angry at them," Mr. Trump wrote in a series of tweets Tuesday morning. "If they move, watch, it will be the beginning of the end—they surrendered, they quit! The Aura will be gone and they will be taxed like never before!"

Harley said making motorcycles abroad for sale in the EU would cut out tariffs officials there imposed last week. "Harley-Davidson motorcycles sold in the U.S. will continue to be made in the U.S.," Harley spokesman Michael Pflughoeft said on Tuesday.

Harley's shares were down about 0.7% by midday Tuesday, following a 6% fall on Monday.

The Milwaukee-based company already assembles motorcycles in Brazil and India from largely U.S.-made parts and plans to open a plant in Rayong, Thailand, later this year. International business has become increasingly important to Harley as sales have fallen at home.

Harley plans to initially absorb about half the cost of the 31% tariff EU officials imposed on its U.S.-made motorcycles, and shift production abroad over the next 18 months. The EU's tariffs were a response to levies the Trump administration imposed this spring on steel and aluminum from producers in Europe and elsewhere.

Mr. Trump said that when he met with Harley executives at the White House early in his administration, he "chided them about tariffs in other countries, like India, being too high."

He also suggested that the company was using EU tariffs as "an excuse" to shift production overseas. "Early this year Harley-Davidson said they would move much of their plant operations in Kansas City to Thailand. That was long before Tariffs were announced."

Harley has said its factory in Thailand will make motorcycles for sale in Asia, and that the closure of the Kansas City plant isn't related. But some union leaders said they, like Mr. Trump, believe Harley is using the trade strife to justify its plans to shift production abroad.

"He took the words right out of my mouth," said Joe Capra, a district representative for the International Association of Machinists union in Kansas City, where Harley plans to close a plant that employs about 800 people by 2019. "Harley-Davidson has been looking at taking jobs overseas for some time."

In his February 2017 joint address to Congress, Mr. Trump singled out Harley as a "great American company" and recounted a visit executives had made to Washington earlier that month, during which they displayed five motorcycles—"made in the USA"—on the White House lawn.

During that meeting, Mr. Trump said he asked executives how the company's international sales were faring. "They told me…that it's very hard to do business with other countries because they tax our goods at such a high rate," Mr. Trump recounted. "They weren't even asking for a change. But I am."

Harley Chief Operating Officer Michelle Kumbier said in a recent interview that tariffs were a barrier to its efforts to sell more motorcycles abroad. Harley wants to make half its annual sales abroad a decade from now, compared with about 40% currently.

"We believe in free and fair trade for us to be able to compete globally," Ms. Kumbier said. "It would be great if there wasn't any tariffs on either side. Products could just flow and compete on their own merit."

Mr. Trump on Tuesday defended his trade strategy. Speaking in a meeting with lawmakers at the White House, Mr. Trump said other countries were more willing to negotiate with the U.S. because of his tariffs.

"Without tariffs, you would never do that," he said. "We're the bank that everybody wants to steal from and plunder."

Some Harley dealers abroad said making Hogs outside the U.S. wouldn't dent their allure to riders.

"As long as they keep the engineering and the Americanism, I don't think it really matters," said Don Rutherford, managing director of West Coast Harley-Davidson near Glasgow, Scotland.

Michael Bolton, director of a United Steelworkers union district representing 1,100 Harley employees at the plant in Kansas City and two plants in Wisconsin, acknowledged that some of Harley's plans to add manufacturing capacity abroad would help get around tariffs in markets like India and Thailand.

But he cautioned Harley against taking the shift too far.

"The company built its reputation and image by making motorcycles here, and if the company wants to continue to market itself as an iconic American brand both at home and abroad, it needs to focus on U.S. production," Mr. Bolton said.

Doug Cameron and John D. Stoll contributed to this article.

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* Trade Rift Within White House Breaks Into the Open

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The New York Times

Business/Financial Desk; SECTB
Long Shadows of Trade War Spook Investors Into Sell-Off

By MATT PHILLIPS
474 words
26 June 2018
The New York Times
NYTF
Late Edition - Final
3
English

Investors have stopped not caring about a trade war.

For months, **financial markets** shrugged off the escalating language and the imposition of tit-for-tat tariffs between the Trump administration and the United States' most important trading partners, including Canada, Mexico, the European Union and China.

But in the past several trading sessions, that apathy has been replaced by what looks like mounting alarm about the prospect of a global race to erect trade barriers.

On Monday, the **Standard & Poor's 500-stockindex** fell sharply, ending the day down 1.4 percent, apparently spooked by signs that the growing trade war could have a negative impact on American companies. That decline, and similar ones in other benchmark indexes like the **Dow Jonesindustrial average**, came after the S.& P. slumped 0.9 percent last week.

''I think we're slowly slipping into a more serious stage in the trade war,'' said Ethan Harris, head of global economics research at Bank of America Merrill Lynch. ''People are beginning to realize there's no sign of de-escalation in sight.''

The sell-off is increasingly broad. Tech shares joined industrials in a sharp fall as American markets opened Monday, after reports that President Trump was considering restrictions on Chinese investments in American technology companies.

The tech-heavy **Nasdaq composite** index and the tech sector of the **S**.**&P**. **500** both fell more than 2 percent.

Semiconductor companies were especially hard hit.

The chip makers Micron Technology and AMD fell 6.9 percent and 4.4 percent. Intel dropped 3.4 percent. Concerns about the impact of a trade war seemed to be spreading to some giant tech companies, including Apple, Google's parent Alphabet, and Microsoft. Because of those companies' large sizes, moves in their stock prices have big impacts on **stock market** indexes.

Industrials also continued to respond poorly to the trade rancor. The **S**.**&P**. **500**'s industrial sector fell more than 1 percent, led by drops in American manufacturers like the aircraft maker Boeing and the machinery manufacturer Caterpillar, both of which have large and important markets in China.

Harley-Davidson shares dropped nearly 6 percent after the company announced it would be shifting some production to Europe to avoid European tariffs on its motorcycles.

The trade war was just one source of anxiety for investors. Among other causes of concern is the flattening of the so-called yield curve, which some worry could portend tough economic times ahead, even though the United States economy currently is robust.

This is a more complete version of the story than the one that appeared in print.

CHART: The **S**. **& P**. **500 Index**: Position of the **S**. **& P**. **500 index** at 1-minute intervals on Monday. (Source: Reuters)

Document NYTF000020180627ee6q0000k

THE WALL STREET JOURNAL.

Economy

CBO: Rising Interest Rates Would Increasingly Pressure Government Finances; Cites combination of higher interest rates, higher federal debt

By David Harrison
617 words
26 June 2018
05:58 PM
The Wall Street Journal Online
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Corrections & Amplifications

The Congressional Budget Office report said an improving economy and rising levels of federal debt would push federal debt payments from 1.6% of GDP in 2018 to 3.1% in 2028 and 6.3% in 2048. An earlier version of this article incorrectly set the 2018 percentage at 1.8%. The report also said the 2048 percentage would equal Social Security spending. An earlier version also erroneously said the 2048 percentage would exceed Social Security spending. (June 26)

Rising interest rates will put increasing pressure on government finances and push interest payments to record levels in coming decades, the Congressional Budget Office said Tuesday.

In its annual long-term budget report, CBO said higher borrowing costs and rising levels of federal debt would push debt payments from 1.6% of the gross domestic product in 2018 to 3.1% in 2028 and 6.3% in 2048, which would be the highest level ever. At that point, interest payments would equal spending on Social Security.

Those payments would help push overall federal spending to 29% of GDP for the first time since World War II.

Rising levels of debt have long been a concern to policy makers. But low interest rates in the years after the recession made those costs cheaper for the government to bear.

Now, the strong economy is causing rates to rise once more, making debt more expensive to service.

CBO projects that yields on the **10**-**year Treasury** note would rise from under 3% today to 3.7% in 2028 and 4.8% in 2048. While that is still relatively low by historical standards, continued federal deficits during that time would push up overall interest payments owed by the government.

As a result, Congress and future administrations responding to economic emergencies could find themselves strapped.

"When outstanding debt is large, the government has less flexibility to address financial and economic crises," the report said.

CBO anticipates the Federal Reserve would continue raising its benchmark interest rate to 4% by 2021. Fed policy makers, by contrast, only project raising rates to 3.4% by 2020.

Rising government-debt levels and rising interest rates would reinforce each other. High debt levels would push interest rates up further, and higher debt payments would boost debt.

At the same time, CBO said the effect of the recent tax cut would result in slower growth in government revenues than previously anticipated through 2026. The report also noted that the aging population would raise the cost of Social Security and Medicare.

The report anticipates that overall federal debt would match the overall economy by the end of the next decade. In the early 2030s, debt as a share of GDP would match its previous record of 106%, reached in 1946. By 2048, debt to GDP would reach 152%.

"The prospect of large and growing debt poses substantial risks for the nation and presents policy makers with significant challenges," said CBO Director Keith Hall in a statement.

The report takes into account last year's tax overall and government spending plans. But it also assumes many of the individual tax cuts enacted last year expire after 2025, as stated in the law. If Congress decides to extend them, that likely would exacerbate the government's debt.

Democrats on Capitol Hill pointed to the report to criticize the tax cuts, saying they worsened the country's fiscal outlook. The cuts were pushed through by Republicans and signed into law by President Donald Trump.

Senate Minority Leader Chuck Schumer (D., N.Y.) called Tuesday's report "another reminder about the true costs of handing out massive tax breaks to billionaires and large corporations."

Rep. Kevin Brady (R., Texas), chairman of the House Ways and Means Committee, said the report pointed to the need to reduce spending, including on large programs such as Social Security and Medicare.

"To fix our national debt problem, Republicans and Democrats need to come together to address both mandatory and discretionary federal spending," he said.

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THE WALL STREET JOURNAL.

Markets
Shanghai Stocks Slide Into Bear Market, Piling On the Gloom in China; Escalating trade tensions with the U.S., a tumbling currency and recent data that suggest growth is softening are among the other bleak signs

By Shen Hong
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26 June 2018
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The Wall Street Journal Online
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English

SHANGHAI—China's main stock benchmark has entered a **bear market**, the latest gloomy sign for the country alongside escalating trade tensions with the U.S., a tumbling currency and recent data that suggest its growth is softening.

The Shanghai Composite Index closed at 2844.51 on Tuesday, down 0.5% on the day and 20.1% below a two-year high reached on Jan. 24. A **bear market** is normally defined as a 20% drop from a recent high.

The latest market slide has come despite the Chinese central bank's weekend move to encourage more bank lending by freeing up funds in the financial system. Investors now say the Chinese market slump could persist unless Beijing steps in with more supportive measures.

"The trade conflict between the U.S. and China has turned out to be more protracted and more fierce than we had expected," said Victoria Mio, Hong Kong-based chief investment officer for China at Robeco, a Dutch asset-management firm.

"The weakening of the economy has also surpassed market expectations, and the Chinese central bank probably needs to do more to alter such expectations," she said. Data for May showed a slowdown in areas ranging from investment to retail sales in the world's No. 2 economy.

China's other main market, based in Shenzhen, has been in **bear-market** territory since February. It counts among its constituents companies more directly affected by trade tensions, including telecom-equipment maker ZTE Corp.

The Shanghai bourse is dominated by China's largest state-owned companies, such as banks, energy companies and airlines. Among its biggest losers this year are steelmakers such as Maanshan Iron & Steel, down 10.7%, and brokerages such as Huatai Securities, down 16.1%.

Investor darlings such as Alibaba and Tencent—China's largest tech companies—are, meanwhile, listed outside mainland China in places like Hong Kong and New York.

Declines in the $4.9 trillion Shanghai market quickened a week ago, when the index plunged 3.8%, its worst day since Feb. 9 when Chinese stocks were caught up in a world-wide selloff. It is on course to log its first three-quarter streak of declines since 2011.

A year-to-date fall of around 14% makes the Shanghai Composite one of the world's worst-performing large stock indexes. By comparison, the **S&P 500** is up slightly for the year, while both the MSCI All-Country Asia Pacific and Stoxx Europe 600 indexes are down about 3%.

Chinese stocks have been hit harder by escalating trade tensions than U.S. markets during the past week, as investors have become more nervous that mutual threats of tariffs on hundreds of billions of dollars worth of goods are more than just a negotiating tactic from both governments.

The lackluster Chinese market sentiment has persisted even after leading index provider MSCI Inc. included more than 200 domestically traded stocks in its indexes for the first time from the start of this month. China's stock markets have become more open to foreign investors in recent years, particularly following the opening of a trading link between Shanghai and Hong Kong in 2014.

Analysts say the yuan's recent slide against the U.S. dollar has dampened overseas investors' interest in China's markets in recent weeks. The Chinese currency is down 0.6% against the greenback in 2018.

"Now that the Chinese markets are much more open to foreign investors, the impact of a weaker yuan has become more pronounced," said Jacky Zhang, a Shanghai-based analyst at BOC International.

Even so, domestic retail investors still dominate trading in China. While the markets have long had a reputation for casino-like **volatility**, they have been relatively calm since early 2016. Many put down the trend to regulators' increased scrutiny of trading activity, which in the past has included calls to fund managers and brokers to restrict heavy selling.

Daily trading volume in Shanghai and Shenzhen combined has shrunk to around 300 billion yuan ($46 billion) this week, down from over 400 billion yuan a month ago and a record 1.3 trillion yuan just before Chinese markets crashed in the summer of 2015.

Another stabilizing factor recently has been the presence in the market of the so-called national team, a collection of state-backed investment funds that stepped in to buy up stocks in mid-2015. Together, these funds own around 5.5% of the market, according to estimates by data provider Wind Info.

Market participants say that while the national team is a strong presence, its high holdings have limited its scope for fresh intervention.

"The national team has pretty much spent all its money, and unless there's a major crisis like the one three years ago, it will probably be on the sidelines for now," said a former official from China's securities regulator.

Moreover, because Beijing views the recent market selloff as still largely a result of the trade tensions with the U.S., it is encountering less public pressure domestically. "What the authorities are really worried about is always domestic turmoil," the former securities official said.

Mike Bird in Hong Kong contributed to this article.

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THE WALL STREET JOURNAL.
U.S. EDITION

Stocks Swing On Trade Remarks --- Dueling comments from administration officials send Dow down 328 points

By Bob Davis
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26 June 2018
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A1
English

WASHINGTON -- Bitter fights over trade within the Trump administration again broke into the open, driving wild swings in the **stock market** as the White House's top trade adviser clashed with the Treasury secretary over restrictions on foreign investment.

For weeks, the administration has been planning a two-pronged effort to block Chinese companies from obtaining advanced U.S. technology. The U.S. would block Chinese companies from investing in U.S. technology companies, while restricting U.S. technology exports to China. Beijing has reacted strongly to the escalating tensions, with President Xi Jinping vowing to "punch back" against the U.S. trade measures.

The rising tensions over technology transfers sent investors fleeing from some of the market's best-performing technology firms on Monday. The **Dow Jones Industrial Average** shed as many as 497 points before ending down 328.09 points, or 1.3%, at 24252.80.

The U.S. goal is to prevent Beijing from advancing with plans outlined in its "Made in China 2025" report to become a global leader in 10 broad areas of technology, including information technology, aerospace and electric vehicles.

"To protect our national security, the United States will implement specific investment restrictions and enhanced export controls for Chinese persons and entities related to the acquisition of industrially significant technology," the White House said on May 29. The plan would be announced by June 30 and put into effect "shortly thereafter," it said.

On Monday morning, in response to a Wall Street Journal article detailing the administration's plans, Treasury Secretary Steven Mnuchin denied China was the target of the investment-control effort. China wouldn't be specifically named, Mr. Mnuchin tweeted at 10:41 a.m. Eastern time. Rather the administration will target "all countries that are trying to steal our technology."

Mr. Mnuchin labeled the Journal article on the investment restrictions as "false, fake news" based on information provided by a "leaker" who "either doesn't exist or know the subject very well."

During the day, markets plunged on fears of a deepening trade war with China. That prompted White House trade adviser Peter Navarro to appear on cable television to try to calm investors.

Messrs. Navarro and Mnuchin have long clashed on tariffs and China policy, among other issues. When the two men were part of a trade mission to Beijing in May, Mr. Navarro confronted Mr. Mnuchin and accused him of making a power grab by meeting one-on-one with China's main economic envoy, rather than meeting as a team.

Mr. Navarro appeared on CNBC at around 3:30 p.m. on Monday to say the investment restrictions were indeed aimed at China -- and not at other countries. "This whole idea that somehow there are going to be investment restrictions to the world, please discount that," Mr. Navarro said, contradicting the Treasury secretary. "What the president has done and stated is that we've got an issue with China coming in and taking our technology," he added.

Mr. Navarro also hinted at the struggles over exactly what will be announced by the end of the week on investment restrictions. "The only thing that's going to happen in the near term is the Treasury Department on Friday is going to report to the president about the issue related to China," he said. "With respect to other countries, there's absolutely nothing on the table."

Although CNBC ran a chyron that said "Navarro: No plans to impose investment restrictions," a person familiar with the White House deliberations said that wasn't supposed to be his message. Rather, the warring sides are continuing to fight over specifics of the investment plan.

Administration officials have said President Donald Trump had been unhappy with the pace of the Treasury's deliberations on investment restrictions and used the May 29 announcement to make sure the department produced a working plan by June 30. Industry officials are expected to have a chance to comment on the plan once it's announced, people familiar with the deliberations said.

Adding to the confusion, after Mr. Navarro spoke on CNBC, White House press secretary Sarah Sanders appeared to side with Mr. Mnuchin. "As the secretary said, a statement would go out that targets all countries that are trying to steal our technology, and we expect that to be out soon," she told a press briefing about 15 minutes after the trade adviser's appearance.

The conflicting signals were similar to an episode in May when Mr. Mnuchin and U.S. Trade Representative Robert Lighthizer crossed swords over whether the U.S. would move forward with tariffs on Chinese imports. Several hours after Mr. Mnuchin told Fox News that the U.S. was "putting the trade war on hold" and wouldn't assess tariffs on Beijing while the two sides talked, Mr. Lighthizer put out a statement saying tariffs remained an important tool to "protect our technology."

Since then, Mr. Trump has said he would impose tariffs on as much as $450 billion of Chinese goods. On July 6, the first tariffs, of 25%, take effect on $34 billion of Chinese imports. Beijing has threatened to match the U.S. tariffs on the same day on a dollar-for-dollar basis.

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THE WALL STREET JOURNAL.
U.S. EDITION

Some Funds Struggle To Win Investors

By Stephanie Yang
810 words
26 June 2018
The Wall Street Journal
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B1
English

Raw materials have staged a powerful rally over the past year, but that hasn't helped some of the biggest commodities hedge funds, which are closing up shop to a degree not seen since at least the turn of the century.

In 2017, closures of commodities hedge funds outnumbered launches for the first time in data going back to 2000, according to data provider Eurekahedge -- a trend that has continued into this year.

The reason? Investors who were burned by the severe two-year market rout that started in 2014 aren't rushing back, fund managers and traders say, despite prices of commodities, including oil, copper, lumber and cotton, all rebounding to multiyear highs.

The long string of fund closures also reflects an evolving market, they say, one that is increasingly driven more by algorithms than fundamental information.

This year, longtime oil investor T. Boone Pickens closed his energy-focused fund, BP Capital, and Jamison Capital Partners LP shut down its $1.5 billion flagship fund. In August, legendary oil trader Andrew Hall closed his main fund at Astenbeck Capital Management LLC.

The number of commodities funds reporting returns has fallen to an all-time low of 130 this year, compared with a peak of 371 funds in 2011, according to data going back to 2007 from research firm eVestment. That comes as assets under management have rebounded to about $83 billion this year from a low of $66 billion in 2015.

"Hedge funds that exclusively trade commodities are a dying breed," said Chris Solarz, managing director at investment-advisory firm Cliffwater LLC. "The big guys are nonexistent."

Such funds have weathered ebbs and flows before, but a longer-term trend of closings could mean that a comeback this time will be more difficult.

Big, bold bets are now harder to pull off, money managers say. Some have avoided outright bets on prices rising or falling, opting instead for trading off small price inefficiencies.

Some traders have also become wary of erratic moves that seem to defy supply and demand signals. On Friday, U.S. **oil prices** surged 4.6% to a four-week high, even as members of the Organization of the Petroleum Exporting Countries agreed to raise production.

While computerized trading long ago invaded markets such as stocks, bonds and currencies, commodities -- which historically have been bought and sold over the phone and require physical delivery and storage -- have been slow to follow.

Automated trading in energy-related contracts for the first time accounted for more than half of futures volume from late 2014 to late 2016, compared with more than 80% in foreign-exchange futures and more than 70% in equities, according to data analysis from the Commodity Futures Trading Commission.

"The market is evolving. It has created new challenges for hedgers and investors to maintain expected trading performance," said Peter Hahn, co-founder of quantitative research firm Bridgeton Research Group.

Mr. Hahn said many commodities funds are turning to a hybrid approach, mixing fundamental bets and quantitative trading as they look for new advantages. "It's a matter of adapting and understanding how to trade with those new participants," he said.

Marwan Younes, chief investment officer of Massar Capital Management, favors a broad data-crunching approach rather than have traders well-versed in one specific sector, such as agriculture or natural gas. His fund is up 7.6% this year through May, according to a person familiar with the matter.

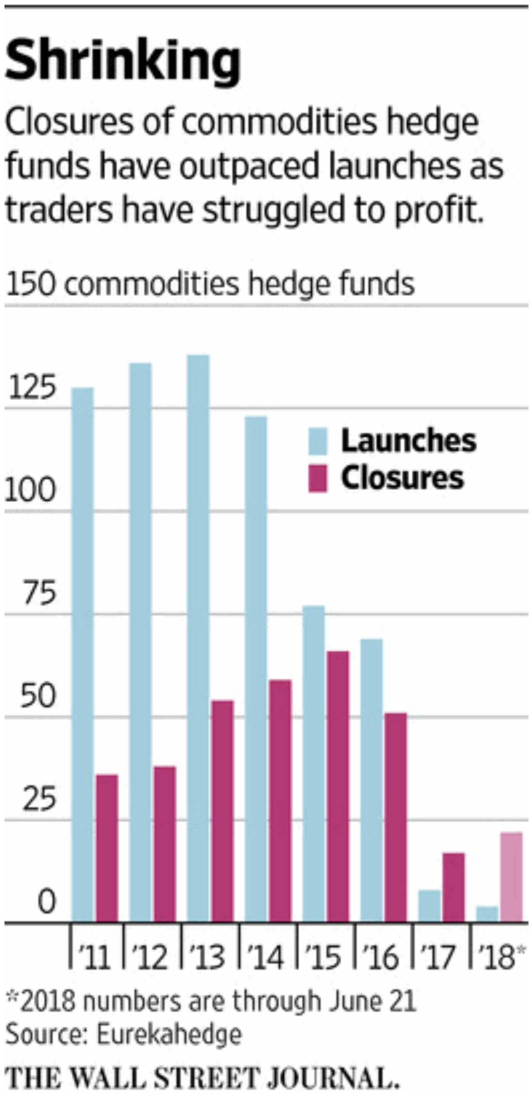
"Twenty years ago, if you were to talk to a commodity manager and ask him why should we invest with you, the typical answer would be, 'Well I have all these networks of people and call them for any information I need.' Today, pointing to proprietary information to be your edge is really dubious," Mr. Younes said.

Eric Armitage, chief executive of London-based East Alpha who started building quantitative models for BP PLC in 2001, said traders have to adapt to changes in available data, for example satellite imagery. "You can't do this as a dark room quant," he said. "You need to know where the holes are in this data or where this data could be fake."

Years of underperformance in commodities have made it a tough sell, investors said, particularly as other assets such as stocks have soared.

But with commodities prices on the rise, some fund managers remain convinced that a comeback is just around the corner, and those left in the game are reluctant to completely abandon fundamental analysis.

"Algos, whilst creating **volatility**, may also take markets to levels that we would not otherwise see," said Luke Sadrian, chief investment officer at Commodities World Capital, a London-based commodity hedge fund. "We still believe that fundamentals are hugely important, but adapt or die."



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Junk Bonds Outdo Higher-Grade Peers

By Daniel Kruger
826 words
26 June 2018
The Wall Street Journal
J
B12
English

In a mostly dismal year for bonds, investors are finding the best returns in the lowest-quality debt.

Government bonds are wilting under signs of rising inflation and an accelerating U.S. economic expansion, and high-grade corporate bonds have fallen as changes to the tax code and softening global growth mean many longtime buyers don't want or need the debt.

But high-yield, or junk, bonds are closely geared toward the strength of the U.S. economy. With U.S. growth picking up and business confidence soaring, high-yield **bond prices** are holding steady even as the Federal Reserve has signaled it is leaning more aggressively on its path of interest-rate increases. When rates are rising, **bond prices** often fall as investors adjust to rising yields in benchmark debt.

Unlike multinational corporations, operations of high-yield borrowers are concentrated within the U.S., meaning their financial results are less likely to suffer from the impact of rising global trade tensions, the disappointing pace of growth in Europe or **volatility** in emerging markets.

The gap between yields on junk bonds and those on U.S. government debt has narrowed this year, even as the spread between highly rated debt and Treasurys has widened. The Bloomberg Barclays U.S. Corporate High Yield index has posted a total return of 0.7% this year, counting price changes and interest payments, ahead of a 3.6% drop for investment-grade corporate debt and a 1.4% decline for Treasurys.

Rising rates are a key factor. Junk debt, which typically offers investors higher interest payments to make up for companies' lower credit ratings, tends to suffer less than Treasurys or highly rated bonds when the Fed raises interest rates. With the Fed on track to raise short-term rates twice more in 2018, some investors are turning to high-yield bonds to cushion the blow to their portfolios.

With larger interest payments buffering against Fed rate increases and a stable **stock market** supporting the environment for riskier securities, "we've been buying into" junk bonds, said Matt Freund, co-chief investment officer and head of fixed-income strategies at Calamos Investments.

Over time, junk bonds produce a higher stream of income than even dividend-heavy stocks such as utilities, which still tend to swing with interest rates, Mr. Freund said.

Shifts in global investment flows have hurt investment-grade debt without hitting high-yield bonds, some analysts said. Over the past few years, investors in Europe and Asia had piled into bonds from U.S. companies because their yields topped U.S. government debt. Steady economic growth made investment-grade corporate debt sufficiently safe for overseas investors.

Now, the widening gap between U.S. and European yields has boosted the U.S. dollar, as higher rates often attract yield-seeking investors to a currency. Those gains have increased the cost of hedging against currency swings for foreign investors, making it too expensive for many to buy investment-grade debt.

"It's creating challenges for Japanese and Taiwanese and European investors to come into U.S. fixed-income," said Ashok Bhatia, a senior portfolio manager in Neuberger Berman's fixed income multisector group.

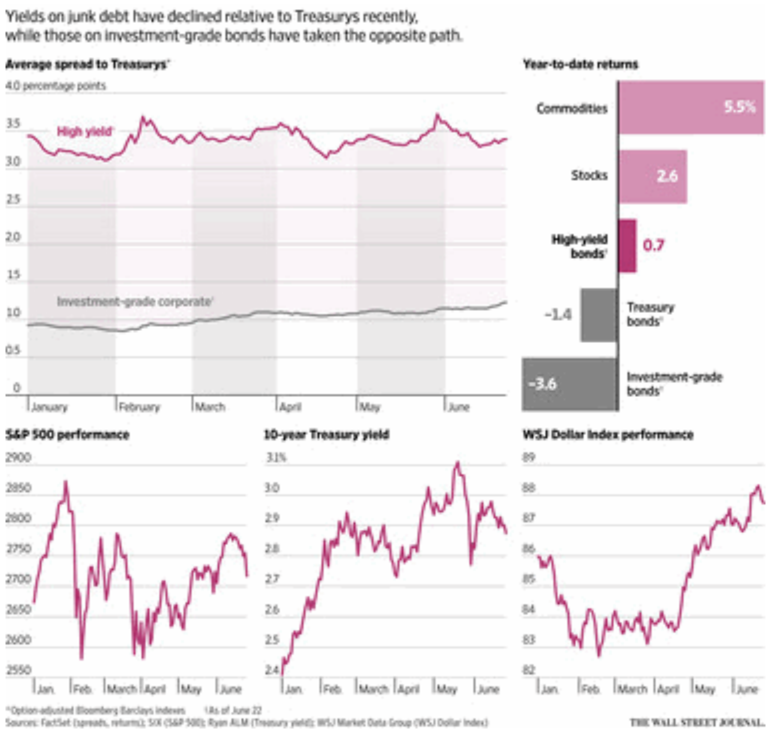
The 2017 tax overhaul also hit investment-grade bonds more than high-yield debt by cutting taxes on companies repatriating overseas earnings. That meant companies including Apple Inc. and Microsoft Corp., which had built up large holdings of short-term U.S. corporate bonds with those earnings, had less incentive to buy the debt.

A growing economy has cut down on defaults by junk-rated issuers, some analysts said. And rising oil prices have lifted energy producers, a large component of high-yield indexes.

That leaves some investors worried about potential losses if the economy turns or oil prices drop. While the high yields on junk bonds can insulate holders from the gradual course of Fed rate increases, prices can fall sharply during times of stress. Given the credit risk involved with high-yield bonds, "that's something we always ask ourselves," said Mr. Freund of Calamos, noting the odds of a recession in the next 12 months appear low.

For now, several investors said they expect headwinds in the markets for Treasurys and investment-grade bonds to help maintain demand for junk debt. That includes an increasing supply from an expected wave of merger-related bond issuance, after a federal judge approved the acquisition of Time Warner Inc. by AT&T Inc. That deal could open the door for a host of new media-company combinations, said Michael Materasso, co-chairman of the fixed-income policy committee at Franklin Templeton Investments.

"High yield has proved to be the sweet spot," said Robert Tipp, chief investment strategist at PGIM Fixed Income. It's "not too exposed to emerging markets and Europe and it's benefiting from the strong economy."



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THE WALL STREET JOURNAL.

Markets

Trade Tit-for-Tat Takes Another Chunk Out of Asian Stocks; Asian markets declined Tuesday, on the heels of heightened trade tensions

By Mike Bird
512 words
25 June 2018
10:48 PM
The Wall Street Journal Online
WSJO
English

Most Asian stock indexes declined Tuesday, after heightened trade tensions hit U.S. equity markets again overnight. U.S. equity futures were up narrowly as European markets opened.

Tuesday's Big Theme

Trade, trade, trade. Asian markets were largely in the red, with a 0.5% drop in the Shanghai Composite taking the index into **bear market** territory, after falling as much as 1.8% earlier in the day. The decline comes after a U.S. stocks selloff deepened Monday in response to news that the White House favors further restrictions on Chinese investment in U.S. technology firms.

After Asian markets closed Monday, the Wall Street Journal reported that Chinese President Xi Jinping suggested his country would "punch back" against further trade restrictions.

What's Happening

Major Asian indexes down include Taiwan's TAIEX at 0.4%, Korea's Kospi by 0.3%. Japan's Nikkei 225 and Hong Kong's Hang Seng were largely flat. Tuesday's drop also leaves the Shanghai Composite index in a **bear market**, having declined more than 20% from its January highs.

That means China has now joined Vietnam and the Philippines, where benchmark equity indexes have already fallen by more than one-fifth from peak levels earlier this year.

Market Reaction

Responses to recent trade rhetoric are divided into two camps. The first includes analysts and investors see the current tit-for-tat retaliation as something which will continue to escalate and impact markets.

"Partly due to Xi's aggressive rhetoric, Trump probably won't be able to back down, or else he will look weak. Note his tactics are almost always to raise the ante, not to back off," said Michael Every, Senior Asia-Pacific strategist at Rabobank.

Of course, other investors see trade tensions as a chance to buy stocks while they're more cheaply valued.

"This is the beginning of an opportunity to buy equities at a discount," said Chris Zaccarelli, chief investment officer at the Independent Investor Alliance. "There should be areas like technology, especially semiconductors, on sale as well as the banks which are going to be driven lower as the U.S. and China continue down this path before eventually pulling back."

Elsewhere

Chinese telecom equipment giant ZTE Corp.'s Shenzhen-listed stock saw its tumble slow on Tuesday, slipping 3.6% after falling by 10% for eight straight trading days. Its overall decline since the end of a two-month trading halt— which followed a U.S. ban on sales to the firm—stands at 58%. ZTE's Hong Kong-listed shares have fallen 53% since the end of the trading halt.

Brent crude prices were up 0.6% at $74.99 per barrel. In foreign exchange markets, the U.S. dollar was little moved, with the ICE U.S. Dollar Index up 0.1%.

Kevin Kingsbury contributed to this article.

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Document WSJO000020180626ee6q0008d

The New York Times

National Desk; SECTA
Facing Tariffs, American Icon Retreats in U.S.

By ALAN RAPPEPORT; Amie Tsang contributed reporting from London.
1,389 words
26 June 2018
The New York Times
NYTF
Late Edition - Final
1
English

WASHINGTON -- As President Trump pursues a protectionist trade policy, he has pointed repeatedly to Harley-Davidson, the iconic American motorcycle manufacturer, as a company that will ultimately benefit.

Instead, it is getting caught in the crossfire.

The Wisconsin company said on Monday it would shift some production of its bikes overseas to avoid stiff retaliatory tariffs imposed by the European Union in response to Mr. Trump's trade measures. The company said the move ''is not the company's preference, but represents the only sustainable option to make its motorcycles accessible to customers in the E.U. and maintain a viable business in Europe.''

Mr. Trump's trade war is beginning to ripple through the United States economy as companies struggle with a cascade of tariffs here and abroad. While Mr. Trump says his trade policy is aimed at reviving domestic manufacturing, Harley-Davidson's move shows how the White House approach could backfire as American companies increasingly rely on overseas markets for materials, production and sales.

The White House is waging several trade wars at once, engaging in fights with China, Canada, Mexico and the European Union, which have each responded with their own retaliatory measures. The trade spats have triggered a range of unintended consequences, including a profit warning last week by Daimler, which blamed retaliatory Chinese tariffs for a slump in the sales of the S.U.V.s it builds in Tuscaloosa, Ala.

Mid Continent Nail Corporation, a Missouri-based manufacturer of nails, said last week that it had laid off 60 of its 500 employees and might be forced to close as it struggles to absorb the higher cost of the steel it imports from Mexico to produce its nails. Stock markets have swooned over the prospect of an escalating trade war that could further hurt American companies, with the **Standard & Poor's 500-stockindex** ending down 1.4 percent on Monday.

Mr. Trump accused Harley-Davidson of using the tariffs as ''an excuse'' to move production out of the United States but insisted in a tweet on Monday that his trade strategy would still work. ''Surprised that Harley-Davidson, of all companies, would be the first to wave the White Flag,'' he said. ''I fought hard for them and ultimately they will not pay tariffs selling into the E.U., which has hurt us badly on trade.''

Last week, the European Union hit back against Mr. Trump's steel and aluminum tariffs with penalties on $3.2 billion worth of American products, including bourbon, orange juice, playing cards and Harley-Davidsons. On Monday, the company said the tariffs on its motorcycles had increased to 31 percent from 6 percent, adding, on average, $2,200 to every motorcycle exported from the United States to Europe.

With United States sales slowing and Europe an increasingly vital market, the company said it would shift production to its overseas facilities to avoid raising costs.

''Harley-Davidson believes the tremendous cost increase, if passed on to its dealers and retail customers, would have an immediate and lasting detrimental impact to its business in the region, reducing customer access to Harley-Davidson products and negatively impacting the sustainability of its dealers' businesses,'' the company said in a public filing.

Mr. Trump has frequently championed the company as a success story in domestic manufacturing. Soon after taking office in 2017, Mr. Trump hosted Harley-Davidson executives at the White House, where he called the firm a ''true American icon'' and thanked it ''for building things in America.''

Like many American companies, Harley-Davidson has increasingly relied on overseas markets for sales and has shifted some production as a result. The company now produces some bikes and parts at facilities in Brazil, Australia, India and Thailand, and has shifted production to India and Thailand specifically to avoid high import tariffs in those countries. The company sold about 40,000 new motorbikes last year in Europe, equivalent to a sixth of its worldwide sales, making the region its most important market after the United States.

[Read more: Even Harley-Davidson can't avoid the tug of overseas factories.]

Harley-Davidson did not specify how many jobs it might shift to its overseas facilities as it ratchets up European production, and a spokesman for the company said it was ''still evaluating'' the need for job cuts in the United States. The company has been consolidating its United States operations, eliminating hundreds of jobs in the process.

Shares of Harley-Davidson fell nearly 6 percent in afternoon trading.

Moving production abroad could draw the ire of Mr. Trump, who as a presidential candidate publicly assailed companies such as the furnace and air-conditioner maker Carrier, which planned to close a plant in the United States and shift manufacturing operations to Mexico. Mr. Trump regularly tells his supporters that American manufacturing is making a comeback and lavishes praise on companies that build domestically.

But that was before Mr. Trump followed through on his plans to impose tariffs on foreign steel and aluminum, a move he says will force other countries to lower their trade barriers. So far, the opposite has happened, as the European Union, Mexico and Canada respond with their own levies, many of which are aimed at products from politically important states that supported Mr. Trump, like Ohio, Iowa, Pennsylvania and Wisconsin.

Speaker Paul D. Ryan, a Wisconsin Republican, said on Monday that Harley-Davidson's decision was evidence that raising trade barriers was a bad idea.

''This is further proof of the harm from unilateral tariffs,'' Mr. Ryan said. ''The best way to help American workers, consumers and manufacturers is to open new markets for them, not to raise barriers to our own market.''

Chad Bown, a senior fellow at the Peterson Institute for International Economics, said that he expected more companies to follow Harley-Davidson's lead as they wrestled with higher production costs from tariffs on raw metals and levies on the finished products they sell overseas.

''This is incredibly self-defeating,'' Mr. Bown said. ''There may be some increased domestic production of aluminum and steel because of the tariffs, but now there is going to be less motorcycle production in the United States for exports.''

He added: ''I think we can expect to see this same kind of activity every time that President Trump tries to impose new tariffs.''

A labor union representing Harley-Davidson employees condemned the move on Monday and accused the company of seizing on Mr. Trump's trade policy as an excuse to move jobs offshore.

''Harley-Davidson's announcement today is the latest slap in the face to the loyal, highly skilled work force that made Harley an iconic American brand,'' said Robert Martinez Jr., the international president of the International Association of Machinists and Aerospace Workers. ''This latest move is in keeping with Harley's past decisions to open plants outside of North America.''

Sharon Zackfia, an analyst with William Blair, estimated that fewer than 10 percent of Harley-Davidson's motorcycles were manufactured abroad. She said that it was hard to predict what the shift might mean in terms of lost jobs, but that the company would be under pressure to spur more domestic demand with its new lines of motorcycles to keep workers at its American plants busy.

The best solution, she said, would be for a truce to be called to avert the trade war.

''Ultimately everyone is hoping that these tariffs or trade wars are transitory, that what happened can be reversed,'' Ms. Zackfia said.

At the White House press briefing on Monday, Sarah Huckabee Sanders, the press secretary, rejected the idea that Mr. Trump's trade policies were hurting American businesses and blamed the European Union for punishing American workers with its ''unfair trade practices.''

And Mr. Trump has shown no signs that he will back down. In a tweet on Sunday, he threatened even more tariffs, saying the United States would retaliate ''with more than Reciprocity'' if ''artificial'' trade barriers were not removed.

Europe is second to only the United States as Harley-Davidson's most important market. President Trump has praised the company ''for building things in America.'' (PHOTOGRAPH BY DREW ANGERER/GETTY IMAGES) (A15)

Document NYTF000020180626ee6q00051

The New York Times

National Desk; SECTA
Tariffs Force Corporations To Enter Fray

By PETER EAVIS
558 words
26 June 2018
The New York Times
NYTF
Late Edition - Final
15
English

Corporate America has largely avoided sticking its head over the parapet in the trade war. That's going to become harder as the bellicose rhetoric transforms into action.

Case in point Harley-Davidson: The company on Monday announced it was planning to shift some production out of the United States to lessen the cost of tariffs that the European Union imposed in response to those put in place by the Trump administration.

Harley-Davidson's move reveals the uncomfortable choices companies face as they navigate escalating trade tensions. The company, by making more motorcycles beyond its United States factories, could draw criticism from President Trump and his supporters. But if Harley-Davidson does not adapt to the rising trade barriers, it stands to sell fewer motorcycles, which could harm its profits.

So far, large companies have mostly left it to their trade groups to speak out against Mr. Trump's trade policies. But when financial pain threatens to become consequential, public companies are obliged to publicly quantify it. Almost by default, then, they are forced to enter the fight. And as more companies do what Harley-Davidson did, the debate over trade wars will focus on the nitty-gritty.

The European Union last week raised tariffs on Harley-Davidson motorcycles to 31 percent from 6 percent. The company said the increase would add $2,200 on average to the cost of a motorcycle exported to Europe from the United States. Harley-Davidson said it would not raise the suggested prices of its motorcycles to cover the cost of the tariffs. It expects, at least for a little while, to bear the additional expense of the tariffs itself, which would cost the company an estimated $90 million to $100 million a year. Over the longer term, Harley-Davidson, based in Milwaukee, intends to make more motorcycles in countries that are not subject to the tariffs. That plan could take nine to 18 months to put into effect, the company said.

A year ago, Mr. Trump lauded the firm for manufacturing in the United States. ''We're proud of you! Made in America, Harley-Davidson,'' he said, when executives from the company drove motorcycles onto the White House lawn.

Harley-Davidson's announcement may make it more likely that Mr. Trump imposes tariffs on European cars, to further pressure the European Union to make trade concessions. But such actions may invite more retaliation from the bloc, and, in turn, more of the sorts of announcements that Harley-Davidson made. The administration may hope that the strong United States economy will allow American companies to better weather the trade battles -- and that other countries will ultimately cave because they cannot afford to lose access to the United States market.

Still, negative corporate announcements bring a jarring specificity to trade wars that can spread through **financial markets** and the wider economy. Harley-Davidson's stock was down over 7 percent on Monday. The **Standard & Poor**'**s 500**-**stockindex** was down 1.8 percent. The benchmark is now only up 1.1 percent since the end of 2017 and down 5.9 percent from its all-time high. The trade war appears to have halted the Trump rally. And there are a lot more Harley-Davidsons on the **stock market**.

Document NYTF000020180626ee6q0004h

THE WALL STREET JOURNAL.
U.S. EDITION

U.S. News: Sales of New Homes Increased 6.7% in May

By Sharon Nunn and Paul Kiernan
293 words
26 June 2018
The Wall Street Journal
J
A2
English

WASHINGTON -- Sales of new homes in the U.S. rose heading into the summer months, despite high selling prices and low home inventory.

Purchases of newly built single-family homes -- a relatively narrow slice of all U.S. home sales -- grew 6.7% to a seasonally adjusted annual rate of 689,000 in May from April, the Commerce Department said Monday.

Still, previously owned homes sales, which represent the bulk of the housing market, have declined from a year earlier in four out of the first five months of this year, signaling home buying in the spring may be stuck in neutral.

Meanwhile, the pace of new-home sales remains well below the elevated levels seen before the 2007-09 financial crisis and recession.

"The rise in new-home sales is likely related to the historically low inventory of existing homes on the market," said Ben Ayers, senior economist at Nationwide. "With fewer buying options among existing homes, home-buyer demand is shifting towards new builds. New-home construction is also increasing with housing starts up to an expansion high in May."

New-home sales data can be **volatile**. May's 6.7% gain came with a margin of error of 14.1 percentage points, but the longer-term trend shows growth. From the prior year, sales increased 14.1% in May.

Sales in the South appeared to drive last month's growth. New-home purchases in the region rose 17.9%, the largest gain since the end of 2014. Meanwhile, sales in the Northeast and West declined and purchases were flat in the Midwest in May.

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REVIEW & OUTLOOK (Editorial)
Trump Rides a Harley -- to Europe

877 words
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J
A16
English

Donald Trump's trade war has been an abstraction for most Americans so far, but the retaliation has now begun in earnest and the casualties are starting to mount. The President's beloved **stock market** took another header Monday on news of more restrictions on investment into the U.S., and the **Dow Jones Industrial Average** is now down for 2018. But the biggest losers Monday were the American workers who make Harley-Davidson motorcycles whose jobs will soon be headed overseas thanks to the Trump tariffs.

Last year Mr. Trump commended Harley-Davidson for "building things in America," calling the company "a true American icon, one of the greats." And he proclaimed last week at a rally in Duluth, Minnesota, "We're bringing back our jobs from other countries." Awkward timing, Mr. President. On Monday the motorcycle company announced it will shift more production out of the United States.

U.S. motorcycle sales have been on the decline, so Harley has kept its rubber side down by focusing on global growth. The company considers the EU a "critical market," and last year it sold nearly 40,000 bikes to European consumers. But in retaliation for Mr. Trump's steel and aluminum tariffs, the European Union raised its tax on American-exported Harleys to 31% from 6%, effective last Friday. That amounts to a $2,200 tax on each motorcycle exported from the U.S. to the EU.

In a Securities and Exchange Commission filing Monday, Harley said "the tremendous cost increase, if passed on to its dealers and retail customers, would have an immediate and lasting detrimental impact to its business in the region, reducing customer access to Harley-Davidson products and negatively impacting the sustainability of its dealers' businesses." Translation for Mr. Trump: Unlike real estate, cars and motorcycles are a global market.

Harley has opted not to raise prices, instead bearing the $90 million to $100 million annual cost of the tariffs in the short term. To avoid those trade penalties in the long term, Harley will scale back U.S. operations over the next 18 months, making more bikes overseas.

Harley hasn't provided details about how its American workforce will be affected. But Harley employs more than a thousand unionized U.S. steelworkers -- the very folks the President claims he's protecting. Harley's main manufacturing facilities are in Wisconsin and Pennsylvania, and Mr. Trump has said the "big league" support of Harley employees helped him win the swing states in 2016.

The only response White House press secretary Sarah Sanders could muster on Monday to the Harley news is that "the European Union is trying to punish U.S. workers by engaging in unfair trade practices." But the Harley harm is made in America -- that is, the White House.

Mr. Trump threw the first punch with his steel and aluminum tariffs, which have already driven up the cost of Harley's raw materials by $15 million to $20 million this year, CFO John Olin said in an April earnings call. Mr. Trump also killed the Trans-Pacific Partnership, which would have cut tariffs on American-made motorcycles. U.S. withdrawal forced Harley to pursue its "Plan B" and build a plant in Thailand to avoid Asian tariffs.

"We would rather not make the investment in that facility, but that's what's necessary to access a very important market," CEO Matt Levatich told Bloomberg in April. Meanwhile, the company will close its 800-worker Kansas City, Missouri, plant by 2019. Harley will expand operations in York, Pennsylvania, but the result is still a net loss in American jobs.

The protectionist pain isn't limited to Harley. Mid-Continent Nail of Poplar Bluff, Missouri, makes about half of the nails produced in America. But Mexican steel wire is the company's main input, and it's now subject to a 25% tariff. Mid-Continent tried passing that added cost to consumers, but purchases plummeted and buyers cancelled existing orders, opting for cheaper Chinese nails. The company has already cut 60 employees from its workforce of 500, and it will likely soon lay off 200 more. It's now pinning its hopes on a tariff exemption from the Commerce Department, which is grappling with a backlog of 21,000 similar petitions.

The list of job casualties will continue to grow. A June report by the economic consulting firm Trade Partnerships Worldwide estimates a net loss of 400,445 jobs over the next three years because of the steel and aluminum tariffs, quotas and retaliation. That's 16 jobs lost for each steel or aluminum job gained.

The damage is likely to have political consequences, as the retaliatory tariffs target industries in swing states. Wisconsin produces more than 90% of America's ginseng, and 95% of that comes from Marathon County. The county went for Mr. Trump in 2016, but it's now wrestling with the consequences of China's new 15% retaliatory tariff. Mr. Trump is also going to have some explaining to do to Wisconsin cranberry farmers, Florida orange-juice producers, and Iowa soy and corn growers.

Good luck to Republicans running on the Trump tariffs in November.

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The New York Times

Business Day
What's the Yield Curve? 'A Powerful Signal of Recessions' Has Wall Street's Attention

By Matt Phillips
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You can try to play down a trade war with China. You can brush off the impact of rising **oil prices** on corporate earnings.

But if you're in the business of making economic predictions, it has become very difficult to disregard an important signal from the bond market.

The so-called yield curve is perilously close to predicting a recession — something it has done before with surprising accuracy — and it's become a big topic on Wall Street.

Terms like "yield curve" can be mind-numbing if you're not a bond trader, but the mechanics, practical impact and psychology of it are fairly straightforward. Here's what the fuss is all about.

First, the mechanics.

The yield curve is basically the difference between interest rates on short-term United States government bonds, say, two-year Treasury notes, and long-term government bonds, like **10**-**year Treasury** notes.

Typically, when an economy seems in good health, the rate on the longer-term bonds will be higher than short-term ones. The extra interest is to compensate, in part, for the risk that strong economic growth could set off a broad rise in prices, known as inflation. Lately, though, long-term bond yields have been stubbornly slow to rise — which suggests traders are concerned about long-term growth — even as the economy shows plenty of vitality.

At the same time, the Federal Reserve has been raising short-term rates, so the yield curve has been "flattening." In other words, the gap between short-term interest rates and long-term rates is shrinking.

The gap between two-year and 10-year United States Treasury notes is roughly 0.34 percentage points. It was last at these levels in 2007 when the United States economy was heading into what was arguably the worst recession in almost 80 years.

As scary as references to the financial crisis sound, flattening alone does not mean that the United States is doomed to slip into another recession. But if it keeps moving in this direction, eventually long-term interest rates will fall below short-term rates.

When that happens, the yield curve has "inverted." An inversion is seen as "a powerful signal of recessions," as the president of the New York Fed, John Williams, said this year, and that's what everyone is watching for.

Every recession of the past 60 years has been preceded by an inverted yield curve, according to research from the San Francisco Fed. Curve inversions have "correctly signaled all nine recessions since 1955 and had only one false positive, in the mid-1960s, when an inversion was followed by an economic slowdown but not an official recession," the bank's researchers wrote in March.

Even if it hasn't happened yet, the move in that direction has Wall Street's attention.

"For economists, of course it's always been traditionally a very good signal of directionality of the economy," said Sonja Gibbs, senior director of capital markets at the Institute of International Finance. "That's why everyone is bemoaning the flattening of the yield curve."

Recession? Really?

Sure, it seems like a strange time to be worried about recession. Unemployment is at an 18-year low, corporate investment is picking up steam, and consumer spending shows signs of rebounding.

Some economists on Wall Street think the economy could be growing at around a nearly 5 percent annualized clip this quarter. But if the current economic vigor is only reflecting a short-term stimulus coming from the Trump administration's tax cut, then some kind of slowdown is to be expected.

"It's very hard to see what's going to goose the economy further from these levels," Ms. Gibbs said.

And the **financial markets** can sometimes sniff out problems with the economy before they show up in the official economic snapshots published on G.D.P. and unemployment. Another notable yield curve inversion occurred in February 2000, just before the **stock market**'s dot-com bubble burst.

In that sense, the government bond market isn't alone. Stocks have been in a sideways struggle since the **Standard & Poor's 500-stockindex** last peaked on Jan. 26. Returns on corporate bonds are negative, as are some key commodities tied to industrial activity.

An important caveat to the predictive power of the yield curve is that it can't predict precisely when a recession will begin. In the past the recession has come in as little as six months, or as long as two years, after the inversion, the San Francisco Fed's researchers note.

In other words, there's a reason to look at the yield curve skeptically, despite its prowess at predicting recessions.

The new fear gauge.

As in all market moves, perceptions of its significance mean the yield curve can sometimes become a feedback loop.

If enough investors begin to grow concerned about a recession, they will most likely put more and more money into the safety of long-term government bonds. That buying binge would likely help flatten, or invert, the yield curve.

Then people will write articles about the curve's sending a stronger signal on recession. And that could, in turn, drive even more people to buy into long-term bonds. Rinse. Repeat.

There's also a practical impact.

But it's not just psychology. The yield curve helps determine some of the decisions that are the most crucial to the health of the American economy.

Specifically, the flattening yield curve makes banking, which is basically the business of borrowing money at short-term rates and lending it at long-term rates, less profitable. And if the yield curve inverts, it means lending money becomes a losing proposition.

Either way, the flow of lending is likely to be curtailed. And in the United States, where borrowed money is the lifeblood of economic activity, that can slam the brakes on economic growth.

The Fed's hand.

There is an argument to be made against reading too much into the yield curve's moves — and it hangs on the idea that, rather than the free market, central banks have had a big influence on both the long-term and short-term rates.

Since the last recession, central banks bought trillions of dollars of government bonds as they tried to push long-term interest rates lower in order to lend a helping hand to the economy.

Even though they're reversing course now, central banks still own massive amounts of those bonds, and that may be keeping long-term interest rates lower than they would otherwise be.

Also, the Federal Reserve has been raising short-term interest rates since December 2015 and has indicated it will keep doing so this year.

So if long-term rates were pushed lower by central bank bond buying, and now short-term rates are being pushed higher as the Fed tightens its monetary policy, the yield curve has nowhere to go but flatter.

“In the current environment, I think it’s a less reliable indicator than it has been in the past,” said Matthew Luzzetti, a senior economist at Deutsche Bank.

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THE WALL STREET JOURNAL.
U.S. EDITION

Index Funds Scurry as Russell Shuffles

By Asjylyn Loder
768 words
25 June 2018
The Wall Street Journal
J
B9
English

Corrections & Amplifications

A record 1.2 billion shares valued at more than $39 billion traded in less than a second on Friday during **Nasdaq**'s closing auction. A Markets article and a What's News item on Monday about the rebalancing of FTSE Russell stock indexes incorrectly said 1.2 million.

(WSJ June 26, 2018)

A graphic with a June 25 Markets article about the Russell 2000 index showed the index threshold and market capitalization of First United Corp. in millions of dollars. The chart was labeled incorrectly as billions of dollars.

(WSJ July 26, 2018)

(END)

A record 1.2 million shares worth more than $39 billion traded in less than a second on Friday during **Nasdaq**'s closing auction. The reason: the end of this year's rebalancing of FTSE Russell's widely followed stock indexes.

There is $9.2 trillion pegged to Russell U.S. benchmarks, dwarfing the $29.5 billion linked to the **Dow Jones Industrial Average**, which made headlines last week by ejecting General Electric Co. after more than a century.

When Russell adds and removes stocks each year to and from its indexes, stocks that are part of the revisions typically experience a trading spike 45 times the average volume, according to research from Keefe, Bruyette & Woods. This year, nearly 300 companies were added or dropped from the Russell 2000 alone.

Getting added to a prominent benchmark is akin to gliding past Wall Street's velvet ropes, a big boost for firms that otherwise hover beneath Wall Street's radar. Walgreens Boots Alliance Inc. climbed 4.6% following the June 19 announcement that it would replace GE in the Dow, even as the index remained flat. For lesser-known firms, winning a coveted spot in the Russell 2000, a popular index of small companies, helps them win the attention of investors.

"You're suddenly attractive to all of these investors that couldn't buy your stock before because you weren't in their benchmark," said Melissa Roberts, head of quantitative research at Keefe Bruyette, a New York investment bank.

The spike in trading activity underscores how index companies have morphed into some of Wall Street's most powerful stock pickers.

Investors have forsaken active money managers in favor of low-cost passive investments, so when major market benchmarks rearrange their lineups, those changes reverberate throughout the **stock market**.

The jockeying was evident last month as traders bid up shares of First United Corp., pushing its market value above the $159.2 million threshold for inclusion in the Russell 2000, a popular index of small companies, Ms. Roberts said.

First United's market capitalization was $132 million on May 9, two days before the deadline to win a spot in the index. Over the next two days, its share price rocketed up 20%. By the time the closing bell rang on May 11, First United's market value had risen to $159.37 million, making it one of the smallest new entrants to the index.

"There was a lot of interest there in making sure this company made it in," Ms. Roberts said.

Investors say First United announced stellar first-quarter results on May 9. But professional traders build models designed to predict which companies will make the cut on deadline day, and the prospect of getting into the Russell had an "accelerating effect" on First United, Ms. Roberts said.

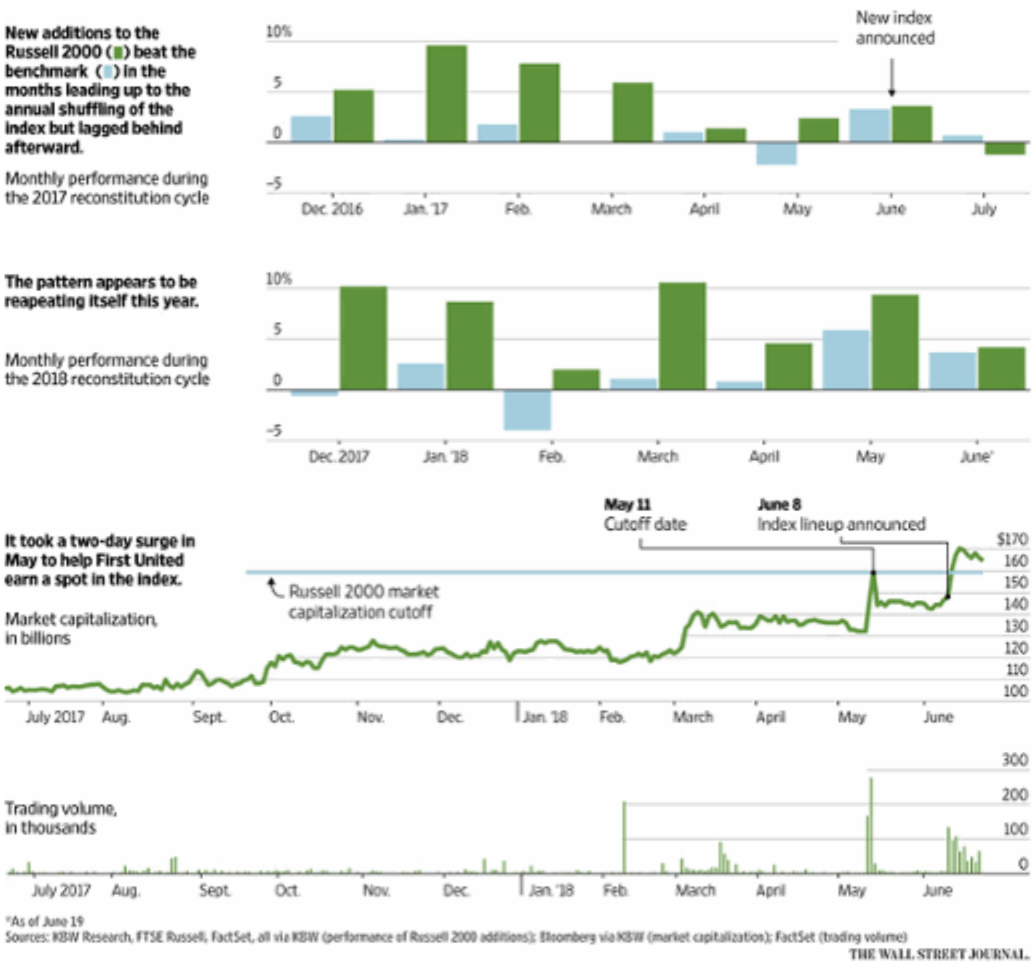
The annual rejiggering of the Russell indexes is unusually easy to predict, even in the world of plain-vanilla benchmarks, Ms. Roberts said. Firms such as Barclays PLC have become well-known Russell forecasters, and traders start placing their wagers on the changes months in advance.

"These are all signs of a transparent and efficient market, and it helps keep markets orderly as opposed to a surprise," said Rolf Agather, a managing director at FTSE Russell, a subsidiary of London Stock Exchange Group. He also pointed out that FTSE Russell has altered its methodology over the years to reduce turnover, which makes it tougher for traders to front-run their indexes.

Critics say all that speculation can inflate the prices of potential new additions and drag down the stocks that are being removed. Earlier this month, acclaimed investor Rob Arnott, founder of Research Affiliates, said fund managers who slavishly mimic their index end up buying high and selling low.

The picture isn't one-sided, Ms. Roberts said. Come rebalance day, passive investors need to buy and sell big blocks of thinly traded shares, and the traders who jumped ahead of the index, will supply much-needed inventory. Passive index-tracking funds had $57 billion of trading to do after Friday's closing bell to get ready for Monday's changeover, she said.

Betting against the Russell also isn't a guaranteed win, said Jared Dillian, investment strategist with research firm Mauldin Economics. Traders aren't just wagering against the index. They also must outwit each other. "You're in this trade with a bunch of other banks and hedge funds," Mr. Dillian said. "But at some point you have to get out."



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THE WALL STREET JOURNAL.

Markets

Turkish Lira Falls With Markets Wary of Erdogan's Fiscal Policies; Investors and analysts are uneasy about the newly re-elected president's relationship with Turkey's central bank

By Mike Bird and Olga Cotaga
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25 June 2018
02:43 PM
The Wall Street Journal Online
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English

The Turkish lira fell after its initial steep climb on Monday, as relief that President Recep Tayyip Erdogan's election victory brought political certainty gave way to long-term concerns about his relationship with the central bank and the country's economy.

The lira rose by as much 3% against the U.S. dollar and euro as European trading hours began, rising to its strongest level in about two weeks, but was down by 0.24% in early morning U.S. trade.

Turkey's main BIST-100 index opened 3.5% higher on Monday before settling at a gain of around 1.5% in late trade in Europe.

Analysts say it is unlikely the lira will resume the steep falls seen before the elections, but most bet that Monday's early gains don't reflect a new trend. They expect the effects of Sunday's election to take a while to sink into the economy and local markets.

Mr. Erdogan secured enough votes Sunday—over 52% with most of the ballots counted—to avoid a second runoff election. But while political events perceived as increasing stability have traditionally caused Turkish assets to respond positively, analysts at Goldman Sachs Group Inc. said in a note before the election, they also said some of Mr. Erdogan's comments during his campaign had "raised concerns over the future direction of monetary policy."

Among the concerns Goldman noted was Mr. Erdogan's advocacy for lower interest rates. Mr. Erdogan has described high interest rates as "the mother and father of all evils," and investors have expressed concern that his preference for lower rates is preventing the country's central bank from supporting the currency.

The central bank raised interest rates twice in short succession early this year as the lira plummeted on fears Mr. Erdogan wasn't allowing the central bank to act independently. An increase in May sent the lira up by around 5% before it closed that day down 2%.

"The big question is now whether President Erdogan will allow the central bank to act with more flexibility, which we have seen some positive signs of during the past month," said Morten Lund, an analyst at Nordea.

Investors are concerned Mr. Erdogan's position on interest rates could hinder the central bank's ability to soothe inflationary pressure. In the last 10 years, the Turkish currency has lost nearly three quarters of its value against the dollar.

The currency's continued fall could exacerbate already-high inflation, which stood at 12.15% in May, and has saddled the country with an increasingly wide current-account deficit, a key indicator of the country's economic vulnerability. Some economic effects of Sunday's election will depend on how the central bank responds to the lira's long decline and the high inflation that the decline helps generate.

"The risks stemming from the election are more likely to materialize over the longer term—in particular, the risk that an Erdogan-AKP government pursues much looser fiscal and monetary policy," said Jason Tuvey, senior emerging markets economist at Capital Economics.

Mr. Erdogan's Justice and Development Party, or AKP, together with alliance partner Nationalist Movement Party, have garnered 53.6% of the vote in the legislative elections, allowing Mr. Erdogan to also maintain control of the parliament.

But some analysts say that with the elections behind him, Mr. Erdogan may be less insistent on looser monetary policy.

"In our view, the incentive to maintain robust growth at all costs should weaken if the AKP and Erdogan win," Rabobank analysts wrote in a note just before the election.

The win secured Mr. Erdogan an executive presidency, which allows him to have almost total control over the levers of the state. But investors are keen to see who Mr. Erdogan brings with him into government.

If Deputy Prime Minister Mehmet Șimșek, who has been responsible for Turkey's economic policy, stays in the government after the elections, that would boost sentiment in the markets and support the lira, said Per Hammarlund, chief emerging markets strategist at Skandinaviska Enskilda Banken AB.

However, "if the economic policy team is dominated by people close to Erdogan, the lira will suffer again," Mr. Hammarlund added.

A decline in **oil prices** may have contributed to the recovery of the lira on Monday. The country is a large importer of crude oil, which is denominated in dollars. Brent crude **oil prices** fell 1.7% Monday to $74.05 per barrel, following a Russia-backed deal by the oil-exporting nations of OPEC to increase output.

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THE WALL STREET JOURNAL.

Markets

U.S. Treasurys Strengthen as Trade Tensions Rise; Fears of growing friction between U.S. and China sent investors into the safety of sovereign debt

By Akane Otani
296 words
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03:30 PM
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English

U.S. government bonds strengthened Monday as fears of mounting trade tensions sent investors into the safety of sovereign debt.

The yield on the benchmark 10-year U.S. Treasury note settled at 2.875%, compared with 2.902% Friday.

Yields, which fall as **bond prices** rise, declined with global stocks as reports suggested President Donald Trump was planning to bar Chinese firms from investing in U.S. technology and block additional technology exports to China. The rules, which would potentially exacerbate tensions between the world's two biggest economies, could be announced by the end of the week, people familiar with the administration's plans told The Wall Street Journal.

The latest sign of conflict between the U.S. and China sent investors out of stocks while stoking demand for Treasurys, which investors tend to buy when they are feeling uncertain about the outlook for economic growth. The yield on the **10**-**year Treasury** note has fallen for four of the past five weeks.

"I'm not entirely convinced that Mr. Trump isn't just playing hardball negotiations, but the trade tensions have the potential to lead to global economic slowdown," said Jerry Paul, senior vice president of fixed income and portfolio manager at Icon Funds.

While bond yields appear to be trapped in a range for now, Mr. Paul said increased issuance should propel yields back above 3% over the next year or two.

"With respect to Treasurys there's still going to be a lot of supply coming onto the market," Mr. Paul said.

Write to Akane Otani at akane.otani@wsj.com

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THE WALL STREET JOURNAL.

U.S. Markets
Markets

U.S. Stocks Fall as Trade-War Fears Rattle Markets; Dow industrials pare losses after Trump aide says there are 'no plans to impose investment restrictions'

By Akane Otani, Allison Prang and Michael Wursthorn
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U.S. stocks tumbled on Monday but later pared declines as investors grappled with conflicting messages from senior White House officials on the future of trade policy between the world's two biggest economies.

Major U.S. indexes had slumped in early trading as the latest jabs between the White House and Beijing exacerbated fears among investors of a full trade war. Technology stocks, in particular, were hard hit and the **Nasdaq Composite** at one point fell nearly 3%.

Stocks abruptly erased some of their losses in the last hour of trading after White House trade adviser Peter Navarro said in an interview on CNBC that there were no immediate plans to impose investment restrictions on China or other countries. That followed a tweet earlier in the day from Treasury Secretary Steven Mnuchin denying reports of policies targeting China, saying instead restrictions would target "all countries that are trying to steal our technology."

The back-and-forth left already unsettled investors off-balance.

"Given the valuation of certain sectors and the rhetoric that we're hearing, I think it would be prudent to not be in the riskiest" areas of the market, said Ernesto Ramos, head of equities at BMO Global Asset Management. He added that his firm has "taken broad measures" to safeguard its holdings but will wait for details about how trade policies will actually play out to determine what to do regarding specific stocks.

The **Dow Jones Industrial Average** lost almost 500 points at one point Monday before paring declines to close down 328.09 points, or 1.3%, at 24252.80. The **S&P 500** fell 37.81 points, or 1.4%, to 2717.07, while the tech-heavy **Nasdaq Composite** lost 160.81 points, or 2.1%, to 7532.01—with both stock indexes notching their steepest one-day declines since early April.

Reports that the U.S. could be considering curbing foreign investment in technology firms increased investor worries that restrictive trade policies could expand beyond auto makers and industrial conglomerates.

Before Monday, the technology sector had been relatively resilient in the face of steep declines in industrial conglomerates and agriculture firms. Analysts said this reflected bets among investors that technology companies would be among the least exposed to tariffs that China and the European Union have imposed on the U.S.

Yet the selling Monday laid bare the vulnerability of those assumptions. Shares of technology companies that have had big gains this year slid: Netflix fell 6.5% in its biggest one-day loss since July 2016, while Facebook lost 2.7%, Amazon.com was down 3.1% and Nvidia shed 4.7%.

Tech stocks are facing "kind of a perfect storm" after their long period of outperformance, Mr. Ramos said.

About 58% of **S&P 500** tech companies' revenue comes from overseas due to the industry's high foreign sales exposure and reliance on a global supply chain. That is the most of all 11 sectors of the broad index, according to FactSet data.

Investors around the globe have been spooked by the prospect of a full-blown trade war between the U.S. and China. While the tariffs so far announced by the U.S. administration—and China's retaliatory measures—cover a small number of goods, analysts fear tensions could escalate and spread across other major economies.

Joseph Amato, chief investment officer for equities at Neuberger Berman, said trade has been the main focus for investors. But he added that the market is less concerned about tariffs that affect a small portion of goods and more worried about other retaliatory measures by China.

A range of companies have already expressed caution about how fractious trade relations could affect their bottom lines. German car manufacturer Daimler AG warned last week that Chinese retaliatory import duties on vehicles built in the U.S. would hit its sales and profits. Shares of Daimler have fallen nearly 10% over the last week, while a global fund that tracks auto stocks, the First Trust **Nasdaq** Global Auto Index fund, has dropped 7%.

Other companies have been less clear about how trade tariffs will affect corporate profits, but some executives say any restrictions would likely eat into profit margins and hamper business activity.

Pioneer Natural Resources Co. Chief Executive Timothy Dove said at a conference last week that steel tariffs, as well as the threat of retaliation from China, would substantially raise his company's costs and curb sales. "We're not terribly happy about how that's going," Mr. Dove had said.

Meanwhile, Ingersoll-Rand CEO Michael Lamach said at a UBS industrials conference last week that the shifting trade landscape has customers asking "what the rules of the game are going forward."

Monday's selling dragged down indexes around the world, with the Stoxx Europe 600 shedding 2% in its biggest one-day percentage slide since March. The Shanghai Composite ended at its lowest level since June 2016 and Hong Kong's Hang Seng Index finished at its lowest level since December.

Recent economic data in Europe and China have pointed to weaker growth than in early 2018, further damping investor sentiment. On Monday, the monthly Ifo Business Climate Index suggested German business sentiment deteriorated further in June.

"We've moved away from the synchronous global expansion," said Bob Baur, chief global economist at Principal Global Investors, who believes global growth peaked around February of this year.

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Search Summary

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Date	06/01/2018 to 06/30/2018
Source	The New York Times - All sources Or The Wall Street Journal - All sources
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Results Found	587
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