

## Turkey's exports to EU up 21 pct in Jan-May 2018

Anadolu Agency, 29.06.2018



Turkey's exports to the European Union in January-May 2018 surged 21 percent year-on-year, the country's statistical authority announced.

Exports to the 28-member EU bloc account for some 51.4 percent of Turkey's overall exports in the five-month period totaling \$35.6 billion while imports from the EU were \$39 billion, up 22 percent on a yearly basis. Turkey's overall exports totaled \$69.3 billion, a 7.9 percent annual hike, and imports reached \$104.5 billion with a 17.2 percent increase.

The country's foreign trade balance ran a \$35.2 billion deficit from January to May, marking a year-on-year rise of 41.4 percent. In May 2018, exports were \$14.3 billion -- up 5.3 percent -- and imports were \$22.6 billion -- up 5.5 percent -- over the same month last year, the institute noted. TurkStat said foreign trade deficit in May reached \$7.7 billion, with a 5.7 percent yearly increase. It said export to import ratio was 64.8 percent, while it was 64.9 percent in May 2017.

## Turkey's new parliament to hold first session on July 8

Anadolu Agency, 27.06.2018



Turkey's new parliament will hold its first plenary session on July 8 at 2.p.m. local time (1100GMT), three days after the Supreme Election Council (YSK) gives final official results for the June 24 general elections.

Republican People's Party's (CHP) Deputy Deniz Baykal -- at 80, the parliament's oldest deputy -- will chair the assembly as the acting speaker. Turkish President Recep Tayyip Erdogan as well as lawmakers will be sworn in at the parliament in the capital Ankara on July 8. After the swearing-in, Baykal will hand over the speaker's duties to Durmus Yilmaz, the second-oldest Member of Parliament.

Yilmaz was elected from the Ankara province as a lawmaker from the Good (IYI) Party. According to official results of Sunday's elections, the Justice and Development (AK) Party won 295 seats in the 600-member Grand National Assembly. The CHP came in second, claiming 146 seats, while the Peoples' Democratic Party (HDP) secured 67 seats, the Nationalist Movement Party (MHP) 49 seats, and the IYI Party 43 seats.

## Turkey strives for development of global free trade

Anadolu Agency, 27.06.2018



Turkey strives for the development of free trade around the world, Economy Minister Nihat Zeybekci said on Wednesday.

“Turkey acts in a more responsible way for the improvement of global trade and we show effort for the development of free trade among the countries,” Zeybekci told reporters in capital Ankara. Zeybekci said Turkey has signed 24 free trade agreements and one preferential trade agreement, adding Ankara is still in talks with some countries, including Mexico, Columbia and Peru, to sign deals. His remarks came after Turkey and and the European Free Trade Association (EFTA) countries.

These are; Iceland, Liechtenstein, Norway, and Switzerland -- on Monday signed an agreement to expand their free trade agreement (FTA). The first FTA, which covers trade in industrial products, fish and marine products, and processed agricultural products between Turkey and EFTA countries, was signed in 1991, according to EFTA's website. Zeybekci said the deal with EFTA countries, updated to modern day circumstances, is the “most comprehensive” free trade agreement that Turkey has signed so far. He added the updated deal will cover more areas such as services, electronics, tourism and health and transportation. Zeybekci said Turkey's bilateral trade volume with EFTA countries was \$9.7 billion in 2017 and direct investment from EFTA to Turkey was \$3.4 billion.

## Declining uncertainty over politics positive on Turkey's ratings, says JCR

Hurriyet Daily News, 26.06.2018



The Japan Credit Rating Agency (JCR) has said that “declining uncertainty” on Turkey’s domestic politics will be a positive for the country’s credit ratings in a note after the June 24 elections.

However, in its note released on June 26, the agency warned about the ineffectiveness of measures to fight the high inflation rate and the current account deficit. According to the Supreme Election Council (YSK), on June 24, Recep Tayyip Erdo an won a majority in the presidential election with 52.5 percent of the vote.

In the parliamentary polls, the “People’s Alliance” of the Nationalist Movement Party (MHP) and the Justice and Development (AKP) won 53.6 percent of the vote, with 99.9 percent of ballot boxes opened. “JCR sees that resultant declining uncertainty over domestic politics would be positive for the ratings,” read the statement. “On the other hand, JCR holds that the major ongoing macroeconomic statistics such as the inflation rate and the current account deficit indicate that measures to correct macroeconomic imbalances as proposed in the former Erdo an administration’s Medium-Term Program (MTP) at the end of September 2017 have not fully proceeded as planned,” it added. JCR concluded that it will keep watching whether the new Erdo an administration will focus on structural reforms aimed for the correction of macroeconomic imbalances and whether it will achieve the targets set forth in the MTP. JCR keeps Turkey’s rating at “BBB-” with a stable outlook, it added.

## Turkey prepares for more roles in NATO

Hurriyet Daily News, 21.06.2018



Amid claims that it no longer has a place in the Western defense alliance, Turkey is preparing for a greater role in the new NATO strategy expected to be approved in the NATO summit in Brussels on July 11-12.

It is not in vain that United States President Donald Trump told Turkish President Erdo an he was looking forward to meeting him during the NATO Summit, which will be Erdo an’s first international conference after being re-elected on June 24, in a phone call with the Turkish president to congratulate him on winning the June 24 elections.



Among the decisions expected to be taken at the summit, there are strategic topics involving Turkey. One of them is for Turkey to assume the command of NATO's Very High Readiness Joint Task Force (VJTF) in 2021. The formation of such a force was decided at the NATO Wales Summit 2014 as a "Spearhead Force" to the NATO Response Force (NRF) for the intervention of a possible crisis within a week. Seven NATO members contribute to it in six groups: The German-Dutch forces, the United Kingdom, France, Italy, Spain, Poland, and Turkey. It is a force of around 5,000 formed in five battalions supported by air forces, navies, and Special Forces of member countries. According to NATO documents, the idea was to "better respond to the changing security environment to the east and south of the Alliance's borders." Turkey, the most southeastern member of the alliance, neighbor both Russia and Middle Eastern countries like Iran, Iraq, and Syria. One of the three tactical command headquarters, the Land Command, is in Izmir, Turkey; the two others being the Maritime Command in Northwood, U.K. and the Air Command in Ramstein, Germany.

The "changing security environment" was the Russian intervention to Ukraine and the annexation of Crimea. NATO had adopted a light attack forces command structure following the Sept. 11, 2001 terrorist attacks by al-Qaeda. The Ukraine case and the concerns of the Baltic states from growing pressure from Russia has forced NATO to adopt a new defense policy. Now, NATO is expected to approve a new strategy with more emphasis on collective defense, combat readiness, mobility, and cyber warfare. It is called the NATO Readiness Initiative (NRI). The idea is to form a force of 30 battalions (approximately the equivalent of eight brigades), 30 warships, and 30 fleets of fighter jets "ready to be employed" in 30 days when they are needed, according to diplomatic sources, who have asked not to be named. Member countries are expected to allocate the military units to be attached to this initiative by 2020. Turkey is among the few countries expected to assign additional military headquarters, which would be in direct contact with the new command to be formed (together with Spain and Poland).

Ankara is planning to suggest the 3rd Army Corps Headquarters in Istanbul as the contact headquarters for the NRI, which had also previously been designated for the NATO Response Force (NRF) since 2002. The 3rd Army Corps headquarters was one of the bases used by the plotters for the military coup attempt in July 15, 2016 but the government assured NATO officials there would be no problem left by the time Turkey assumes rotational command. Another issue expected to be on the NATO agenda during the summit is to increase the NATO presence in the Black Sea considering the increased presence of Russia, especially after the annexation of Crimea. Turkey is the NATO member with the longest shore to the Black Sea and naval bases. Its NATO presence in the Black Sea in the form of patrols and exercises has been tripled in the last three years, according to Turkish sources, as long as the 1936 Montreux agreement permits in terms of days.



Last year, as he was elaborating on the need of a stronger response force, NATO Secretary General Jens Stoltenberg said “multinational battle groups in the eastern part of the Alliance are now fully operational and we are strengthening our presence in the Black Sea region.” “Turkey abides by all NATO decisions taken,” one official source has told Hürriyet Daily News. “But we have two reservations, such as the binding clauses of the Montreaux agreement and to not attempt any action to agitate Russia, which we have not seen any violation of so far from our allies.” On the other hand, the Turkish military’s role in NATO in Afghanistan, which is to protect and operate the Kabul airport, and the logistical support it provides via its strategic airbase in southern Turkey, ncirlik, will continue. The new roles Turkey is expected to assume in addition to the current ones in the Western Alliance was discussed between the Turkish leadership and Stoltenberg during the latter’s meetings in Ankara on April 16-17 this year. On the other hand, the U.S. and NATO object to the Turkish government’s purchase of the Russian-made S-400 missiles to be integrated to Turkey’s NATO interoperable air defense. Another rift is about the continued arrest of the American pastor Andrew Brunson. Those issues might come up in Erdoğan’s contacts in Brussels. Turkey has demands from NATO as well. For some time, Turkey has been asking NATO and its biggest ally the U.S. for more cooperation and understanding in the fight against terror. Erdoğan and Foreign Minister Mevlüt Çavuşoğlu have said a number of times that the U.S. and NATO member countries should not distinguish between terrorist organizations and should show solidarity with Turkey. “The anti-terror struggle is not a struggle only against the Islamic State of Iraq and Levant [ISIL] and al-Qaeda,” the Turkish source said. “Turkey has been suffering from terrorism a lot, as Stoltenberg acknowledges this.”

Ankara has been objecting to the U.S.’s cooperation with the People’s Protection Units (YPG) in Syria against ISIL, accusing the YPG of being the Syrian wing of the outlawed Kurdistan Workers’ Party (PKK), which has been attacking Turkey for more than three decades and is designated as a terrorist group by the U.S. as well. Turkey also wants the extradition of Fethullah Gülen, the U.S.-based Islamist preacher who is accused of masterminding the 2016 coup attempt, and the ex-military officers following him, who have sought asylum from different NATO members, mainly Germany and Greece.

# Chevron, Exxon CEOs worry global trade conflict could harm economy

Reuters, 26.06.2018



The leaders of two of the world's largest energy companies said on Tuesday they worry a trade conflict between the United States and other nations could destabilize the global economy.

U.S. President Donald Trump has in recent months imposed tariffs on steel, aluminum and other imports, steps that have resulted in retaliatory measures against U.S. crops, motorcycles and other products, including petroleum. That has sparked concern amongst Chevron Corp, Exxon Mobil Corp and other major oil and natural gas producers.

It is that Trump's actions could imperil relations with some of their largest customers, including China and the European Union. The United States, the world's largest natural gas producer, has begun exporting more of the fuel, part of Trump's approach to energy diplomacy. But the tariffs could undermine that plan. "The risk of trade wars starts to weigh on people's perception of economic growth in the future," Chevron Chief Executive Mike Wirth said at the World Gas Conference in Washington. "These things run the risk of becoming a bit of drag on growth." Chevron tries to buy steel for its pipelines and other equipment from U.S. manufactures but cannot always do so, Wirth said. Darren Woods, Exxon's CEO, said his company is trying to keep a "level headed voice" around the tariffs. "The world has been very well served with low tariffs and free trade," Woods said. "With tariffs, you run the risk of making some projects less attractive." Both companies are major natural gas producers in the United States, with Chevron focused especially on the Marcellus shale in Pennsylvania and Exxon on the Eagle Ford shale in Texas.

The two executives, who appeared jointly on a conference panel, argued that natural gas is the best way to help cut global greenhouse gas emissions and also increase the availability of power across the developing world. Natural gas had for several years enjoyed a designation as a "bridge fuel" away from hydrocarbons toward renewable energies. This view has come under assault recently by environmentalists, something both CEOs pushed back on. "Renewables are terrific, but you need the lights and the power and the air conditioning all the time," said Wirth, who became Chevron's CEO earlier this year. "You've got to have a mix." Natural gas, Woods said, "as the fuel of the future is a part of the solution to climate change."

# EU hails Turkey for hosting 3.5 million refugees

Anadolu Agency, 27.06.2018



The European Union praised Turkey for hosting more than 3.5 million refugees.

In a statement, the EU's General Affairs Council commended Turkey's significant efforts in hosting and addressing their needs. The move came as the council gathered in Luxembourg and released a statement on the EU membership process of six countries including Turkey, Montenegro and Serbia. It described Turkey as a "key partner" and reaffirmed "the importance it attaches to EU relations with Turkey". The council "remains committed to maintaining an open and frank dialogue.

That is addressing common challenges and to cooperating in essential areas of joint interest such as migration, counterterrorism, energy, transport, the economy and trade", the statement said. "The continued implementation of the EU-Turkey Statement, which reduces irregular and dangerous crossings [by migrants] and saves lives in the Aegean Sea, is in the interest of both sides and remains crucial," it added. Turkey hosts nearly 3.6 million Syrian refugees, according to a refugee association's data. In March 2016, Turkey and the EU signed a deal aimed at stemming the irregular migration flow through the Aegean Sea by taking stricter measures against human traffickers. The deal also aimed to improve conditions for Syrian refugees in Turkey. The statement said Turkey's "constructive cooperation" on the migration crisis has "delivered clear results". "The council reiterates that continued implementation of the EU-Turkey Statement and continued support for partners along the Western Balkans route is required," it added. "The EU will continue its financial support and technical assistance to strengthen cooperation in this field, including through the EU Facility for Refugees in Turkey," according to the statement.

Meanwhile, the council also underlined the "continued need to focus" on the rule of law and fundamental rights in Turkey. "Turkey has been moving further away from the European Union," the statement said. "Turkey's accession negotiations have therefore effectively come to a standstill and no further chapters can be considered for opening or closing and no further work towards the modernization of the EU-Turkey Customs Union is foreseen," it added. Turkey applied for membership in the European Economic Community, a precursor to the EU, in 1987. It became eligible for EU membership in 1997 and accession talks began in 2005.

## EU to start accession talks with two Balkan countries

Anadolu Agency, 27.06.2018



The European Union decided Tuesday to start accession negotiations next year with Macedonia and Albania.

The move comes as the European Council adopted conclusions on the EU's enlargement policy and the EU-Western Balkans stabilization and association process. The conclusions reaffirmed the EU's commitment to the enlargement process and to the European perspective of the Western Balkans. The Council agreed to respond positively to the progress made by Macedonia and Albania and set out the path towards opening accession negotiations.

EU foreign policy chief Federica Mogherini had recommended the EU Council in April to start accession negotiations with Macedonia and Albania. Greece, both a NATO and EU member, has long opposed Macedonia's official name, as it has a region by the same name in the north of its country. Due to Athens' veto, the dispute has been one of the main obstacles to Macedonia's ambitions to join NATO and the EU. On June 17, Greece and its northern neighbor signed a historic accord on renaming Macedonia to the Republic of Northern Macedonia, ending a longstanding dispute between the two countries. The agreement opened the way for the start of Macedonia's accession negotiations to the EU.

## African development bank president awarded Togo's highest civilian honor

AFDB, 26.06.2018



President of the African Development Bank, Akinwumi Adesina, has been honored with the Commander of the Order of Mono– the highest civil honor of Togo.

The national honour, bestowed on personalities who have shown exceptional merit, was awarded by the Head of State of Togo, Faure Essozimna Gnassingbé, on the sidelines of a visit to Togo for the launch of the Mécanisme Indicatif de Financement Agricole (MIFA), a program aimed at improving farmers' access to finance. Addressing participants at the ceremony, Adesina said:





“Transforming agriculture is the key to reviving rural economies and turning them into new zones of economic prosperity. The MIFA initiative you are launching today is another building block in Togo’s agricultural transformation strategy jointly developed by the African Development Bank and the Government of Togo, with the support of the Nigeria Incentive-Based Risk Sharing system for Agricultural Lending (NIRSAL).” MIFA’s goal is to reduce the risk of lending to agriculture and increase access to finance for farmers. “When fully implemented, it is expected to rapidly increase bank lending to the agricultural sector, reduce interest rates, and reach 1 million farmers with access to credit in the next 3-5 years,” Adesina explained. In attendance at the event were President Gnassingbé and members of his cabinet, including Prime Minister Komi Selom Klassou, members of the diplomatic corps, the President of the International Fund for Agricultural Development (IFAD), Gilbert Fossoun Hougbo, NIRSAL CEO, Aliyu Hameed, as well as representatives from the private sector.

MIFA is based on Nigeria’s successful experiences with NIRSAL, where it helped de-risk lending by commercial banks to agriculture. According to IFAD President Hougbo, “innovation is critical to boost the agricultural sector which remains a cornerstone for achieving the Sustainable Development Goals. MIFA is an innovative financial mechanism which will help support smallholders technically and financially”. Prime Minister Komi Selom Klassou, who launched the operational phase of MIFA, says agriculture accounts for 46% of Togo’s GDP with vast growth potential. “This innovative instrument is a “relief” and pragmatic response to the problem faced by small farmers who receive low financial support because of high lending risks. The African Development Bank has helped Togo implement AgriPME, a system that allows farmers to access fertilizer using their mobile phones. In 2016/2017, more than 77,500 farmers, 38% of them women, received their fertilizers through the system. AgriPME has allowed the government to better target farmers and deliver subsidized farm inputs. AgriPME has also improved transparency, accountability and increased public spending efficiency. A total of 40,000 MT of fertilizer were provided to farmers, compared to 30,000 MT on average over the period 2009-2015, an increase of 45%. The system has also led to CFAF 3.5 billion in savings for the Government of Togo.

Since the beginning of its operations in Togo in 1972, the African Development Bank Group has approved 76 operations representing a total of USD 538.24 million. The current portfolio comprises 13 transactions with a total net commitment of USD 297.80 million. It includes 10 domestic transactions valued at US \$ 143.94 million, or 32% of the global envelope, and 3 multinational operations of US \$ 153.86 million. Transport infrastructure represents 75.55% of the portfolio, followed by economic and financial governance (13.88%) and the social sector (8.77%). Agriculture, water and sanitation, energy, and the financial sector account for about 0.6% each.

# US restrictions on Chinese investment next front in trade dispute

Washington Post, 26.06.2018



U.S. President Donald Trump this week is due to launch the next phase of his economic confrontation with Beijing, with new restrictions possible on Chinese investments to clamp down on access to sensitive American technologies.

That could open U.S. firms like Apple and General Motors up to new forms of retaliation from China and experts worry it also marks another step in government intervention in the free market, a “radical departure” for the United States that could prove mutually destructive. But contradictory statements on June 25 from senior U.S. officials have muddied the waters on what path the White House will take.

Trump has threatened to strike back against China’s retaliation to the U.S. tariffs that are due to take effect July 6 -- potentially escalating the tariffs to \$450 billion in Chinese goods. Meanwhile, later this week, the Treasury Department is due to unveil a proposal on investment and export restrictions. Trump in late May announced plans to impose steep tariffs on Chinese goods, and to follow up by June 30 with “specific investment restrictions and enhanced export controls” on Chinese companies and investors in “industrially significant technology.” According The Wall Street Journal, the measures likely would target investments in the United States by any firm that is 25 percent Chinese held, although that threshold could drop if the investment is considered sensitive. U.S. Treasury Secretary Steven Mnuchin vehemently denied the reports by Bloomberg and The Journal as “false, fake news.” “The leaker either doesn’t exist or know the subject very well. Statement will be out not specific to China but to all countries that are trying to steal our technology,” Mnuchin said on Twitter, noting he was responding for Trump.

However, that contradicts the White House’s own May 29 statement which specified that new measures would target China. U.S. stocks on June 25 briefly fell more than two percent from Friday’s close and senior White House economic adviser Peter Navarro appeared on television to try to calm investor fears about a possible trade war. However, his confusing interview to CNBC did little to clarify the situation, as he said the administration was “not singling out China” but also that Treasury would release a report on June 29 on the issue of investment restrictions on China. He said investors should be bullish on the US economy, claiming Trump’s aggressive trade maneuvers had created new domestic investment. The economy “is going to a beautiful place right now,” Navarro said on CNBC. “It’s something you could only dream about.” After his comments, stocks recovered some ground and the benchmark Dow Jones Industrial Average closed with a loss of 1.3 percent, or 325 points. Trump has blamed past U.S. administrations for being soft on China and allowing the country to become dominant in manufacturing, and for failing to protect sensitive technologies.

The administration could expand existing authorities for the Committee on Foreign Investment in the United States, or CFIUS, which is led by the Treasury and which already has blocked some Chinese investments in ports and semiconductors. Even the hint of a possible CFIUS review can kill a potential investment. Congress also is looking at ways to tighten the investment review process. According to the Rhodium Group, a research firm, Chinese investment in the United States fell 35 percent in 2017 from the record \$45.6 billion in 2016, and has slowed to a trickle, just \$1.4 billion in the first quarter of this year. New export controls would make it more difficult for U.S. firms to sell technology to China if Washington deems it to be “industrially significant.”

## Trump’s plan to crack down on foreign investment is much less harsh than expected

CNBC, 27.06.2018



The White House won’t be looking to block companies with at least 25 percent Chinese ownership from buying certain U.S. tech-related companies.

Instead, the government will rely on the newly strengthened Committee on Foreign Investment in the United States to deal with concerns about foreign purchases of sensitive domestic technologies, a senior administration official said Wednesday. In all, the measures the administration announced were less harsh than proposals floated earlier in the week, providing relief to markets that continue to worry about the threat of a global trade war.

“The issue of protecting technology is very important,” Treasury Secretary Steven Mnuchin told CNBC. More trade controversy erupted this week after news reports Monday that President Donald Trump was looking to step up efforts to safeguard U.S. technology that would include blocking the purchase by companies with heavy Chinese ownership from buying American firms. Statements from the White House generated fears the restrictions would become global. The administration has sought to stop Chinese companies from allegedly stealing intellectual property, and intends to institute a series of tariffs while the issue is addressed.



The Senate on Tuesday overwhelmingly adopted changes to how CFIUS operates, beefing up the committee's authority to assess threats against U.S. business, with tech a focus. "We will have the necessary tools to protect investments, whether it's China or anybody else," Mnuchin said. "We are not singling out China, but we will protect technology transfer to China as we will to other important areas." Mnuchin said the committee has broader powers on several levels, including the ability to block some joint ventures. Under the previous authority, if a Chinese-owned company tried to acquire a U.S. company, it could be blocked but then could form a joint venture that could not be blocked. That will change "if it is critical technology," Mnuchin said. Markets had worried that the U.S. was going to institute sweeping bans that might stifle investment and escalate a global trade war. Stock futures, which previously indicated a lower open on Wall Street, turned positive as the news broke. The CFIUS-related legislation, called the Foreign Investment Risk Review Modernization Act, passed the House by a 400-2 margin. While the statements Wednesday pointed to a less restrictive environment than markets had feared, Mnuchin said the U.S. nevertheless will take a tough stand when it comes to protecting technology.

"We've been very aggressive," he said. "There were cases in the previous administration that most likely were passed that if we had reviewed we probably would have taken a much more aggressive view on. But the purpose of this legislation is that there are areas that we can protect." In a statement, Trump said the upgraded CFIUS "will enhance our ability to protect the United States from new and evolving threats posed by foreign investment while also sustaining the strong, open investment environment to which our country is committed and which benefits our economy and our people. "I have concluded that such legislation will provide additional tools to combat the predatory investment practices that threaten our critical technology leadership, national security, and future economic prosperity," Trump added, In addition to the committee's involvement, Commerce Secretary Wilbur Ross also will be involved in examining export controls. The move comes as the U.S. has been engaged in a series of trade skirmishes as tariffs are readied for July 6 implementation. Mnuchin is overseeing the process as CFIUS chair. The Treasury secretary said the decision to rely on the committee came late Tuesday and was unanimous. Multiple reports indicated that the issue over how to regulate foreign investment in U.S. companies generated deep division in the White House, particularly between Mnuchin and Peter Navarro, a top economic advisor to Trump. Mnuchin also said that the latest move was not in reaction to the wobbling in financial markets that has come during the latest round of trade-related headlines.

# The Fed's effort to control the rise of its key interest rate is running into some problems

CNBC, 27.06.2018



The Federal Reserve's effort earlier this month to tamp down the rise of its benchmark interest rate already isn't running as smoothly as officials might have anticipated.

At its June 12-13 meeting, the Federal Open Market Committee hiked its target overnight funds rate 0.25 points to a range of 1.75 percent to 2 percent. At the same time, it raised the interest on excess reserves 0.2 points to 1.95 percent. The move was meant to contain the rise of the funds rate, which historically trails the IOER.

In the weeks running up to the meeting, the funds rate closed within 5 basis points, or 0.05 percent, of the IOER, instead of staying within the midpoint of the target range as it has done since the Fed began hiking the funds rate in December 2015. However, in the days since, the funds rate has moved even closer to the IOER. As of Friday trading, the funds rate has edged up to 1.92 percent — now just 3 basis points away from the IOER, though still 8 points away from the top of the trading range set at this month's meeting. For the Fed, it's a potential headache as the central bank sees to unwind the programs it initiated to pull the economy out of the financial crisis. The Fed kept interest rates at historically low levels and bought up nearly \$4 trillion worth of Treasuries and mortgage-backed securities in an effort to keep rates anchored and maintain liquidity flow through the financial system. For investors, it means that continued upward pressure on the funds rate as the Fed unwinds the bonds on its balance sheet could keep the FOMC at bay in its stated intention to continue hiking interest rates.

"Here we are, and I think they will be lucky to get one more done this year, because whenever the curve flattens the market's going to look at the Fed and say, 'Really?' and the Fed will have to blink," said Christopher Whalen, head of Whalen Global Advisors, an investment bank consultancy. "They're telling everyone there's going to be a couple more rate increases, and that's fanciful." In addition to approving the rate hike, the FOMC got more aggressive with its forecast, indicating two more increases in 2018 and at least three in 2019. However, the rise in the funds rate to near the top of its range along with a general decline in the difference between government debt yields of various maturities has raised questions about how much tighter the Fed can get. Though the committee was fairly explicit at the meetings about its intentions, and Chairman Jerome Powell last week also affirmed his belief that the Fed should keep hiking, traders in the funds market are assigning just a 45 percent chance of two more increases this year. Internally, Fed economists saw the IOER adjustment as a small technical adjustment. But the continued upward pressure could change the rate calculus, as well as the extent of the balance sheet reduction. In a program that started in October 2017, the central bank is allowing a capped level of proceeds from its bond holdings to run off each month and is reinvesting the rest.



Whalen thinks the Fed has made a “fundamental screw-up” in the process by focusing solely on short-term reverse repo operations to control rates when yields are compressing across the duration curve. The New York Fed, which runs the central bank’s trading operations, declined a request for comment. “Jay Powell should be managing the yield curve,” Whalen said, using the chairman’s nickname. “He should make sure the curve remains positive, which means he can’t just wait for the portfolio to run off. He’s got to be willing to sell the long end of the market. It wouldn’t have a huge impact, but it would at least keep the curve positive.” Taking substantial action at this point, though, would send what could be a negative message to the market — that the balance sheet runoff, which former Chair Janet Yellen said would be “like watching paint dry,” is running into snags and requires corrective action.

However, the Fed would have no choice if there are indications that it can’t control the market movements, particularly considering the record level of Treasury debt the government has issued this year. “This is exposing how tenuous that process is and the great unknown of what’s going to happen,” said Danielle DiMartino Booth, founder of economic consulting firm Money Strong and a former advisor to former Dallas Fed President Richard Fisher for nine years, including during the financial crisis. “These are plumbing issues that are coming back to haunt the Fed.” The flood of debt issuance combined with rate hikes and the balance sheet runoff is creating a tightening in financial conditions that the Fed may not have anticipated. While Powell and others have touted the strength of the economy as justification for raising rates, the yield curve compression is signaling to some market participants that a slowdown may not be that far in the distance. An inverted yield curve, in which longer-term yields are lower than short-term, indicate that markets believe growth will be slower in the future. “There are a lot of things going on right now, none of which are favorable for the Fed trying to create a perception that they’ve got everything under control,” DiMartino Booth said.

Other issues also are at play in terms of the funds rate closing in on the IOER level. Smaller banks “have been much more aggressive” in expanding lending than large banks, causing them to have to borrow from bigger institutions. That is creating most of the demand in the short-term funds market as big banks already have nearly \$2 trillion in reserves at the Fed. That in turn is driving the funds rate higher, said Steve Blitz, chief U.S. economist at TS Lombard. Blitz said there remains some confusion about how high the level of reserves needs to be at the Fed, creating uncertainty about how far the Fed should go in tightening. As for the effort to keep the funds rate in check, “it doesn’t seem to be working,” he added. Whalen suggested the Fed should revisit a process known as “Operation Twist” that it conducted amid the bond buying. The Fed in that instance bought long-term holdings and sold an approximately equal amount of shorter-term Treasuries in an order to drive down rates farther out on the curve. Whalen said the Fed should reverse that process this time to keep shorter-term rates low, without expanding the size of its balance sheet. Whether the Fed would be willing to do such an about-face at this stage, though, is in doubt. “You’re talking about a massive reversal of position,” DiMartino Booth said. “I think that would send a very bad signal for markets.”



# Announcements & Reports

## *The U.S., NATO, and the Defense of Europe: Underlying Trends*

**Source** : CSIS

**Weblink** : [https://csis-prod.s3.amazonaws.com/s3fs-public/publication/180627\\_US\\_NATO.Report.pdf?9jrIB.LEVnm9MWWGjS6Nyc3EKf3yD.E6](https://csis-prod.s3.amazonaws.com/s3fs-public/publication/180627_US_NATO.Report.pdf?9jrIB.LEVnm9MWWGjS6Nyc3EKf3yD.E6)

## *ZTE, the Telecom Wars, and Cyber Spies*

**Source** : CSIS

**Weblink** : <https://www.csis.org/analysis/zte-telecom-wars-and-cyber-spies>

## *Intellectual Property and the International Trade Commission*

**Source** : CSIS

**Weblink** : <https://www.csis.org/analysis/intellectual-property-and-international-trade-commission>

# Upcoming Events

## *The Battle for India's Future: Democracy, Growth and Inequality*

**Date** : 03 July 2018

**Place** : London

**Website** : <https://www.chathamhouse.org/event/battle-india-s-future-democracy-growth-and-inequality>

## *Preventing Sexual Exploitation in the United Nations*

**Date** : 04 July 2018

**Place** : London

**Website** : <https://www.chathamhouse.org/event/preventing-sexual-exploitation-united-nations>

## *Inside the White House: The Transition from Obama to Trump*

**Date** : 04 July 2018

**Place** : London

**Website** : <https://www.chathamhouse.org/event/inside-white-house-transition-obama-trump>



## *The United States in Afghanistan and Pakistan*

**Date** : 09 July 2018  
**Place** : London  
**Website** : <https://www.chathamhouse.org/event/united-states-afghanistan-and-pakistan>

## *Fighting Financial Crime 2018*

**Date** : 10 September 2018  
**Place** : London  
**Website** : <https://www.chathamhouse.org/conferences/fighting-financial-crime-2018>

## *Illicit Financial Flows 2018*

**Date** : 01 October 2018  
**Place** : London  
**Website** : <https://www.chathamhouse.org/conferences/illlicit-financial-flows-2018>

## *Climate Change 2018*

**Date** : 15 October 2018  
**Place** : London  
**Website** : <https://www.chathamhouse.org/conferences/climate-change-2018>

## *Global Trade 2018*

**Date** : 01 November 2018  
**Place** : London  
**Website** : <https://www.chathamhouse.org/conferences/global-trade-2018>

## *The Future of London as a Financial Centre*

**Date** : 12 November 2018  
**Place** : London  
**Website** : <https://www.chathamhouse.org/conferences/future-london-financial-centre>