

MAKING SENSE OF *THIS* WORLD

16 April 2018



R&R Weekly Column
By Brunello Rosa



Red Lines or Red Flags?

On April 14th, the United States, the United Kingdom and France launched airstrikes targeting sites associated with Syria's chemical-weapons capabilities. As we discuss in the [scenario analysis that we publish today](#), in our baseline, this will remain a one-off episode, whose economic impact and repercussions on financial markets are likely to be limited, apart from some short-lived volatility in equity and oil prices, and a possible fall in US Treasury long-term yields.

If our baseline is correct, this military strike was justified by the need to punish the Syrian regime for the alleged use of chemical weapons in the April 7th attack on the city of Douma, which the government denies. Chemical weapons have been internationally banned since April 1997. Former US President Barack Obama set the use of chemical weapons as a "red line," and therefore a trigger for intervention in Syria, but subsequently avoided any involvement following the September 2013 Ghouta chemical attack. Therefore, President Trump would be rightly reacting to Syria crossing an internationally sanctioned "red line:" he has taken retaliatory measures after both April 2017 and April 2018 chemical attacks.


"Tit for Tat" is the game-theoretical strategy of "equivalent retaliation" that seems to be very much in vogue in DC in this period: let's not forget the lingering trade war between US and China, which the two sides are fighting along the same lines. The problem with that strategy is that it might lead to the stabilisation of the situation with a new (not necessarily better) equilibrium. Or it might, conversely, lead to a further escalation of tensions if the response is not considered proportionate by one of the two contenders, or if other actors enter the scene (in the Syrian crisis, it could be Russia intervening in the conflict). It's too early to say whether these two (very different types of) wars will further escalate or subside. But there is definitely a more "assertive" stance prevailing in DC at this stage, compared to the past, on a number of dossiers.

We discussed in [previous columns](#) how the changes recently occurred in the team of advisors of the US President and top US officials (moderate pragmatists were replaced by more ideologically driven hawks) could eventually lead to increased tensions on a several fronts. We didn't need to wait too long to see the effects of those changes. A collateral effect of a state of war in the US is that the President, as commander-in-chief, gains manoeuvring space and alignment of the administration, including the so-called "deep state," behind him.

In conclusion, it is perfectly legitimate and justified to react when "red lines" are crossed. The question here is whether the series of events of the last few weeks are starting to represent "red flags" for how the situation can evolve in the months and years to come.

Our Recent Publications

 **BOC Preview: Cautious BOC To Stay on Hold In April**
by Joseph Shupac and Brunello Rosa, 13 April 2018

 **US-Led Airstrikes On Syria Likely to Have Limited Economic and Financial Impact**, by Francisco Quintana and Pablo Gallego Cuervo, 16 April 2018



The Week Ahead

US - Retail sales are expected to pick up. Following three months of declines, consensus expects stronger March retail sales (c: 0.3% y-o-y; p: -0.1%).

Canada – BoC likely to keep its policy rate unchanged (c: 1.25%; p: 1.25%), as [discussed in our preview](#).

EZ and UK - Inflation is expected to remain stable. March y-o-y CPI is expected to be flat in the EZ (c: 1.4%; p: 1.4%) and to decline marginally in the UK (c: 2.6%; p: 2.7%).

China - Data likely to portray a stable economy. In particular, data will be released for Q1 2018 GDP growth (c: 6.8% y-o-y; p: 6.8%) and February retail sales growth (c: 9.9% y-o-y; p: 9.7%).

Iraq - The campaign for the May 12 parliamentary election will kick-off. The nine political blocs—five Shia, two Sunni and two Kurdish—that have shared power since 2003 are expected to dominate, deciding among them the PM.

The Quarter Ahead

US – Unlikely to get permanently involved in Syria. On April 14th, a US-led coalition carried out strikes in Syria, to respond to an alleged chemical weapons attack on April 7th against civilians and rebel forces in Douma, near Damascus. The attacks focused on facilities linked to the development of these weapons.

Air strikes Are Likely to further increase the price of oil in the short term. During the past week EIA data showing: a) rise in US crude oil inventories (a: +3.3 mb w-o-w; c: -0.2 mb); and b) US production increase (to over 10.5 mb/d) created downward pressure on prices. However, concerns about a US intervention in Syria pushed the price of oil up by 8.2% w-o-w to 72.6 USD/bbl. The strikes carried out on Friday night will further increase oil prices in the short term.

The economic impact of US sanctions on Russia likely to subside. Last week, as a result of US sanctions: a) the RUB plunged to the weakest level since December 2016, depreciating by 6.3% w-o-w; and b) the Russian stock market suffered its biggest plunge since the annexation of Crimea in 2014, closing the week with a 3.1% w-o-w loss. Over the next weeks tension are likely to decrease, the currency will stabilize and investors will return to the stock market, which currently presents attractive valuations (forward PE ratio of 12.1).

Turkey – The widening C/A deficit makes hikes likelier. In February, the 12m rolling C/A deficit rose further to USD 53.1bn (p: 51.5bn), ~6.2% of GDP, creating pressure on the currency to depreciate. Therefore, the likelihood of a policy rate hike in the April 25 meeting of the CBT is increasing. During the week, the USD/TRY rose by 1.2% to 4.10.

GCC - Bond issuance will remain strong. GCC countries face a USD 90bn fiscal shortfall in 2018 to be funded largely through bonds. Saudi Arabia raised USD 11bn this week, by issuing USD 4.5bn of bonds due in 2025, USD 3bn due in 2030, and USD 3.5bn due in 2049, at 140bps, 175bps and 210bps over US Treasuries of equivalent duration, respectively. Qatar announced the issuance of 5, 10 and 30-year bonds with an initial price of ~170bps, 200bps, and 230bps over equivalent USTs. This is Qatar's first bond sale since the diplomatic crisis began in June 2017.

Last Week's Review

Risks of a global trade war declined. Following some conciliatory remarks by the Chinese President Xi Jinping, President Trump suggested that the US might: a) be able to avoid a trade war; and b) consider re-joining the TPP trade deal. **Markets reacted with gains:** The S&P500 rose by 2.0% w-o-w, and volatility decreased to 17.4 (-4.1 points w-o-w), below its long-term average of 22 points. The 10-y UST yield rose 5bps w-o-w to 2.83%, supported by rising inflation (March CPI a: 2.4% y-o-y; c: 2.4%; p: 2.2%). The USD weakened against a basket of currencies (DXY declined by 0.3% w-o-w) and the EUR (EUR/USD rose by 0.3% w-o-w to 1.233).

Europe - The right-wing populist Fidesz-KDNP alliance won the parliamentary election in Hungary, securing a third term in office for PM Viktor Orban. The coalition got 49.2% of the vote (p: 44.9%), and preserved its two-thirds majority. The result will increase tensions with the EU over migration and the future of the Union.

China - Inflation declined more than expected: In March, CPI came out at 2.1% y-o-y (c: 2.6%; p: 2.9%).

Pablo Gallego Cuervo and Renata Bossini contributed to this Viewsletter.

The picture in the front page comes from [this website](#)



@RosaRoubini



Rosa & Roubini



Rosa&Roubini Associates

For more information, please call us on +44 (0)207 1010 718 or send us an email to info@rosa-roubini-associates.com

www.rosa-roubini-associates.com

118 Pall Mall, London SW1Y 5ED



Abbreviations, Acronyms and Definitions

a	Actual	KSA	Kingdom of Saudi Arabia
ann.	annualized	LN	Northern League
bn	Billion	M5S	Five Star Movement
BCB	Central Bank of Brazil	m-o-m	Month-on-month
BoC	Bank of Canada	mb	Million barrels
BoE	Bank of England	mb/d	Million barrels per day
BoJ	Bank of Japan	MENA	Middle East and North Africa
bpd	Barrels per day	mn	Million
bps	Basis points	MPM	Monetary Policy Meeting
c	Consensus	NAFTA	North-American Free Trade Agreement
C/A	Current account	OECD	The Organization for Economic Cooperation and Development
CB	Central bank	Opec	Organization of Petroleum Exporting Countries
CBK	Central Bank of Kuwait	p	Previous
CBO	US Congressional Budget Office	pw	Previous week
CBT	Central Bank of the Republic of Turkey	PCE	Personal Consumption Expenditures
CDU	Christian Democratic Union of Germany	PE	Price to earnings ratio
CNY	Chinese Yuan	PM	Prime minister
CBT	Central Bank of the Republic of Turkey	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DFMGI	Dubai Financial Market General Index	QCB	Qatar Central Bank
DJIA	Dow Jones Industrial Average Index	QAR	Qatari Riyal
d-o-d	Day-on-day	QE	Quantitative easing
DXY	US Dollar Index	q-o-q	Quarter-on-quarter
EC	European Council	RBA	Reserve Bank of Australia
ECB	European Central Bank	REER	Real Effective Exchange Rate
EIA	US Energy Information Agency	RUB	Russian Rouble
EM	Emerging Markets	SAMA	Saudi Arabian Monetary Authority
EP	European Parliament	SHCOMP	Shanghai Stock Exchange Composite Index
EU	European Union	tb/d	Thousand barrels per day
EUR	Euro	tn	Trillion
EZ	Eurozone	TPP	Trans Pacific Partnership
Fed	US Federal Reserve	TRY	Turkish Lira
FOMC	US Federal Open Market Committee	UAE	United Arab Emirates
FRB	US Federal Reserve Board	UK	United Kingdom
FX	Foreign exchange	US	United States
FY	Fiscal Year	USD	United States Dollar
GCC	Gulf Cooperation Council	USD/bbl.	USD per barrel
GBP	British pound	UST	US Treasury bills/bonds
GDP	Gross domestic product	VAT	Value added tax
GOP	Grand Old Party (US Republican Party)	VIX	Chicago Board Options Exchange Volatility Index
IMF	International Monetary Fund	WTI	West Texas Intermediate
IPO	Initial public offering	w-o-w	Week-on-week
JPY	Japanese yen	y-o-y	Year-on-year
k	thousand	y-t-d	Year-to-date
KDNP	Christian Democratic People's Party (Hungary)	ZAR	South African Rand
KRG	Kurdistan Regional Government	10-y	10 year