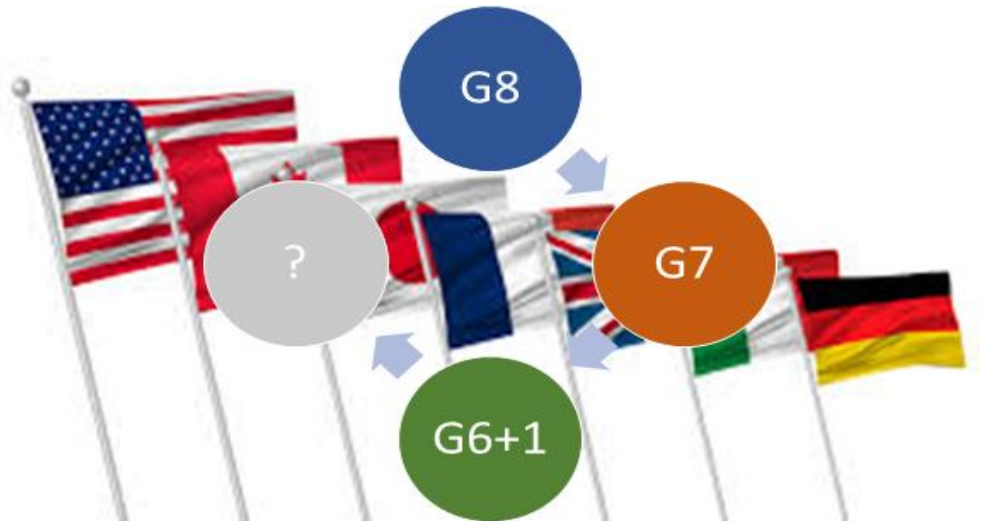


MAKING SENSE OF *THIS* WORLD

4 June 2018



R&R Weekly Column
By Brunello Rosa



G8, G7, G6+1 and ?


This week the world's seven most advanced economies will convene in Canada for their periodic G7 meeting. Not long ago, this reunion was called G8, as also Russia was participating (from 1997 to 2014, when it was excluded due to the Crimean annexation). In our [recent trip report from Russia](#), we discuss how the series of sanctions that have hit Russia from 2014 onward has convinced its omnipotent President Putin to pursue more in-ward looking policies as opposed to the structural reforms suggested by his advisors, aimed at opening up the Russian economy and increasing its sluggish growth potential. However, the rise of autocratic, inward-looking, protectionist and sometimes nationalistic leaders (discussed in [a previous column](#)) is a widespread phenomenon, as testified by the upcoming presidential and parliamentary elections in Turkey (on June 24th), where President Erdoğan aims at further increasing its grip on the country, as discussed [in our recent paper](#).



In the US, the democratically elected President Trump is adopting an increasingly protectionist stance, as demonstrated by the decision to impose tariffs on US import of steel and aluminium from Mexico, Canada and the EU, after the exemption period expired this week. This comes at the time the US is already in a [potential trade war with China](#) and is [re-negotiating NAFTA](#). At the G7 meeting of finance ministers and central bank governors, six countries asked US Treasury Secretary Steve Mnuchin to convey their "unanimous concern and disappointment" about the tariffs to the President. Somebody has already started to re-label next week's G7 meeting as a G6+1. Is it the end of it? Well, [in Italy](#), the new Conte government has just been sworn in, supported by reportedly populist parties such as Five Star and League. For the time being, the EU has shown its friendly face to Italy, saying (with Juncker, Moscovici and Merkel) that European partners are ready to cooperate with the new Italian government. But what if Italy starts significantly to drift away from its traditional pro-European and pro-NATO stance? Will the G7 become G5+1+1?

What about Germany? For the time being, as discussed in [our recent trip report](#), the political system is trying to revitalise the centre ground, but – in case of failure – populist and extremist parties from the right and the left are ready to make significant electoral progress and render Germany as ungovernable as Italy is. Would that mean we are going to have a G4+1+1+1? Maybe, unless also the UK starts significantly deviating from its traditional free-trade policies by making the wrong customs arrangements, post-Brexit (as we discuss in our upcoming trip report); in which case we might have a G3+1+1+1+1. What if [Macron fails to reform France](#) and [Abe manages to change the Japanese pacifist constitution](#)? At that point, there wouldn't be much left of the once seemingly invincible consensus of the world's most industrialised nations.

The reality is that the pendulum of history is swinging in a direction that is opposite to the one that led to the equilibria reached after World War II, and the formal and informal institutions that emerged from them. Physics tells us that, unless a lot of effort is made to stop its movement, the pendulum will continue to swing until the opposite (dis-)equilibrium is reached.

Our Recent Publications:

 [Turkey: Volatility Until the Elections, Slow Normalization Thereafter](#) By Alessandro Magnoli Bocchi and Pablo Gallego Cuervo, 1 June 2018

 [Russia Trip Report: Putin to Continue Inward-Oriented Economic Policies](#) By Nouriel Roubini, 29 May 2018
 [Italy Working Paper: Political Crisis Intensifies and Becomes Institutional](#) By Brunello Rosa, 29 May 2018



The Week Ahead

G7 – The periodic meeting of the most advanced economies will take place on 7 and 8 June in Canada.

US - EU and Canada are expected to react to tariffs. The EU will open a WTO case against the US, as they challenge the legitimacy of US tariffs. The EU and Canada are also considering tariffs on, respectively, USD 7.5bn and 12.8bn of imports from the US.

EZ - GDP growth will show stable growth in Q1 (GDP y-o-y, c: 2.5%; p: 2.5%).

The Quarter Ahead

US - Fed will continue to tighten monetary policy, despite rising geopolitical concerns - which continue to weaken expectations on further hikes. The market-implied likelihood of a 25-bps hike at the June 12-13 FOMC meeting declined to 91% (*pw*: 93%), while the likelihood of “at least three” and “at least four” hikes in 2018 declined to 83% (*pw*: 84%) and 37% (*pw*: 40%), respectively (CME).

US-North Korea negotiations will resume. The June 12 meeting between the leaders of the two countries was confirmed last Friday.

EM currencies will remain under pressure. Last week, the Bank of Indonesia hiked its policy rate by 25bp (to 4.75%), to protect its currency.

Turkey - Ahead of the June 24 presidential and parliamentary election, the Country will remain vulnerable. Last week, the TRY appreciated against the USD (USD/TRY -1.5% w-o-w, to USD/TRY 4.65), as the CBT: *a*) announced the simplification of its interest rates system by setting as benchmark the one-week repo rate; and *b*) more than doubled it (*a*: 16.5%; *p*: 8.0%). [President Erdogan is expected to be re-elected](#), and an alliance led by his party AKP is likely to get majority in Parliament.

The GCC economies will improve their fiscal position. In May, Saudi Arabia's FX reserves reached a 14-month high (USD 506bn), supported by rising oil receipts.

Opec - Likely to boost oil output to reduce upward pressure on prices. The decision is expected to be announced at the June 22 Opec meeting. Last week, Brent oil price rose to USD/bbl 76.8 (+0.4% w-o-w).

Last Week's Review

US - Employment data were better than expected... The US economy reached its lowest unemployment rate in 18 years (May, *a*: 3.8%; *c*: 3.9%; *p*: 3.9%) after adding 223k jobs in May (nonfarm payrolls, May, *c*: 188k; *p*: 164k), while other data were in line with expectations (average hourly earnings y-o-y change, *a*: 2.7%; *c*: 2.7%; *p*: 2.6%; core PCE, April, y-o-y, *a*: 1.8%, *c*: 1.8%; *p*: 1.8%).

... Lifting US stocks. The S&P500 rose by 0.5% w-o-w—recovering from losses earlier in the week due to: *a*) the EZ crisis; and *b*) rising trade risks—which increased demand for US 10y bonds (-3bps w-o-w to 2.90%)—after the US decision to impose tariffs on imports of steel (25%) and aluminum (10%) from the EU, Mexico and Canada—while volatility was unchanged. The USD remained flat against a basket of currencies (DXY: -0.1% w-o-w).

Europe, the likelihood of early elections in Italy and Spain decreased... In Italy, President Mattarella approved a new—less Eurosceptic—government proposed by the M5S-League coalition, reducing markets' concerns. In Spain, the opposition leader Sánchez—supported by far left and regional parties—ousted PM Rajoy through a no-confidence vote. The new PM intends to govern for an unspecified period before calling for fresh elections

... Helping European markets to partially recover from the strong correction they had suffered earlier in the week. The Eurostoxx50 fell by 1.8% w-o-w (up from a -4% on Monday) while the IBEX 35 and the FTSEMIB declined by 2.0% and 1.3% w-o-w, respectively. 10y bond yields rose in Italy (+22bps w-o-w, to 2.67%), and decreased in Spain (-3bps w-o-w, to 1.44%), remaining flat in Germany at 0.40%. The EUR ended the week flat against the USD (EUR/USD at 1.166), supported by: *a*) the improvement in the political outlook; *b*) the pick-up of EZ inflation (CPI, May, y-o-y, *a*: 1.9%; *c*: 1.6%; *p*: 1.2%; ECB's target: 2.0%); and *c*) expectations of resilient growth in Q2 (ESI, May, *c*: 112.5; *p*: 112.7).

GCC - Bond yields fell last week. Yields in GCC bonds tracked the performance of US benchmarks: the yield on the Bloomberg Barclays GCC Credit and High Yield index fell by 3bps to 4.56%.

Pablo Gallego Cuervo and Renata Bossini contributed to this Viewsletter. The picture on page 1 was built starting from an image from [this website](#)



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Abbreviations, Acronyms and Definitions

a	Actual	IPO	Initial public offering
AKP	Justice and Development Party	IS	Islamic State
ann.	annualized	JPY	Japanese yen
ARS	Argentinian Peso	k	thousand
bn	Billion	KSA	Kingdom of Saudi Arabia
BCB	Central Bank of Brazil	LN	Northern League
BoC	Bank of Canada	MSS	Five Star Movement
BoE	Bank of England	m-o-m	Month-on-month
BoJ	Bank of Japan	mb	Million barrels
bpd	Barrels per day	mb/d	Million barrels per day
bps	Basis points	MENA	Middle East and North Africa
c	Consensus	mn	Million
C/A	Current account	NAFTA	North-American Free Trade Agreement
CB	Central bank	OECD	The Organization for Economic Cooperation and Development
CBK	Central Bank of Kuwait	Opec	Organization of Petroleum Exporting Countries
CBR	Central Bank of Russia	p	Previous
CBT	Central Bank of the Republic of Turkey	pw	Previous week
CNY	Chinese Yuan	PCE	Personal Consumption Expenditures
CBT	Central Bank of the Republic of Turkey	PE	Price to earnings ratio
CPI	Consumer Price Index	PM	Prime minister
DJIA	Dow Jones Industrial Average Index	PMI	Purchasing managers' index
d-o-d	Day-on-day	pps	Percentage points
DX	US Dollar Index	QCB	Qatar Central Bank
EC	European Council	QAR	Qatari Riyal
ECB	European Central Bank	QE	Quantitative easing
EM	Emerging Markets	q-o-q	Quarter-on-quarter
EP	European Parliament	RBA	Reserve Bank of Australia
EPS	Earnings per share	REER	Real Effective Exchange Rate
ESI	EZ Economic Sentiment Indicator	RUB	Russian Rouble
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
FM	Future Movement	UAE	United Arab Emirates
FOMC	US Federal Open Market Committee	UK	United Kingdom
FRB	US Federal Reserve Board	US	United States
FTSEMIB	Benchmark Milan Stock Exchange Index	USD	United States Dollar
FX	Foreign exchange	USD/bbl.	USD per barrel
FY	Fiscal Year	UST	US Treasury bills/bonds
G7	Group of Seven (Canada, France, Germany, Italy, Japan, UK and US)	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	w-o-w	Week-on-week
GOP	Grand Old Party (US Republican Party)	y-o-y	Year-on-year
IBEX35	Benchmark Madrid Stock Exchange Index	y-t-d	Year-to-date
IMF	International Monetary Fund	ZAR	South African Rand
INR	Indian Rupee	10-y	10 year
		ZEW	Centre for European Economic Research