MAKING SENSE OF *THIS* WORLD — *16 July 2018*

R&R Weekly Column
By Brunello Rosa

Trade Skirmishes And Technological Wars

A series recently-published of articles (for example on the New York Times and Le Figaro) reported the fast development in China of facial-recognition and other surveillance technologies that allow the authorities (central and local governments, public administrations, school boards, etc.) to follow almost any moment of people's life, in a country with a 1.4bn population. The authors of these articles suggest how these systems are the technological evolution of other forms of social control that have traditionally characterised the Chinese society for centuries, from household communities to workplaces. These surveillance technologies would also allow the government to finally implement a system of "social reputational scores" that was conceived in the 1990s as way of assessing people's creditworthiness, now expanded to a much greater scope.

In schools, systems of continuous surveillance would allow the teaching board to make a real 360-degree evaluation of scholars, not just through traditional test scores, but also by assessing presence, participation and activity of pupils during school hours, interest for the subjects studied, overall behaviour during examinations as well as during recess. This way, the authorities claim, only the best of the best (not just academically, but also in terms of behaviour) will really emerge in a dramatically competitive environment such as the Chinese society today. At the same time, it is quite natural to think that, with these technologies, the governmental control of people's activities (including those of political, or politically-sensitive, nature) can also be implemented and enhanced.

Let's set aside, for a moment, the moral, ethical and political implications of these technologies, which could amount to a rather dystopian, Orwellian big-brother future, where the combination of artificial intelligence (AI), Internet of Things (IOT), big data, robots and automation eventually lead to the emergence of a combined system of machines not dissimilar to the Skynet of the *Terminator* saga, which eventually becomes self-sufficient and auto-directed. (With some sense of humour, the Chinese police called exactly "Skynet" their system of surveillance cameras). What is mostly relevant for us at this juncture is the fact that the new battlefield for world economic leadership is exactly within the perimeter marked by AI, IOT, big data, robots and automation, with a geopolitical angle constituted by the cyberwarfare, and a financial angle deriving from the addition of Fin-Tech to the mix.

As discussed in a recent report by Nouriel Roubini, in this race to the 21st century economic supremacy, China is ahead of any other country in the world, having set the goal of being the number one in the 10 most advanced technologies of the future (including AI, robotics, EV and driverless cars, biotech, aerospace, and others) by 2030, even by using aggressive industrial policies that will include government funding, subsidies and below-market rates loans. One can see how the ongoing trade tensions (with tariffs and counter-tariffs between US and China) are just skirmishes (that could still lead to a full-blown trade war, if not contained), compared to the much deeper and broader lingering technological war between the world's super-powers.

Our Recent Publications

- *Yield Curve "Near-Inversion" Does Not Imply U.S. Recession, by Brunello Rosa, 4 July 2018*
- *BOC Review: Hike Now, and on a Half-Yearly Basis, by Joseph Shupac and Brunello Rosa, 12 July 2018*

The Week Ahead

On Monday, the presidents of the US and Russia will meet. The meeting—which follows a tense NATO summit last week—is expected to improve the relationship between the two countries.

In the US, retail sales are expected to decelerate (*c:* 0.4% y-o-y; *p:* 0.9%). In the EZ, June CPI should remain in line with the ECB target (June CPI, *c:* 2.0% y-o-y; *p:* 2.0%) with a minor pickup in core inflation (*c:* 1.1% y-o-y; *p:* 1.0%).

In China, Q2 2018 GDP growth is expected to have softened. Data on Chinese GDP growth (Q2 y-o-y) are likely to confirm a deceleration of the economy (*c:* 6.7% y-o-y; *p:* 6.8%).

The Quarter Ahead

In the US, the Fed will continue to hike rates and reduce USD global liquidity… In the US: *a)* the Fed will accelerate the pace of balance sheet reduction to 40bn per month in Q3 and 50bn per month in Q4); *b)* the government will increase bond issuance; while *c)* the Fed will keep hiking rates (likely in September and December), to close the year with a 2.25-2.50% policy rate.

… putting pressure on EM currencies to weaken further. EMs will remain vulnerable to outflows in Q3 due to: *a)* declining USD liquidity; *b)* rising US interest rates; *c)* a stronger USD; and *d)* trade war fears. EM assets are under increasing pressure: while currencies remained stable (MSCI EM currency index: -0.1% w-o-w), stocks suffered outflows: investors withdrew USD900m from EM equity funds for the week ending on July 11. This was the 10th straight week of outflows, accumulating losses to more than USD17bn since the start of May. EM CBs will likely be forced to increase interest rates to pre-empt further currency depreciation.

***In the near term, trade tensions will remain high, but will not lead to a trade-war*.** Concern continues to rise after the US—following the adoption of tariffs on USD34bn of imports from China last week—announced this week that it is considering tariffs on a further USD200bn of imports. These concerns weakened the CNY by 0.7% w-o-w against the USD (to USD/CNY 6.70). As the US November mid-term elections approach, further tariffs are likely to be imposed. Thereafter, the US government will likely soften its position.

In Turkey, investors' concern will remain high in the near term. The announcement of the new cabinet and recent changes in the CBT governance rules—reducing the tenure of the board members and giving the president full power on their appointment—have increased investors' concerns and caused the TRY to depreciate against the USD (USD/TRY 4.84, +5.9% w-o-w).

Bahrain will continue to face a decline in fiscal revenues. Bahrain's economy shrank—for the first time in seven years—by 1.2% y-o-y in Q1 2018, hit by a 14% y-o-y fall in oil production.

Brent oil prices will remain above 70 USD/b, in spite of the announced Opec output expansion. Brent prices declined by 2.3% w-o-w, to 75.3 USD/b due to the improvement on Libya's exports and trade war fears. However, the risk of output shortage remains elevated: Opec has only 2.1m b/d of spare capacity (in KSA, Kuwait and the UAE), which will be further reduced if KSA delivers on its promise to increase output to 11mb/d (June, *a:* 10.42; *p:* 10.0).

Last Week's Review

***In the US, signs of economic strength drove stock market performance*.** Global stocks rose by 0.2% w-o-w (MSCI ACWI). In the US, the S&P500 increased by 1.5%, reaching a five-month high, driven by: *a)* the upbeat economic assessment of the Fed's semi-annual monetary policy report; and *b)* supportive June CPI data, both headline (*a:* 2.9% y-o-y, the highest since 2012; *c:* 2.9%; *p:* 2.8%) and core (*a:* 2.3% y-o-y, an 18-month high; *c:* 2.3%; *p:* 2.2%). The VIX index declined by 1 point to 12, further below its long-term trend of 22. The 10y UST yield remained stable at 2.83% (+1bps w-o-w). The USD strengthened against a basket of currencies (DXY +0.7% w-o-w), and was flat against the EUR (EUR/USD 1.17).

In the EZ, Germany's June CPI remained unchanged, in line with expectations (*c:* 2.1% y-o-y; *c:* 2.1%; *p:* 2.1%).

In China prices rose moderately (June CPI, *a:* 1.9% y-o-y; *c:* 1.9%; *p:* 1.8%).

In Canada, the BoC raised its benchmark rate by 0.25bps to 1.50% (*c:* 1.50%), on account of the strength of the economy.

Egyptian CPI inflation rose to 14.4% (June*, y-o-y, p:* 11.4%), driven by a new wave of subsidy cuts.

Pablo Gallego Cuervo *contributed to this Viewsletter.* *The picture in the front page comes from this website*

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Abbreviations, Acronyms and Definitions

a	Actual
AKP	Justice and Development Party, Turkey
ann.	annualized
ARS	Argentinian Peso
bn	Billion
BoC	Bank of Canada
BoE	Bank of England
BoJ	Bank of Japan
bpd	Barrels per day
bps	Basis points
BS	Balance sheet
c	Consensus
C/A	Current account
CB	Central bank
CBK	Central Bank of Kuwait
CBR	Central Bank of Russia
CBT	Central Bank of the Republic of Turkey
CDU	Christian Democratic Union, Germany
CNY	Chinese Yuan
CPI	Consumer Price Index
DJIA	Dow Jones Industrial Average Index
d-o-d	Day-on-day
DXY	US Dollar Index
EC	European Council
ECB	European Central Bank
EIA	US Energy Information Agency
EM	Emerging Markets
EP	European Parliament
EPS	Earnings per share
EU	European Union
EUR	Euro
EZ	Eurozone
Fed	US Federal Reserve
FM	Future Movement
FOMC	US Federal Open Market Committee
FRB	US Federal Reserve Board
FX	Foreign exchange
FY	Fiscal Year
GCC	Gulf Cooperation Council
GBP	British pound
GDP	Gross domestic product
GOP	Grand Old Party (US Republican Party)
IMF	International Monetary Fund
INR	Indian Rupee
IPO	Initial public offering
IS	Islamic State
JPY	Japanese yen
k	thousand
KSA	Kingdom of Saudi Arabia
LN	Northern League, Italy
M5S	Five Star Movement, Italy
m-o-m	Month-on-month
mb	Million barrels
mb/d	Million barrels per day
MENA	Middle East and North Africa
MHP	Nationalist Movement Party, Turkey
mn	Million
NAFTA	North-American Free Trade Agreement
NATO	North Atlantic Treaty Organization
OECD	Organization for Economic Cooperation and Development
Opec	Organization of Petroleum Exporting Countries
p	Previous
PBoC	People's Bank of China
PCE	Personal Consumption Expenditures
PE	Price to earnings ratio
PM	Prime minister
PMI	Purchasing managers' index
pps	Percentage points
pw	Previous week
QCB	Qatar Central Bank
QAR	Qatari Riyal
QE	Quantitative easing
q-o-q	Quarter-on-quarter
RBA	Reserve Bank of Australia
RRR	Reserve Requirement Ratio
RUB	Russian Rouble
SHCOMP	Shanghai Stock Exchange Composite Index
tb/d	Thousand barrels per day
tn	Trillion
TPP	Trans Pacific Partnership
TRY	Turkish Lira
UAE	United Arab Emirates
UK	United Kingdom
US	United States
USD	United States Dollar
USD/b	USD per barrel
UST	US Treasury bills/bonds
VAT	Value added tax
VIX	Chicago Board Options Exchange Volatility Index
WTI	West Texas Intermediate
w-o-w	Week-on-week
y-o-y	Year-on-year
y-t-d	Year-to-date
2y; 10y	2-year; 10-year