

MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
By Brunello Rosa



The Flip Side To This Very Hot Summer

It's August, schools are closed and some of our readers are probably enjoying well-deserved holidays. This year summer temperatures are warmer than usual, in many parts of the world. In Europe average temperatures are reportedly [6-12 degrees Celsius above normal seasonal averages](#), and have touched 40 degrees Celsius (104 Fahrenheit) in a number of countries, even in Northern Europe. These extreme weather conditions could make holidays more enjoyable for those spending time at beaches, lakes, or mountains, but on a larger scale they are unlikely to be good news. Because of the hot weather, forest fires have been raging in a number of places: [California](#), [Sweden](#), [Britain](#), and [Australia](#). In Greece, the fire that recently claimed more than 90 victims near [Athens](#) was partly caused by high temperatures and drought. Assuming that high temperatures are the result of climate change, their long-term implications are likely to be severe. In his seminal book [Connectography](#), Parag Khanna provided a picture of how [the world might look at temperatures 4 degrees warmer than usual](#). Comparing that picture with maps showing present-day migration flows (maps from the [International Organization for Migration](#), for example), one can already see astonishing similarities. People are leaving places of recent or impending desertification. As far as Europe is concerned, the largest places of origin for migrants are countries in the Sahel and Sub-Saharan Africa. This is because the Sahara Desert has expanded to the south, making living conditions in some areas (via agriculture, drinkable water, etc.) impossible. People from these regions try to reach Europe by crossing the Mediterranean, leaving Africa from countries such as Libya where border controls have been reduced by political weakness of public authorities. Political authorities in Europe, the US, and other parts of the world continue to make the distinction between a refugee ("someone who has been forced to flee his or her country because of persecution, war or violence", [according to UNHCR](#)) and an economic migrant ("a person who leaves their home country to live in another country with better working or living conditions", according to [Cambridge Dictionary](#)). Only the former is entitled to receive international protection by being granted asylum in recipient countries. There is an inconsistency here: people escaping declared and recognised wars are classified as refugees and are entitled to apply for asylum and remain in the countries they have arrived in, while those escaping an equally certain death due to incipient desertification are considered economic migrants and can be sent back to their countries of origin. In our opinion, this distinction is flawed and outdated. As Prof. Jeffrey Sachs wrote [in a recent article](#), "we are all climate refugees now." As discussed [in a recent book](#), because of the social and political implications of climate change and migrations, conflicts are also more likely to emerge in migrants' countries of origin. Political authorities need to start acting in accordance with this new reality, since ignoring it only feeds populism. There are now tens of millions of internally-displaced people, refugees and "economic migrants." They will all want a chance for a better (or any) life, and will go to the most advanced economies. In 2015, for example, [Germany became the single largest recipient of new individual asylum claims globally](#), with 441,800 registered individuals. It became the second most common destination for international migrants globally, one spot behind the US and ahead of Russia. One can understand traditional or populist political parties being resistant to this new phenomenon, but that will not change the fact that it will become more evident in the years to come. According to Prof. Sachs, "there is still [another 0.5° Celsius or so of warming](#) to occur over the coming decades based on the current concentration of CO₂". The environmental effects of this have yet to be observed. Climate change, to be sure, is not just an environmental phenomenon to be discussed in large international symposia. It is an emergency, with massive economic, social, and political ramifications that need to be tackled with the utmost determination and sense of urgency. Before it is too late.

Our Recent Publications

 [BOE Ends Up Delivering A Dovish Hike](#), by Brunello Rosa,
2 August 2018



 [The Geopolitical Corner - Trump Re-Ignites the Iranian Nuclear Crisis](#), by John Hulsman, 2 August 2018

The Week Ahead

In the US, we expect inflation to remain stable (CPI July y-o-y, c: 2.9%; p: 2.9%).

In the UK, GDP growth will likely remain weak, at its lowest level since Q2-2012 (c: 1.2%; p: 1.2%). Last week, [the BoE hiked rates to 0.75% \(+25bps\)](#)—the highest level since 2009—but gave no indication on future increases. GBP slid to GBP/USD 1.300 (-0.8% w-o-w).

On August 6, the US will re-impose sanctions on Iran. Concerns on their effect on the Iranian economy have sparked protests, amid high unemployment (Q1-2018, a: 12.1%; p: 11.9%) and IRR depreciation (USD/IRR 44,122, +22.2% y-t-d). President Trump's offer to meet Iranian President Rouhani "without pre-conditions" was rebuffed by Iranian officials.

The Quarter Ahead

Global growth and inflation will likely decelerate. In the EZ, Q2-2018 growth decelerated more than expected (a: 2.1% y-o-y; c: 2.2%; p: 2.5%). CPI growth accelerated marginally (July, a: 2.1% y-o-y; c: 2.0%; p: 2.0%) still driven by energy prices: (core CPI July y-o-y, a: 1.1%; c: 1.0%; p: 0.9%).

In the US, the Fed will continue to tighten. The likelihood of "at least two additional hikes in 2018" rose to 68.5% (pw: 67.7%), supported by: a) July inflation data above the Fed's 2% target (PCE a: 2.2% y-o-y; c: 2.3%; p: 2.2%. Core PCE, 1.9 % y-o-y; c: 2.0% y-o-y; p: 1.9%); and b) solid July employment data: i) change in average hourly earnings (a: 2.7% y-o-y; c: 2.7%, p: 2.7%); ii) change in non-farm payrolls (a: 157k m-o-m; c: 190k; p: 248k); and iii) unemployment rate (a: 3.9%; c: 3.9%; p: 4.0%).

Tariffs are set to escalate, but will likely not lead to a trade war. The US is considering increasing from 10 to 25% the proposed tariffs on Chinese goods worth USD200bn, as: i) talks between US and China remain at a standstill; and b) the CNY continues to weaken (USD/CNY 6.827, +5.0% y-t-d). China announced plans to retaliate—with tariffs ranging from 5 to 25%—on imports from the US worth USD 60bn.

In Italy, further sell-offs of government bonds are likely. The 10y Italian bond yield rose by 20bps w-o-w (to 2.94%) on concerns over tax cuts and increased fiscal spending.

In the UK, the likelihood of a hard Brexit is increasing. Last week, UK's PM May failed to obtain support from French President Macron to soften the EU's red lines. EU negotiators rejected the latest UK proposal in order to preserve the integrity of the single market.

In China, policy will help stabilize growth and financial markets. China's Politburo quarterly meeting resulted in calls for: a) a bigger role of fiscal policies in expanding domestic demand; b) more infrastructure spending; and c) a "prudent monetary policy".

EMs will remain vulnerable to outflows due to: a) declining USD liquidity; b) rising US interest rates; c) a stronger USD; and d) trade war fears. EM currencies will depreciate further (MSCI EM currency index: -3.3% y-t-d). Bonds are holding up, with EM bond funds receiving inflows of USD 864mn w-o-w (p: 592mn), reaching a total of USD 20bn y-t-d.

Brent oil prices will remain above 70 USD/b. Brent prices declined by 1.5% w-o-w, to 73.2 USD/b, due to: a) US crude stockpiles rising in the week ending July 27 (a: +3.8mb w-o-w; c: -2.5mb; p: -6.1mb); b) expectations that sanctions on Iranian oil exports could be postponed; and c) renewed trade war concerns.

Last Week's Review

In the US, stocks and the USD were supported by upbeat expectations on economic growth and earnings. The S&P500 rose by 0.8% w-o-w—its fifth straight weekly gain—and the USD appreciated (against a currency basket: DXY +0.5%; and the EUR: EUR/USD 1.157, -0.8%), driven by: a) the FOMC keeping rates on hold at 2.00% while issuing a bullish assessment of the economy; and b) S&P500 earnings: with Q2 data published for 81% of the firms, 80% reported a positive EPS surprise, with a blended earnings rate of 24.0%. The VIX declined by 1.4 points to 11.6 (52w avg.: 13.6; 10y avg.19.6): Concerns about trade wars kept demand for bonds steady, with 10y UST yields declining 1bps w-o-w, to 2.95%.

In Japan, in line with our view, the BoJ kept rates on hold (a: -0.10%; c: -0.10%; p: -0.10%).

In Turkey, the TRY depreciated against the USD (USD/TRY 5.081, +4.7% w-o-w), due to: a) US sanctions on Turkey's ministers of Justice (Mr. Abdulhamit Gül) and Interior (Mr. Süleyman Soylu) over the detention of US pastor Brunson; and b) a CPI acceleration (July, a: 15.8% y-o-y; c: 16.4%; p: 15.4%).

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



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Abbreviations, Acronyms and Definitions

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