



R&R Weekly Column
By Brunello Rosa



IMF Downgrades World Economic Outlook for 2019, Citing “Challenges To Steady Growth”

Last week the IMF released its [latest World Economic Outlook](#). In it, the IMF lowered its forecast of global growth in 2019 (by 0.2%, to 3.7%, the same rate of growth it predicts to occur in 2018), citing a number of “rising risks,” including multilateralism being challenged worldwide, the ongoing US-China trade dispute possibly morphing into a full-fledged trade war with global implications, the possible impact of continued Fed monetary tightening on US and global financial conditions, and rising political and economic risks in the EU. This outlook downgrade might have contributed to the continuation of the ongoing sell-off in global equity markets, which we discuss in an upcoming report. Last week, MSCI AWCI lost 3.9%, the S&P500 4.1%, Eurostoxx 50 4.5% and MSCI EMs 2.1%, while volatility rose above its 10-year average.

A focus on European political risk is warranted given developments that occurred during the past weekend. In Germany, the CSU (the CDU’s sister party in Bavaria) “won” the regional election with such a huge loss of votes, falling from an absolute majority to only around 37%, that it would be more correct to describe this electoral performance as [a historical defeat](#). This election is important for a number of reasons. At a local level, the right-wing populist AfD, which entered the regional parliament for the first time with 11% of votes, is proposing an alliance with the CDU to govern the Land. Such an alliance would be another example of the “Austrian model”, wherein a right-wing populist party offers its support to prop-up a government led by the Christian-democratic party. (Italy’s Deputy PM Matteo Salvini is also actively pursuing this model, at the European level). For the time being, it seems that the CSU will look for other allies to govern with, but things may change in future. At a national level, the CSU’s defeat in Bavaria will make its positions even more radicalised, further putting at risk Angela Merkel’s fragile *grosse coalition*. Finally at the European level, the more the German government moves to the right, the more likely it is that the necessary advancement of the EU and the EZ towards more integration will be slowed down.

In the UK, negotiations for [a deal to be presented at the EU summit on Wednesday broke down](#) on Sunday. The UK rejected the draft withdrawal treaty proposed by Brussels, as it was unwilling to accept the backstop that would allow Northern Ireland to remain within the EU customs union. This stand-off in the negotiations might imply that the extraordinary EU Council meeting that will be held in November to finalise the deal might not take place, and the UK might leave the EU without a deal. The 27 EU ambassadors have been summoned by chief negotiator Michel Barnier to participate in urgent meetings. Last week, the BOE warned that [GBP 41 trillion of derivatives will face legal uncertainty after Brexit on 29 March](#) unless the EU takes action to ensure the continuity of existing rules.

Finally, European governments will have to present their Draft Budgetary Plans by the midnight of 15 October, and all eyes are on Italy’s budget, which is at serious risk of non-compliance, which if it were to occur could mean the EU opening an excessive deficit procedure (EDP) for the country. The 10y BTP/Bund spread remains above 300bps, while Deputy PMs Luigi Di Maio and Matteo Salvini remain defiant and have said that the government will not backtrack on its budget plans, regardless of mounting market concerns. [This increases the likelihood of an EDP being opened and downgrades by rating agencies occurring](#) (in October, Moody’s and S&P are expected to announce their ratings decisions). In Europe, Italian assets were the worst performers during the week, with FTSEMIB down by 5.4%.

Our Recent Publications

 [DISRUPTIVE IDEAS: The Journey To the Next Recession and Financial Crisis in 2020 Has Already Begun](#), by Nouriel Roubini and Brunello Rosa, 9 October 2018

 [SCENARIO ANALYSIS: ITALY Walking A Dangerous Line](#), by Brunello Rosa, 5 October 2018



The Week Ahead

In the US, the publication of the FOMC meeting minutes will reiterate the Fed's intention to gradually increase rates. In 2018, the Fed foresees unemployment to remain at 3.7% (a 49-year low) and growth to accelerate to 3.0% (from 2.3% in 2017). The Fed's position is unlikely to be altered by: i) last week's softer-than-expected inflation (September CPI, a: 2.3%; c: 2.4%; p: 2.7%; September PPI, a: 2.6%; c: 2.8%; p: 2.8%) or; ii) pressure from President Trump—who sharply escalated his criticism to higher rates. In December 2018, the Fed is likely to hike the policy rate to 2.25-2.50%. **Retail sales growth is expected to remain flat** (retail sales ex-autos September m-o-m, c: 0.3%; p: 0.3%).

In the EZ, inflation is expected to remain unchanged (September CPI y-o-y, c: 2.1%; p: 2.1%).

The Quarter Ahead

Global growth will continue to decelerate. Last week, the IMF lowered its estimate for global growth (by 0.2 pps, to 3.7% for 2018 and 2019), citing "rising risks", as: a) multilateralism is being challenged worldwide; b) the ongoing US-China dispute could develop into a trade war, with global implications; c) **in the US, the Fed will continue to tighten monetary and financial conditions**; and d) **in the EU, political and economic risks will continue to rise**, as: i) **in the UK, a Brexit deal is unlikely before the October 18 EU summit**; and ii) **in Italy**, Deputy PM Matteo Salvini said: "the government will not backtrack on its budget plan, regardless of mounting market concerns" – increasing the likelihood of rating agencies downgrades (in October, Moody's and S&P are expected to announce their decisions). In Europe, Italian assets were the worst w-o-w performers (FTSEMIB, -5.4%; 10y sov. bond yields, +17bps, to 3.58%).

A hard landing in EMs weakness is unlikely. In a tighter-liquidity environment, most large EMs are managing their economic challenges.

China is financing growth through debt issuance. Last week, China issued USD 3bn in USD-denominated bonds at 5, 10 and 30y maturities; strong demand (6 times oversubscribed) suggests that investors are not concerned about: i) decelerating growth—next week, Q3-2018 GDP growth will be announced (c: 6.6% y-o-y, p: 6.7%); or ii) trade policy uncertainty.

Turkey is moving towards policy normalization. Last week, the TRY appreciated against the USD (+4.4%, to USD/TRY 5.871) supported by: a) the release of US Pastor Brunson, which is expected to reduce US economic pressures; b) a C/A surplus (August: USD2.6bn, compared to a USD0.9bn deficit a year earlier); and c) a new program to reduce inflation, launched by the government in collaboration with the private sector.

In Brazil, Mr. Jair Bolsonaro, the populist right-wing candidate, is likely to win the presidential elections. The leader of PSL won the first round with 46% of the votes, a 17-point lead over left-wing leader Haddad. The second round will take place on October 28. The BRL appreciated by 1.5% w-o-w against the USD (to USD/BRL 3.783).

In GCC, Kuwait will strengthen its collaboration with Turkey and China. Kuwait and Turkey signed a defense agreement to enhance military cooperation starting in 2019, while China is expected to participate in the future development of the northern islands.

Brent oil price will likely remain close to 80 USD/b. The price declined to 81.1 USD/b (-4.8% w-o-w), as fears about demand growth started to weigh on traders.

Last Week's Review

Global stocks declined for the third consecutive week. The fall in stock prices gathered speed, as investors focussed on: a) rising UST yields, which could lead to higher borrowing costs for heavily indebted companies; and b) global trade tensions, in a context of growth deceleration. In w-o-w terms, stocks fell across the world (MSCI AWCI, -3.9%; S&P500, -4.1%; Eurostoxx 50, -4.5%; MSCI EMs, -2.1%), while volatility rose above its 10y average (VIX, +6.5 points to 21.3; 52w avg.: 14.1; 10y avg.: 19.2).

Global bond indices rose moderately as investors rotated into fixed-income (BAML Global, +0.2%; BAML EMs, +0.2%). The UST 10y yield declined by -9bps w-o-w, to 3.14%.

The USD weakened w-o-w against: 1) a currency basket (DXY, -0.4%); 2) the EUR (EUR/USD +0.3%, to 1.156); and 3) EMs currencies (MSCI EM Currency index +0.2%).

Pablo Gallego Cuervo contributed to this Viewletter.

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



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Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	NAFTA	North-American Free Trade Agr.
bpd	Barrels per day	NATO	North Atlantic Treaty Organizat.
bps	Basis points	OECD	Organization for Economic Cooperation and Development
BS	Balance sheet	Opec	Organization of Petroleum Exporting Countries
c	Consensus	p	Previous
C/A	Current account	P2P	Peer-to-peer
CB	Central bank	PBoC	People's Bank of China
CBB	Central Bank of Bahrain	PCE	Personal Consumption Expenditures
CBK	Central Bank of Kuwait	PE	Price to earnings ratio
CBT	Central Bank of Turkey	PM	Prime minister
CDU	Christian Democratic Union, Germany	PMI	Purchasing managers' index
CNY	Chinese Yuan	pps	Percentage points
CPI	Consumer Price Index	pw	Previous week
DJIA	Dow Jones Industrial Average Index	QCB	Qatar Central Bank
DJEM	Dow Jones Emerging Markets 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 Commission	RE	Real estate
ECB	European Central Bank	RBA	Reserve Bank of Australia
ECJ	European Court of Justice	RRR	Reserve Requirement Ratio
EIA	US Energy Information Agency	RUB	Russian Rouble
EM	Emerging Markets	SWF	Sovereign Wealth Fund
EP	European Parliament	tn	Trillion
EPS	Earnings per share	TRY	Turkish Lira
EU	European Union	UAE	United Arab Emirates
EUR	Euro	UK	United Kingdom
EZ	Eurozone	US	United States
Fed	US Federal Reserve	USD	United States Dollar
FOMC	US Federal Open Market Committee	USD/b	USD per barrel
FRB	US Federal Reserve Board	UST	US Treasury bills/bonds
FX	Foreign exchange	VAT	Value added tax
FY	Fiscal Year	VIX	Chicago Board Options Exchange Volatility Index
GCC	Gulf Cooperation Council	WTI	West Texas Intermediate
GBP	British pound	WTO	World Trade Organisation
GDP	Gross domestic product	w	Week
IMF	International Monetary Fund	w-o-w	Week-on-week
INR	Indian Rupee	y	Year
IPO	Initial public offering	y-o-y	Year-on-year
IRR	Iranian Rial	y-t-d	Year-to-date
JPY	Japanese yen	ZAR	South African Rand
k	thousand	2y; 10y	2-year; 10-year
KSA	Kingdom of Saudi Arabia		

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