

MAKING SENSE OF *THIS* WORLD

12 November 2018



R&R Weekly Column
By Brunello Rosa



History is On the Move in the Anglosphere


Important events occurred both in the US and the UK last week, events which deserve plenty of attention from investors. [In the US](#), President Trump's Republican Party managed to increase its majority in the Senate and win the majority of gubernatorial races, but lost its control of the House of Representatives. As we will discuss at length in our upcoming report on the results of this election, the Democrats managed to elect to Congress a number of [high-profile first time politicians](#) (including Alexandria Ocasio-Cortez), but the "blue wave" many had expected did not materialise. The Democrats will now be able to scrutinise the Trump administration's actions more closely (and possibly even launch an impeachment process), and choose whether or not to block legislation initiatives the Republicans might put forth, such as a new round of tax cuts or a serious infrastructure spending program. Nevertheless, if the Democrats want to win the presidential race in 2020, they need to start trying to identify a suitable candidate soon. In fact, in spite of losing control of the House, Trump felt emboldened by the election results. Following the election, he pushed attorney general Jeff Sessions to resign, thus putting the future of the Mueller's investigation in doubt. With Trump's domestic agenda perhaps likely to be blocked by the Democratic majority in the House, will Trump focus on foreign policy instead, [as most presidents tend to do during the second half of their terms in office](#)? As we discussed [in a recent report](#), there is a risk of there being a wag-the-dog moment in 2020, if Trump is tempted to embark upon military adventures in order to secure a second term.


Meanwhile, the new round of sanctions on Iran has indirectly led to a fall in oil prices, as other countries increased their production. Oil prices have now entered a bear market, after having recently touched their 2018 highs. In forthcoming research, we will update [our outlook for oil in coming years](#). If a new round of US tax cuts becomes less likely, the risk of inflation surprises would be reduced, and the likelihood that the Fed will need to speed up its pace of tightening will be lower as a result. This has helped the bull flattening of the US Treasury curve, with the long end of the curve remaining in check in spite of the near certainty of there being a fourth 25-bps increase in the Fed funds rate in December, [after last week's FOMC meeting](#). The long end of the yield curve also remains anchored by persistently low Japanese long-term yields. In [our recent BOJ report](#) we discuss why we believe this is likely to continue well into 2019.

On the other side of the Atlantic, as we discussed in our [recent UK trip report](#), Brexit negotiations are now entering crunch time. The days ahead will be crucial; an agreement between the EU and the UK ideally needs to be reached in time for EU President Tusk to call a special EU summit by the end of November and pass the "deal" through the British parliament before Christmas, leaving enough time for other European parliaments to ratify this "divorce deal." This schedule might prove to be too optimistic, however. There is a risk that a political and economic crisis might first be needed in order to break the impasse that exists between the UK and the EU. As a proof of this, on Friday the British government lost another key member: Transport Secretary Jo Johnson (brother to former foreign secretary Boris) resigned, while calling for a second referendum in which three choices should be available to voters: accept a deal potentially brought back by Theresa May, leave the EU without a deal, or remain in the EU. This week might prove essential to see whether the government and the EU might at least agree on a withdrawal deal. (Whether the British government's cabinet and, more importantly, Britain's parliament will accept such a deal, is of course a different matter). It will be some time yet before all this uncertainty is dissipated.

Our Recent Publications

 [**MONETARY AFFAIRS: BOJ Still Far From A Shift In Policy Regime, But The Triggers For A Change Are Now Clearer,**](#)
by Nouriel Roubini, 8 November 2018

 [**The Geopolitical Corner – The Damage Merkel Has Wrought**](#) by John Hulsman, 9 November 2018

 [**TRAVEL NOTES: UK: In this "Final Rush," Risks Remain That A Political And Economic Crisis Might Be Needed To Break the Brexit Impasse,**](#) by Brunello Rosa and Nouriel Roubini, 7 November 2018



The Week Ahead

In the US and the EZ, inflation is expected to remain slightly above the CB's targets. Inflation data in the US (October y-o-y, c: 2.4%; p: 2.3%) and the EZ (October y-o-y, c: 2.2%; p: 2.2%) are anticipated to come in above the Fed and ECB's target of 2%.

The Quarter Ahead

In the US, the result of the mid-term elections is unlikely to influence the monetary policy outlook. Last week, the Democrats took control of the House of Representatives while Republicans increased their majority in the Senate. The risk of legislative stasis is rising: while infrastructure spending could become an area of bipartisan collaboration, it is unlikely that the Democrats will want to make such a huge political favour to the President. In the FOMC November meeting, the Fed confirmed its intention to hike rates in December, based on a bullish outlook for the US economy. The market-implied likelihood of a hike in December fell marginally to 75.8% (pw: 79.0%). Until year-end, the USD is expected to strengthen.

In the EU, growth is likely to decelerate... The EZ composite PMI fell to 53.1 in October (c: 52.7; p: 54.1), the lowest level since September 2016, while the Sentix index, a gauge of business expectations, fell to its weakest level since 2014. Italy's composite PMI dropped to 49.3, suggesting an upcoming contraction ***...and political tension will remain high.*** Last week, Italian bonds came under pressure—the 10y bond rose by 9 bps to 3.40%—after the EC published updated economic projections in which Italy is expected to breach the 3% fiscal deficit target. In the UK, the GBP slipped back below USD1.30, after the abrupt resignation of the transport minister raised doubts about PM Theresa May reaching a Brexit deal with the EU by end-November.

In Turkey, policy normalization is likely to negatively impact growth. The anti-inflation program has yet to succeed: last week, prices reached a 15-year high (CPI October, a: 25.2% y-o-y; c: 24.5%; p: 24.5%). Eventually, lower fiscal spending will have a negative impact on consumption: last week, Moody's and the EC revised down 2019 growth forecasts (to -3.0 and -1.5% respectively). The TRY weakened by -0.6% w-o-w to USD/TRY 5.460.

Demand for GCC fixed income is likely to remain strong. Last week, Bahrain's state-owned oil company Nogaholding (BB- by Fitch) raised USD1bn (a USD500m 6y bond at 7.625% and a USD500m 10y bond at 8.375%). The issuance—the first by a Bahraini entity since the country's GCC allies delivered a financial aid package last month—was 2.5 times oversubscribed.

In the GCC, oil output will rise. Last week: a) Abu Dhabi unveiled a USD132bn investment plan to boost oil output from the current 3mb/d to 4 by 2020 and 5mb/d by 2030; and b) Kuwait announced plans to increase its output capacity for light crude oil to 250,000 b/d (from 175,000 now) and initiated exports of this new oil grade.

Oil prices will continue to decline because of a higher-than-expected supply. WTI prices entered a bear market (a 20% decline since their peak in October), due to: a) the exemptions granted by the US last week to eight importers of Iranian oil; b) pledges by the KSA to rise output; and c) an increase in US stockpiles. Opec and Russia met in Abu Dhabi to discuss output cuts for next year of about 1 million b/d. Analysts are revising down (to less than USD80/b) their end-2018 forecasts to take into account the higher-than-expected supply.

Last Week's Review

DM stocks reacted positively to news from the US. The Fed's bullish assessment of the economy and the decline in uncertainty after the midterm elections lifted US equities (S&P 500, +2.1%; Eurostoxx 50, +0.5%). In EMs, concerns about rising interest rates led to price declines (MSCI EMs, -2.1%). Global stocks remained stable (MSCI ACWI, +0.9%) and ***volatility fell below its 10y average*** (VIX, -2.1 points to 17.4; 52w avg.: 14.9; 10y avg.: 18.9). In the fixed income space, bonds returns were flat (BAML Global bond index +0.1% w-o-w) across most markets (S&P Global DMs, -0.1%; BAML EMs, 0.0%); the yields of bonds perceived as "safe" remained stable (UST 10y, -3bps to 3.19%; Germany -3bps to 0.41%).

The USD strengthened w-o-w against: 1) a currency basket (DXY, +0.4%); and 2) the EUR (EUR/USD -0.4%, to 1.133), while EMs currencies remained flat (MSCI EM Currency index, +0.0%).

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	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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