Rosa & Roubini
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MAKING SENSE OF *THIS* WORLD

17 December 2018

R&R Weekly Column
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Central Banks Take Centre Stage At Year's End

As 2018 comes to an end, central banks are taking centre stage once more. As we discuss in greater detail on the second page of this Viewsletter, economic activity is slowing down globally. Economic activity is reverting to trend growth, and in Q3 experienced episodes of contraction in Japan, Germany, Sweden, and elsewhere. In spite of tightening labour markets, closing output gaps, and rising salaries, core inflation in developed markets (DMs) remains subdued while headline inflation is being dragged down by falling oil prices. (Low core inflation has been due to technological innovations, labour re-organisation and weaker unions, and disruptions in global supply chains, among other factors, all of which are contributing to keep Phillips curves flatter than they would be otherwise). In this environment, central banks in DMs can afford to adopt a more cautious approach to monetary policy normalisation, while some central banks in emerging markets are increasing rates to defend their currencies and achieve inflation targets.

Last week, the European Central Bank kept its policy stance unchanged and confirmed its intention to terminate its net asset purchases at the end of this year. It will proceed with full reinvestment for an extended period of time after the first rate increase, which is unlikely to occur before Q4 2019 (and will possibly occur later than that, given the balance of risks is shifting to the downside). Earlier in the month, the Bank of Canada kept its overnight rate unchanged at 1.75% and struck a dovish note, citing lower oil prices and constrained investment. This week, the Fed is expected to increase its Fed funds target range by 25bps to 2.25-2.50%, and suggest a slower pace of policy tightening going forward. The Bank of Japan is expected to keep its policy stance unchanged and extremely accommodative, until core inflation starts to rise convincingly. The Bank of England is also expected to remain on hold this week, as it observes the unfolding of the Brexit saga. Finally, we expect the Riksbank to wait until 2019 before raising its repo rate, and we expect the Swiss National Bank to shadow very closely any changes in the ECB's policy stance.

In emerging markets, while the Turkish CBRT left its policy rate at 24% last week and while the People's Bank of China continues to provide monetary accommodation as part of the broader stimulus package implemented by Chinese authorities to cushion the effects of trade wars with the US, the Reserve Bank of India, which is in the middle of the crisis with the government over its independence, left its key policy rate steady at 6.5% on December 5th as part of its gradual tightening process. On December 12th, meanwhile, the central bank of Brazil voted unanimously to hold its key Selic rate steady at 6.50%, amid soft GDP growth and below-target inflation. In contrast, last Friday the central bank of Russia unexpectedly raised its benchmark one-week repo rate by 25bps to 7.75%, in order to limit rising inflation risks, given the upcoming VAT rate increase expected to occur on January 1, 2019. This move followed the unexpected decision by the South African Reserve Bank to raise its repo rate by 25bps to 6.75% at the end of November (its first hike since March 2016) given rising inflation on the back of a weakening currency.

With global growth decelerating, inflation remaining subdued in DMs and rising in some EMs (given EM's weaker currencies), still-constrained fiscal policy, and financial markets becoming volatile and nervous, central banks will continue to play a crucial role in shaping macroeconomic and market dynamics also in 2019 and subsequent years.

Our Recent Publications

- *PREVIEW: Fed to Signal Slower Pace of Policy Normalization, by B. Rosa, A. Waters and Nouriel Roubini, 17 December 2018*
- *PREVIEW: Riksbank Likely To Wait Longer Before Lift-Off, by Brunello Rosa and Alex Waters, 14 December 2018*
- *REVIEW: ECB Confirms Its Policy Stance (With Few Details on Reinvestment), by Brunello Rosa, 13 December 2018*
- ***The Geopolitical Corner**: Macron And Europe At The Brink, By John Hulsman, 11 December 2018*

The Week Ahead

In the US, the Fed is expected to increase its policy target range by 25bps (Fed, c: 2.25-2.5%; p: 2-2.25%). The probability of three or more hikes in 2019 stands at 18.5%, down from 45.6% a month ago.

In the UK policy rates are expected to remain stable, given the current political instability, (BoE, c: 0.75%; p: 0.75%).

In Japan, no change in the policy stance by the BoJ is expected: (BoJ, c: -0.1%; p: -0.1%).

In Turkey, the CBT signalled that a tight monetary policy will be maintained until inflation improves significantly.

The Quarter Ahead

The US and China could gradually move towards a trade agreement: last week, China showed a conciliatory approach by reducing tariffs on US cars, while US President Trump indicated that he might intervene in support of Huawei's CFO in order to secure a deal.

In the EZ, the growth momentum keeps decelerating (PMI Composite December, a: 51.3 y-o-y; c: 52.8; p: 52.7) while political risks increase: *a)* in the UK, the likelihood of a disorderly Brexit is rising: PM May postponed the Parliament's vote on the "Brexit deal" and suffered—but won—a no-confidence vote; additionally, a new round of talks with the EU ended without concessions to the UK; *b)* in Italy, an agreement with the EU seems closer as the ministry of finance is working towards lowering 2019's deficit to 2%; *c)* in France, the measures announced by President Macron in order to appease protesters will push the deficit above the 3% limit set by the EU, prompting Italy to stress the importance of its expansionary fiscal policies.

Signs are emerging of softer inflation in the EZ, where is expected to remain around the 2% target (CPI November, c: 2.0%; p: 2.0%) with a weak but stable core (CPI core November, c: 1.0%; p: 1.0%). ***Interest rates hikes by the ECB are getting increasingly unlikely in 2019***, especially in the ongoing context of softening growth and rising risks.

Last Week's Review

Real Economy: Growth Keeps Softening Around The World

In Japan, growth contracted more than expected (GDP Q3, a: -2.5% q-o-q ann.; c: -1.9%; p: -1.2%).

In China, retail sales growth decelerated to a 15-year low (retail sales November, a: 8.1% y-o-y; c: 8.8%; p: 8.6%), and ***industrial production fell to a three-year low*** (industrial production November, a: 5.4% y-o-y; c: 5.9%; p: 5.9%).

In Turkey, GDP decelerated in line with expectations (GDP Q3, a: 1.6% y-o-y; c: 1.6%; p: 5.2%).

In the US, core prices remained stable. Headline inflation declined as expected (CPI November, a: 2.2% y-o-y; c: 2.2%; p: 2.5%) while core inflation stabilized (CPI November, a: 2.2% y-o-y; c: 2.2%; p: 2.1%).

Monetary Policy: Normalization Continues In DMs

In the EZ, the ECB announced the end of its QE program, and committed to reinvest maturing assets in full.

In Turkey, the CBT kept the policy rate unchanged at 24%.

Global Markets: Concerned by Deceleration of Growth

The markets were concerned by the global deceleration—made evident by Chinese and European activity data—and by Brexit-related risks affecting the EZ. Flight to safety drove flows from stocks into bonds and from all currencies into the USD.

Global stocks fell w-o-w (MSCI ACWI, -1.0%) driven by the US (S&P 500, -1.3%) and EMs (MSCI EMs, -1.1%). In the EZ, stocks registered mild gains (Eurostoxx 50, +1.1%). Volatility remained above historical averages (VIX, -1.0 to 22.2; 52w avg.: 15.8; 10y avg.: 18.5).

Bonds indices w-o-w remained flat (BAML Global bond index, +0.0%) with minor losses in the US (Reuters US bond index, -0.5%). Sovereign bond yields rose marginally in the US (10y yield, +4bps to 2.89% and remained flat in Germany (10y yield, unchanged at 0.26%).

Currencies: w-o-w, the USD rose against a basket of currencies (DXY, +1.0%) and the EUR (EUR/USD, -0.7% to 1.130).

Commodities: The recent Opec cuts did not support oil prices; w-o-w, Brent prices fell by 2.6% to 60.1 USD/b, in line with the end-of-the-year estimate of 65 USD/b.

Francisco Quintana *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*	*M5S*	*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*		