

MAKING SENSE OF THIS WORLD

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R&R Weekly Column By Brunello Rosa



Clouds Are Gathering On The Horizon

As we discuss in greater detail on page two of this *ViewsLetter*, clouds start gathering on the global economy. In the US, the stalemate in Congress regarding the budget (and in particular the controversial USD 5bn financing for the wall at the border between US and Mexico) has caused a government shutdown that is now entering its fourth week (becoming the longest in the US history). Apart from the obvious collapse in the provision of services (in airports, national parks, museums and other publicly-managed organisations), the pain starts being felt by 420,000 government employees, whose payslips are showing "zero salaries" for most of them. All this will have eventually a macroeconomic impact, when the figures for Q4 2018 and Q1 2019 growth will be released in coming months. In Europe, the situation is not much rosier: industrial production in the largest Eurozone economies (Germany, France, Italy) has collapsed recently, partly as a result of the difficulties of German car manufacturers to adapt to new emission standards. In France, the protest of the Yellow Vests continues to be intense and to put pressure on President Macron. In Italy, after the contraction recorded in Q3, there is a serious risk that also Q4 2018 GDP growth will witness a negative figure: that would mark the beginning of a technical recession (so much for the supposedly expansionary policies of the new populist government). In the UK, it is almost certain that Theresa May's deal with the EU will be voted down by parliament, marking the beginning of a political crisis that is likely to be protracted for weeks, and that will likely have severe economic repercussions.

In Emerging Markets, the situation remains problematic: China's economic slowdown resulting from the trade tensions of 2018 has yet to be reversed, in spite of the expansionary (fiscal, monetary and credit) policies adopted by the authorities. Glimmer of hopes derive from the unexpected extension of trade talks with the US: but make no mistake – whatever deal can be agreed on, will only be partial and temporary; the cold war with the US is set to continue for decades. In Brazil, Bolsonaro's government has yet to show its true colours, but the market is giving him the benefit of the doubt. Regarding Turkey, our latest scenario analysis discusses the evolution of the country over the next few years, but we don't expect a real stabilisation to begin before the local elections in March. Given this background, it's not a surprise that the World Bank (whose Chief departure) has opened a complicated transition phase) has revised lower its global growth forecasts. How are policymakers and financial markets reacting to all this?

As one could expect, an endogenous policy response has already begun. The Fed has signaled that it can be more patient in implementing its policy tightening cycle, making a pause in March more likely. The Bank of Canada has kept on hold its policy rate in January, as it did in December. The ECB and BOJ are currently on auto pilot, and the BOE is ready to react any way needed to Brexit developments, so its tightening cycle is on pause until May at the earliest. With central banks more cautious in the withdrawal of liquidity, risky asset prices could take a breath: equity prices are slowly recovering the losses suffered in the last few weeks of December. This is what 2019 is likely to be: a transition year between the 2017-18 expansion and a possible crisis and recession in 2020. Financial markets are likely to be cushioned from the effects of bad news coming from the macroeconomy and geopolitics by the endogenous policy response.

Our Recent Publications

MACRO PICTURE: Turkey: Economic Stabilization After The March Local Elections, by Alessandro Magnoli Bocchi, 11 January 2019

PREVIEW: BOC Likely To Remain on Hold, While Sounding Upbeat, by Alex Waters and Joseph Shupac, 7 January 2019

** REVIEW: BOC Remains on Hold, With Hawkish Undertones, by B. Rosa, A. Waters, J. Shupac, 9 January 2019







Looking Ahead

Global Outlook: Lower Growth And Rising Risks, Monetary Tightening On Hold

Next week in the EZ, headline and core inflation are expected to remain stable (CPI December, c: 1.6% y-o-y; p: 1.6%; CPI Core December, c: 1.0% y-o-y; p: 1.0%).

Next week in Japan, headline inflation is expected to decrease (CPI December, c: 0.8% y-o-y; p: 0.9%).

In the US, government's political gridlock makes a fiscal boost unlikely in coming weeks. The better than expected recent labor data improved market sentiment, reducing the market expectations of no hikes in 2019 to 85% (pw: 96%).

An improved outlook for the US-China dispute is expected over the next few weeks. The latest round of US-China trade talks showed signs of progress, increasing the likelihood of an agreement before the end-March deadline.

The World Bank cut its 2019 forecast for global growth to 2.9% (from 3.0%), down from 3.0% in 2018 (previously 3.1%) due to slowing trade and investment flows, and rising interest rates.

In the EU, recession fears are rising: in Germany, industrial production fell by -1.9% in November (a y-o-y low of -4.6 percent); France, the EZ's second largest economy, is also facing difficulties. The fragile Greek and Italian economies are likely to suffer. Political tensions are also rising as the UK Parliament is expected to vote on PM May's Brexit proposal on January 15: a "no" vote would increase the likelihood of a "hard Brexit".

In Turkey, declining inflation forecasts brought about expectations about a 50bps cut in Q1.

Last Week's Review

Real Economy: Disinflation Support A Pause In Monetary Policy Normalization

In the US, political uncertainty remains high as the government shutdown extends into its fourth week.

Inflation moved in line with expectations: headline inflation decelerated (CPI December, a: 1.9% y-o-y; c: 1.9%; p: 2.2%), while core inflation remained stable (CPI ex. food and energy December, a: 2.2% y-o-y; c: 2.2%; p: 2.2%).

In China, December's inflation declined below expectations (CPI December, a: 1.9% y-o-y; c: 2.1%; p: 2.2%).#

In the GCC, PMIs hint to deceleration: Saudi Arabia's PMI fell to 54.5 in December from 55.2 in November. In UAE, PMI dipped to 54.0 in December from 55.8 in November.

Policy: Monetary Policy Normalization On Hold

In the US, the Chairman of the Fed talked about a "pause" in the tightening cycle and reemphasized that they would exercise "patience", reducing the likelihood of a hike in March.

<u>Financial Markets: Global Stocks Rise On Improving US-China Relations, Higher Corporate Earnings, And Slower Policy</u> Normalization, Oil Up Again On Declining Supply

Global stock markets rose after: *a)* the US-China talks were extended for an unscheduled third day, fuelling optimism that the world's largest and second-largest economies can strike a trade deal; *b)* corporate earnings are expected to beat overly-negative forecasts; and *c)* the Fed reaffirmed its commitment to pause further tightening.

Global stocks rose w-o-w (MSCI ACWI, +2.9%) driven by the US (S&P 500, +2.5%). Volatility decreased towards its long-term average (VIX, -3.2 points to 18.2; 52w avg.: 17.0; 10y avg.: 18.4).

Bonds indices fell w-o-w (BAML Global bond index, -0.1%), driven by the US (Reuters US bond index, -0.3%). Sovereign bond yields rose in the US (10y yield, +4bps to 2.70%) and fell in Germany (10y yield, -3bps to 0.18%). Demand for EM bonds remains strong: Turkey borrowed USD2bn through a 10y USD bond at 7.68% yield.

In the GCC, fixed income issuance is expected to grow, as from January 1st, 2019 J.P. Morgan has included into its Emerging Market Bond Index (EMBI) sovereign and quasi-sovereign bonds from Saudi Arabia, UAE, Bahrain, Kuwait, and Qatar. The inclusion could potentially bring approximately USD60bn of active and passive inflows. In Saudi Arabia, the government has started to market a dual-tranche US dollar bonds with price guidance set at 200bps above 10y UST and 235bps above 30y UST.

Currencies: w-o-w, the USD fell against a basket of currencies (DXY, -0.5%), and the GBP rose (GBP/USD, +0.9% to 1.284) on hopes of a Brexit delay.

Commodities: Brent prices rose by 6.0%, to 60.5 USD/b, as production cuts by major oil producers continue to materialize.



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Abbreviations, Acronyms and Definitions

AMP Justice and Development Party, Turkey mon. annualized mon.	а	Actual	LN	Northern League, Italy
Argentinian Peso org. Averagrege mb.d MENA Million barrels per dey MENA Million barrels per dey MENA Million Billion Billion Billion Billion Billion Box of England Box of England Box of England Box of England Box of Jopan Box	AKP	Justice and Development Party, Turkey	M5S	Five Star Movement, Italy
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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	FX	Foreign exchange	VAT	Value added tax
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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	GCC	Gulf Cooperation Council	WTI	West Texas Intermediate
IMFInternational Monetary Fundw-o-wWeek-on-weekINRIndian RupeeyYearIPOInitial public offeringy-o-yYear-on-yearIRRIranian Rialy-t-dYear-to-dateJPYJapanese yenZARSouth African Randkthousand2y; 10y2-year; 10-year	GBP	British pound	WTO	World Trade Organisation
INRIndian RupeeyYearIPOInitial public offeringy-o-yYear-on-yearIRRIranian Rialy-t-dYear-to-dateJPYJapanese yenZARSouth African Randkthousand2y; 10y2-year; 10-year	GDP	Gross domestic product	W	Week
IPOInitial public offeringy-o-yYear-on-yearIRRIranian Rialy-t-dYear-to-dateJPYJapanese yenZARSouth African Randkthousand2y; 10y2-year; 10-year	IMF	International Monetary Fund	W-O-W	Week-on-week
IRRIranian Rialy-t-dYear-to-dateJPYJapanese yenZARSouth African Randkthousand2y; 10y2-year; 10-year	INR	Indian Rupee	у	Year
JPY Japanese yen ZAR South African Rand k thousand 2y; 10y 2-year; 10-year	IPO	Initial public offering	у-о-у	Year-on-year
k thousand 2y; 10y 2-year; 10-year	IRR	Iranian Rial	y-t-d	Year-to-date
,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,	JPY	Japanese yen	ZAR	South African Rand
KSA Kingdom of Saudi Arabia	k	thousand	2y; 10y	2-year; 10-year
	KSA	Kingdom of Saudi Arabia		

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