

MAKING SENSE OF *THIS* WORLD

21 January 2019



R&R Weekly Column
By Brunello Rosa




Short-Term Macro Wobbles, Long-Term Demographic Issues


The global economy continues to decelerate. As a result of its longest ever government shutdown, US growth is likely to suffer in the coming months. (US PMI's are expected to show this starting this week). The glimmers of hope coming from US-China trade talks, with [China offering to increase its imports from the US to USD 1tn in the next six years](#) (from 190bn in 2018), might not be enough to stop this deceleration, in the absence of fiscal and monetary stimulus. In China, Q4 GDP figures this week are expected to confirm a deceleration from 6.5% to 6.4% y-o-y, led by a contraction in exports. In the Eurozone, Germany's preliminary GDP growth figures showed a deceleration to 1.5% in 2018 (down from 2.2% in 2017), after its GDP contracted in Q3. According to Banca d'Italia, Italy seems destined for a technical recession, its GDP having contracted in Q4 2018 after also doing so in Q3. The central bank has [updated its forecast for Italy's GDP growth in 2019 to 0.6%](#), a pace of growth that is only about half of the most recent 1% growth forecasted by the country's government (a forecast that does not even rule out the possibility of a supplementary budget during the year, in order to realign Italy's fiscal deficit to the level agreed upon with the EU).

Given these decelerating conditions, and considering that inflation remains easily in check, short-term policy responses are underway. Last week, the PBoC injected a net CNY 560bn (USD 83bn) into its banking system, the highest amount ever recorded in a single day. Next week, the Fed is likely to provide further hints about a pause in its tightening cycle. This week, the ECB should acknowledge the ongoing economic deceleration and suggest continued or increased gradualism regarding its exit from the extraordinary accommodation it has provided in the last five years. Also this week, [we expect the BoJ not to take any meaningful action](#) while downwardly revising its growth and inflation outlook. We also expect [Norges Bank not to move this week](#) while confirming its forward guidance for a hike to take place in March. In the UK, on Monday the government will present its Plan B for Brexit, but no vote is expected until next week. The BoE remains ready for any eventuality. Considering these moves, markets are having a bit of respite: risky asset prices are slowly recovering the losses they experienced at the end of last year.

Underlying these short-term wobbles are much deeper economic challenges. In our [recent in-depth report on demographics](#), we discuss how current demographic trends tend to impact economic and political developments, policy choices and market outcomes more profoundly than short-term policy (monetary, fiscal, regulatory) fixes. In our global overview, we look at demographic developments in the US, Latin America, Europe and Asia, finding that most of the policy choices we see being made today are already partly the result of underlying trends that have been in place for decades. The coming generation of policymakers will be bounded and constrained by these persistent trends. The moral of the story here is quite simple. While managing short-term macroeconomic developments, policy makers should also address long-term issues. Otherwise, the challenges these long-term issues pose will eventually become insurmountable by conventional instruments.

Our Recent Publications

 [PREVIEW: Norges Bank: Waiting For March To Hike](#), by
Alex Waters, 18 January 2019

 [PREVIEW: BoJ: A Stronger Yen May Cause Some Discomfort](#) by Alex Waters, 17 January 2019

 [DISRUPTIVE IDEAS: The Revenge Of Demographics](#),
by Brunello Rosa and Joseph Shupac, 15 January 2019

Looking Ahead

In the US, as 800,000 federal workers remain in furlough, growth is expected to suffer; this week, the PMI is likely to decelerate (US Markit manuf. PMI January, c: 53.4; p: 53.8).

In the UK, during this week PM May is expected to hold cross-party talks to devise a “plan B” on how to proceed.

In the EU, concerns about an upcoming economic slowdown are mounting, but the PMI is likely to remain stable this week (EZ Markit manuf. PMI January, c: 51.4; p: 51.4).

This week the ECB is likely to maintain rates unchanged (c: 0%; p: 0%). Analysts expect it to adopt a more cautious tone.

This week in Japan, the BoJ is also likely to maintain its current, accommodative stance (c: -0.1%; p: -0.1%).

The PBoC - given the ongoing economic deceleration (GDP Q4, c: 6.4% y-o-y; p: 6.5%) - will continue to support the financial sector: last week, the PBoC injected a net CNY 560bn (USD 83bn) into the banking system, the highest amount ever recorded in a single day.

In India, inflation remained at an 18-month low (a: 2.2%; c: 2.2%; p: 2.3). Given a structurally low inflation and the upcoming elections, the pressure on the CB to cut interest rates is likely to increase.

Last Week's Review

Real Economy And Monetary Policy Expectations: Softer Growth And Stable Prices Likely To Delay Monetary Policy Normalization

In the US, the longest government shutdown on record (almost one month) is hampering growth.

Trade-related concerns declined, after China offered to increase imports from the US to USD 1tn (from USD 190bn in 2018) - over the next six years. **In China**, an unexpectedly strong decline in trade activity hints to: 1) activity front-loading; and 2) softer external demand (December export growth, a: -4.4%, c: 2.0%, p: 5.4%; December import growth, a: -7.6%, c: 4.5%, p: 3.0%).

The expectations about further Fed's monetary tightening are declining, after an over-reaction earlier in the year: the market-implied likelihood of no rate hikes in 2019 fell to 68% (pw: 85%).

In the UK, PM May's Brexit deal was heavily defeated by the parliament (432 votes against-202 for). However, the government survived a no-confidence vote (325-306).

In the EU, in 2018 Germany's GDP grew at 1.5%, a deceleration from 2.2% in 2017 and its weakest pace in five years.

In Italy, budget-related tension subsided; yields on 10y bonds fell by 13bps to 2.73%, the lowest level in six months, as foreign investors drove bid-to-cover ratios to more than 3 and buyers shrug off the risk of political turbulence and slowing EU growth.

Eurozone headline and core inflation remained stable (CPI December, a: 1.6% y-o-y; c: 1.6%; p: 1.6%; CPI Core December, a: 1.0% y-o-y; c: 1.0%; p: 1.0%).

In Japan, headline inflation fell below expectations (CPI December, a: 0.7% y-o-y; c: 0.8%; p: 0.9 %).

In Turkey, the CBT left the policy rate unchanged at 24%, as the CB remains vigilant about inflation.

Financial Markets: Positive Performance Of Global Stocks And USD

Most global markets experienced a positive performance, extending their streak into the fourth week, driven by progress in the trade discussions between the US and China. Optimism over a potential bilateral deal helped to offset worries about the prolonged US government shutdown.

Global stocks rose w-o-w (MSCI ACWI, +2.2%) driven by the US (S&P 500, +2.9%) and EMs (S&P EMs, +1.7%). Volatility decreased towards its long-term average (VIX, -0.4 points to 17.8; 52w avg.: 17.1; 10y avg.: 18.3).

Fixed-income indices fell during the week (BAML Global bond index, -0.1%), driven by the US (Reuters US bond index, -0.5%). Sovereign bond yields rose in the US (10y yield, +8bps to 2.78%) and fell in Germany (10y yield, +8bps to 0.26%).

Currencies: w-o-w, the USD rose against a basket of currencies (DXY, +0.7%); the GBP rose (GBP/USD, +0.2% to 1.287) on hopes of a Brexit delay.

Commodities: Brent prices rose by 3.7%, to 62.7USD/b, driven by stronger expectations about demand, as concerns about global trade subsided.

Farah Aladsani 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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