

MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
By Brunello Rosa



This Week, Activity Resumes in Full Swing

After the holiday break, activity resumes in full swing this week. An appetizer came last Friday, with the release of the Non-Farm Payroll (NFP) and related data. The US economy showed signs of continued strength with the labour market adding 312k jobs (versus 177k expected) and the unemployment rate ticking up to 3.9% (versus an expected 3.7%, unchanged from the previous month), pushed by higher labour force participation (at 63.1%, versus 62.9% previously). On the inflation front, average hourly earnings also rose to 3.2% y-o-y (more than the expected decline to 3.0% from the previous 3.1% reading); this week's data on CPI will clarify whether the tightness of the labour market will be able to translate into higher headline and core inflation.


Also this week, the minutes of the FOMC meeting in December will shed further light on the Fed's thinking concerning its [25bps rate increase in the Fed funds target range, to 2.25%-2.50%](#). The policy stance of the Fed in the first few months of the year will be a key driver of market sentiment. While the market-implied probability of there being no Fed hikes in 2019 has increased to 90% (versus 64% last week), currently the Fed is strictly data dependent and unlikely to commit to any specific policy action in coming weeks. The Fed has three instruments at its disposal: rate policy, Quantitative Tightening (QT, i.e. the reduction of its balance sheet) and forward guidance via the "dot plot." We believe that the bar for altering the pace of QT, which is pre-set and mostly dictated by technical factors, is quite high. The Fed might opt for a combination of rate policy, forward guidance and communication (including its press conferences at every meeting) to steer market sentiment.

Equally important for market participants will be the resumption of trade talks between China and the US, following the truce agreed to on the sidelines of the [G20 meeting in Buenos Aires at the end of November](#). We continue to believe that trade tensions are only the visible skirmishes in a much deeper, geopolitically-motivated technological competition between the rising power of China and the incumbent American superpower; a competition that is rapidly becoming a new Cold War.

On Wednesday, the Bank of Canada will also meet for its policy meeting and the release of its latest Monetary Policy Report. Until a few months ago, January was considered the chosen month for an additional 25bps increase to a rate of 2.0%, but the situation has changed in the last few weeks, with the [collapse in oil prices](#) and the correction in risky asset prices that has affected most developed markets, including in North America. Market consensus is now expecting no interest rate change to occur. Another central bank at the centre of investor attention this week will be the ECB, which will release the accounts of its [December monetary policy meeting](#). Market participants will look for further clarification on the ECB's re-investment policy, following the end of its bond-buying program. So, this week market participants will again have their plates full with news to digest. All this activity will mark the beginning of another challenging year, one that could possibly lead to [another global economic slowdown and financial crisis occurring in 2020](#). In this respect, while investors exited equity funds amid the correction in risky asset prices at the end of last year, [gold prices started to rise again](#), together with inflows into gold-backed ETFs.

Our Recent Publications

 [*TRAVEL NOTES: FRANCE: Social Tensions Upend French and Eurozone Politics*](#), by R. Bourgeot, 19 December 2018

 [*Global Economic Outlook and Strategic Asset Allocation For 2019: Skating On Thinner Ice*](#), by Nouriel Roubini, B. Rosa and A. Magnoli Bocchi, 18 December 2018



Looking Ahead

This week, *the US-China trade dispute is expected to see some respite*: the first formal talks since the beginning of the three-month truce kick off on Monday.

This week in the US, headline inflation is expected to remain stable (CPI December, c: 2.2% y-o-y; p: 2.2%), while core inflation is expected to decelerate (CPI Ex Food and Energy December, c: 2.1% y-o-y; p: 2.2%).

This week in China, inflation is expected to come down moderately (CPI December, c: 2.1% y-o-y; p: 2.2%).

In coming weeks in the US, political uncertainty intensifies, as the government shutdown extends into its third week and president Donald Trump: 1) threatens to use his executive powers to order the building of a border wall; and 2) continues to blame the Chairman of the Fed for recent stock market losses.

In coming weeks, EZ political risks remain elevated: in the UK, the likelihood of a “no deal” Brexit rises ahead of the Parliament voting scheduled for the week of January 14. In Italy, market concerns resumed as the ECB appointed external administrators to take charge of Carige bank—the 10th largest in the country—after it failed to raise new capital.

Last Week's Review

Real Economy: US Economy Remains Strong

In the US, the manufacturing PMI hit a 15-month low in December (ISM manuf., a: 57.9; c: 58.0; p: 59.3).

In December, labour market indicators showed strength (nonfarm payrolls, a: 312k; c: 177k; p: 176k; average hourly earnings, a: 3.2% y-o-y; c: 3.0%; p: 3.1%); the unemployment rate ticked up (a: 3.9%; c: 3.7%; p: 3.7%), pushed by higher labour force participation (a: 63.1%; p: 62.9%).

In Europe, the manufacturing PMI remained unchanged (a: 51.4; c: 51.4; p: 51.4) *while in China, it fell below the 50 benchmark* (NBS manuf. PMI December, a: 49.4; c: 49.9; p: 50.0).

Policy: US Policy Normalisation Might Slow Down; China Monetary Easing Accelerates

In the US, rising uncertainty about the growth outlook continues to lower the expectations of interest-rates increases: the market-implied likelihood of “no Fed hikes in 2019” has increased to 90% (pw: 64%). The Fed Chairman Jerome Powell said that the Fed will “take a patient approach to monetary tightening”.

In China, monetary easing accelerates. To reduce the risk of a sharp economic slowdown, Chinese authorities are adopting a more accommodative stance: last week, the PBoC cut banks' RRRs for the fifth time in a year. The 100bps reduction—to 14.5% for large banks and 12.5% for smaller institutions, taking place on January 15th and January 25th by 50bps each—frees up USD116bn for new lending.

Financial Markets: Stocks Rise On Positive US Labour Data, Oil Up Due To Lower Supply

Global stocks rose, supported by a better-than-expected jobs report for December, the Fed Chairman's comments on delaying policy normalization and rising expectations of an improved US-China relationship. These factors offset the negative impact of Apple's sales projections, which triggered a market sell-off on fears of a deceleration of global growth.

Global stocks rose w-o-w (MSCI ACWI, +1.6%) driven by the US (S&P 500, +1.9%). Volatility decreased, but remains above historical averages (VIX, -6.9 points to 21.4; 52w avg.: 16.8; 10y avg.: 18.4).

Bonds indices rose w-o-w (BAML Global bond index, +0.3%), driven by the US (Reuters US bond index, +1.5%). Sovereign bond yields fell in the US (10y yield, -8bps to 2.66%) and Germany (10y yield, -3bps to 0.21%).

Currencies: w-o-w, the USD fell against a basket of currencies (DXY, -0.2%), and the JPY jumped (USD/JPY, +1.6% to 108.520) but strengthened against the EUR (EUR/USD, -0.4% to 1.139).

Commodities: Brent prices rose by 9.3%, to 57.1 USD/b, its largest weekly gain in 2 years. Oil prices saw strong gains, as production cuts by major oil producers started to materialize.

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	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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