

MAKING SENSE OF *THIS* WORLD

1 April 2019



R&R Weekly Column
By Brunello Rosa




Uncertainty Weighs On The Macro and Market Environment And Necessitates Policy Easing


A growing number of policy and macroeconomic uncertainties are weighing on household and business confidence and, by extension, are weighing on global economic activity. Between the world's major superpowers (US and China) there is a trade dispute that remains unresolved, and the two sides admit that it might take months before a deal that can satisfy both sides is finally struck. Meanwhile Italy is [making side deals with China regarding China's Belt and Road Initiative](#), a move that has infuriated its American and European partners alike. In Europe, the Brexit saga is getting more and more complicated, with Britain's parliament having rejected for a third time the deal its prime minister negotiated with the EU. There are less than two weeks left before the UK crashes out of the EU without any formal arrangement; EU Council President Donald Tusk has called an extraordinary summit for April 10th. Theresa May [is likely to try to push her deal through parliament for a fourth time](#) before giving up. If she fails to do so, then a further extension of Article 50, snap elections, or a new referendum cannot be ruled out. All of this is occurring just a few months before crucial EU elections will take place, elections in which [populist parties are expected to do very well](#) and could potentially bring about a radical shift in the European policymaking. Perhaps a small sign of hope came last week, with the election of a [pro-European, anti-corruption candidate, Zuzana Caputova, as president of Slovakia](#), breaking for the first time the unity of the fiercely anti-European Visegrad group (the group of countries that includes Poland, Hungary, Slovakia and Czechia).


In emerging markets, [local elections in Turkey](#) were held yesterday at a time of renewed tensions for the Lira. The central bank in effect increased the policy rate to 25.5% by suspending the regular 1-week repo auctions (priced at 24%), thereby forcing banks to borrow through the O/N lending facility. In Ukraine, [the first round of a presidential election](#) could result in the victory of the comedian Volodymyr Zelensky, who has almost no political experience to oversee the ongoing results of the tragic developments that have taken place in the country during the last few years.

This is just a sampling of events currently weighing on investor and consumer confidence, as economic growth is slowing down globally and inflation is falling back below central bank targets. Where some policy space is available (and sometimes even where it is not), governments are trying to cushion economic activity with fiscal support. Equally, central banks have all turned dovish, have paused their tightening cycles, or are prepared to cut rates again if necessary, at the same time as yield curves are (chiefly in the US) becoming inverted. As we discussed [in our recent analysis](#), the Fed might even amend its inflation targeting regime to make sure that lost inflation does not become foregone (sometimes called *bygone*) inflation. The [ECB recently provided more accommodation](#), and, at its recent Watchers conference in Frankfurt, [confirmed that it is looking at measures to protect bank profitability from rates being low for a longer period of time](#). The [BOE again left its rates unchanged at its MPC meeting in March](#), knowing that the key driver of any future move will be the outcome of the Brexit process. The [RBNZ has just updated its forward guidance](#) and indicated that its next move is likely to be a cut, putting pressure on the RBA to move the balance of risks to the downside. In EMs, [central banks have less pressure to defend their currencies from an appreciating dollar](#), given the recent dovish U-turn by the Fed. Some of them are ready to cut rates in coming months, as inflation has generally fallen within a manageable 5-10% range. As we discussed in [our latest Strategic Asset Allocation and Market Update](#), risky asset prices will be supported by reduced liquidity withdrawal by central banks, even as these asset prices remain vulnerable to bouts of volatility. In such an environment, investors will likely maintain a defensive risk profile, and continue to focus on and prioritize capital preservation above other investment goals.

Our Recent Publications

 [STRATEGIC ASSET ALLOCATION And MARKET UPDATE: Maintain A Defensive Risk Profile, Focus On Capital Preservation](#), by A. Magnoli Bocchi, 29 March 2019

 [REVIEW: RBNZ Prepares For a Rate Cut \(And Puts Pressure On RBA To Shift The Balance Of Risks To the Downside\)](#), by Alex Waters and Brunello Rosa, 28 March 2019

 [Changes In The Fed's Monetary Policy Strategy, Tools And Communication Policy: Likely Move To Flexible Average Inflation Targeting](#), by Nouriel Roubini, 25 March 2019

Looking Ahead

The Week Ahead: Elections To Take Place In Turkey And Ukraine

In the US labor data are expected to recover after an unexpected slowdown in February (Nonfarm payroll Mar., c: 175k; p: 20k; avg. hourly earnings Mar., c: 3.4% y-o-y; p: 3.4%).

On March 31, elections took place in: *i) Turkey*, where AKP, the ruling party, is likely to win the local elections, although with declining support compared previous ones; and *ii) Ukraine*, where all presidential candidates have declared their intention to deepen Ukraine's ties to the West.

In the EU, inflation data is expected to remain unchanged, below ECB's target (CPI Mar., c: 1.5% y-o-y; p: 1.5).

The Quarter Ahead: Geopolitical Tensions Will Continue

In the US, senior officials indicated that trade negotiations with China could take "a few more weeks, or months". The US is requesting: *i)* market access for US companies; *ii)* protection of US intellectual property; and *iii)* an "enforcement mechanism for the deal".

In the US, the market-probability of: *a)* no Fed hikes in 2019 remains at 100%; and *b)* a rate cut rose to 66% (p: 38%).

In the UK, the likelihood of a "no deal" exit on April 12 rose significantly after PM May's 'Brexit agreement' was rejected by the parliament for the third time (344-286). On Monday there will be a new set of indicative votes on a narrower selection of options, and PM May attempt to have a fourth meaningful vote on some version of her deal. If that fails, the UK is likely to seek another extension, which might force the country to participate in the May 23 EU elections.

In the EU, ECB President Draghi stated, "the ECB could (...) offset the impact of negative interest rates", which banks blame for weakening profitability, to support the banking sector.

Last Week's Review

Real Economy: Growth And Inflation Decelerate, Geopolitical Tensions Rise

In the US, weaker growth is weighing on consumer confidence (Mar., a: 124.1; c: 132.0; p: 131.4). Policy uncertainty keeps hampering the real economy: *i)* US-China trade negotiations entered their eighth month; *ii)* in the US, the trade deficit narrowed to USD 55.1bn in January (c: 57.0bn; p: 59.8bn); and *iii)* in **China**, industrial earnings dropped sharply, eroded by lower prices and slower sales (industrial profits Feb., a: -14.0% y-o-y; p: 10.3).

In Turkey, In Turkey, TRY volatility rose, as investors reacted to declining CBT reserves and lower TRY liquidity.

Inflation fell below: *i)* expectations; and *ii)* the 2% CB benchmark - in both the **US** (PCE Jan., a: 1.4% y-o-y; c: 1.7; p: 1.8; core PCE Jan., a: 1.8% y-o-y; c: 1.9; p: 2.0) and **Germany** (CPI Mar., a: 1.3% y-o-y; c: 1.6%; p: 1.5). As **the Fed** signaled that rate-hikes are off the cards in 2019, the market began pricing in two cuts by the end of 2020. CBs kept interest rates unchanged in New Zealand (a: 1.75%), the Czech Republic (a: 1.75%) and Egypt (a: 15.75%).

Financial Markets: Markets Lifted By Hopes Of A Solution To The US-China Disagreement

Market drivers: hopes for US-China trade progress outweighed worries about the global economic deceleration.

Global stocks w-o-w rose (MSCI ACWI, +0.6%) driven by the US (S&P 500, +1.2%) and the EZ (Euro Stoxx 50, +1.4%). Volatility fell (VIX S&P 500, -2.8 points to 13.7, 52w avg.: 16.6; 10y avg.: 17.8).

Fixed-income indices: w-o-w, fixed income delivered slightly positive returns (BAML Global index, +0.2%), with a volatility above its 52w average (VIX US 10y bond +0.1 points to 4.4, 52w avg.: 3.9; 10y avg.: 5.7). In 2019, the issuance of MENA fixed income has almost doubled (USD 32.3bn y-t-d) compared to the same period of 2018 (USD 17.9bn).

In Qatar, QNB has issued USD 1bn bonds due 2024 at 3.5%, with a bid to cover rate of around three.

Currencies: the USD rose w-o-w (DXY, 0.7%), while the EUR and GBP weakened (EUR/USD, -0.8% to 1.122; GBP/USD, -1.3 % to 1.303). EM currencies fell (MSCI EM currency index, -0.2%) and—despite an increase in volatility—the TRY strengthened w-o-w (USD/TRY +4.0% to 5.541).

Commodities: crude prices rose as Russia and OPEC confirmed their commitment to trimming production (Brent, 2.0% to 68.4 USD/b).

Farah Aladsani contributed to this Viewsletter.



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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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