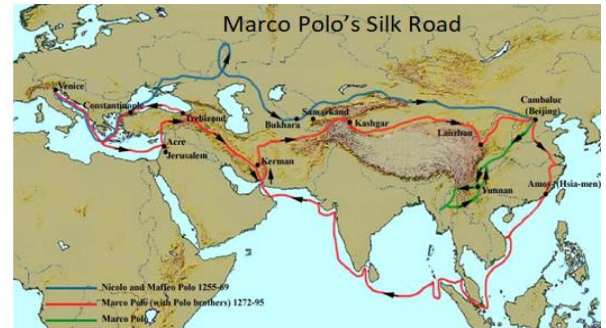




R&R Weekly Column  
By Brunello Rosa



Sources: NDRC, Commerce Ministry, Digital Silk Road Project, IMF, <http://www.silk-road.com/arti/marcopolo.shtml>

## China's Belt and Road Initiative: Is Italy "Open For Business" or "Up For Sale"?

China's President Xi Jinping and Italy's Prime Minister Giuseppe Conte were present at a ceremony in Rome on Friday, in which 29 protocols of a "non-binding" Memorandum of Understanding (MoU) were signed by several members of their two governments. The protocols cover areas including agriculture, e-commerce, satellites, beef and pork imports, media, culture, banking, natural gas, steel, science and innovation. They also set up a dialogue mechanism between the two countries' respective finance ministers. Among the various deals signed between China and Italy were two port management agreements between China Communications Construction and the ports of Trieste (which is situated in the northern Adriatic Sea) and Genoa, which is Italy's biggest seaport. Luigi Di Maio, Italy's deputy prime minister, said that the value of the various deals is around EUR2.5bn, with the potential of rising to EUR 20bn over time, if and as Italy succeeds in its intention to rebalance the trade deficit it has with China by increasing Italian exports to China as well as Chinese investment in Italy. This Memorandum of Understanding has raised more than one eyebrow in Europe and in Washington, as Italy is the first G7 country and the largest country in the EU and Eurozone to have yet signed up for China's flagship Belt and Road Initiative (BRI). The EU has re-affirmed that China is a "strategic rival" of the EU, and the US fears that Rome might be weakening its traditional Western ties with NATO, the EU and the Eurozone. Press reports preceding Xi's trip to Rome suggested that Italy's top-ranking officials had discussed with their Chinese counterparts the possibility of China buying Italian sovereign debt (which is the third largest amount of sovereign debt in the world). Italy's European partners have warned the country not to fall into a "debt trap" in which its strategic decisions would eventually be made by the owner of its sovereign debt rather than decided upon by the Italian government.

*The reason for China to sign such a deal is obvious:* Xi will be able to show, both domestically and to his strategic rivals (particularly the US), that he managed to bring a large G7, NATO and EU member country to China's side in the BRI, which is regarded as the most important Chinese geostrategic initiative. The level of commercial commitment China is making with this deal is minimal (as its effects will only be produced over a long period of time), while the political prize of the deal (prestige, which is being realized immediately) is huge. When Xi will get to Paris this week, the tune will be different. France, Germany and Brussels are worried about China scooping up strategic European assets, so they are likely to impose restrictions – albeit less draconian than the US ones – to Chinese takeovers of strategic European assets. France and Germany are also trying to build European champions to avoid US and China dominate key industries. *Now, why would Italy sign such a memorandum?* There are several explanations. First, historically the starting point of the Silk Road (or its terminus, depending on which direction you were travelling) was Venice, the city from which the explorer and merchant Marco Polo departed to discover China, in what President Xi labelled as the first contact between China and Western civilisation. So, one cannot be surprised if China views Trieste's port (near Venice) as the end of a modern "sea road". Trieste is strategically important for China because it offers a connection from the Mediterranean to landlocked countries such as Austria, Hungary, the Czech Republic, Slovakia and Serbia, all of which are markets China hopes to reach through its BRI. Secondly, Italy has been known for decades for its ability to have friendly relationships with strategic rivals: the USA and the Soviet Union, Iran and Iraq, Israel and the Palestinians, etc. (This is a reason why often Italian troops are used in peace-keeping operations by the United Nations). Italy could very much remain a loyal member of the Western alliance while also doing business and even signing deals of this kind with China. (Indeed, the US itself, while remaining the cornerstone of the Western alliance, is seeking to sign an MoU with China to end the ongoing trade war. And the largest holder of US sovereign debt is China). Third, a stagnating economy like Italy needs to show it is "open for business" if it wants to attract foreign investment, including from China.

Yet there are also risks involved in signing this deal. Foremost of these would be China gaining a level of geo-strategic influence in Europe much greater than the acquisition of Greece's port of Piraeus allowed it at the end of the Greek economic crisis in 2015. Another risk is that, with Italy already taking an ambiguous stance vis-à-vis its position versus the EU and Russia, Italy risks not being considered a loyal partner to Europe, and instead is perceived to be, in effect, "up for sale" to the highest bidder, no matter who that might be. Third, this entire story shows – once again – how weak the European construction is when it comes to defending common European interests. In a world that is increasingly becoming bi-polar, wherein countries have to pledge their alliance to *either* the US *or* China, the EU could play a vital role in presenting itself as a global actor pushing for peace, prosperity, the welfare state, democracy and environmental protection. Yet when EU countries do not work together, they have little leverage to advance even their own positions. Unless the EU completes its transition towards becoming a cohesive political entity, it will not be able to play a positive global role in coming years.

### Our Recent Publications

*Review: Hawkish Norges Bank Raises Rates and Signals Another Hike Within Six Months*, by B. Rosa and A. Waters, 21 March 2019

*Review: Fed Delivers Another Dovish Surprise*, by Brunello Rosa and Alex Waters, 20 March 2019



Looking Ahead

The Week Ahead: Further Political Uncertainty

**In the US-China** trade negotiations, most analysts expect the upcoming new round of talks to result in a deal by the end of April. However, given President Trump's comment that his "administration was ready to leave tariffs unchanged for a substantial period" the risk of a "no deal" remains elevated.

**In the US**, PCE inflation is expected to remain below the 2% benchmark (PCE price index Jan., *p*: 1.7% y-o-y; Core PCE price index, *p*: 1.9% y-o-y).

**In Turkey**, local elections are due on March 31<sup>st</sup>. Polls show that the AKP-MHP alliance is likely to win, although with less support than in previous elections.

The Quarter Ahead: Further Growth Deceleration

**In the US**, the FOMC downgraded its assessment of the economy: the median projection for 2019 growth declined to 2.1% (*p*: 2.5%).

**In the UK**, PM May obtained from the EU an extension—until April 12—to come up with an alternative plan for her Brexit deal.

**The Fed** kept interest rates unchanged (2.25% - 2.50%), and *i*) hinted that no further rate hikes will take place in 2019, given: *a*) the "waning global economic momentum"; *b*) global trade tensions; and *c*) political uncertainties; and *ii*) announced that between May and September, it will reduce the amount of monthly UST sales from USD30bn to USD15bn, and to zero thereafter. The monthly reduction of USD20bn of MBS will remain in place. As a result, the market-probability of: *a*) no Fed hikes in 2019 remains at 100%; and *b*) a rate cut rose to 58% (*p*: 38%).

**In China**, the government announced that—instead of using fiscal deficits and QE—it will support the economy with market liberalization measures, RRR and interest rate cuts and reductions in VAT and social security contributions.

Last Week's Review

Real Economy: Further Signs Of Growth Slowdown Forced Central Banks To Pause Tightening

**In the US**, the composite PMI showed a stronger-than-expected deceleration across all sectors (PMI Comp. Mar., *a*: 54.3; *c*: 55.2; *p*: 55.5).

**In the EU**, *i*) the composite PMI fell below expectations (PMI Comp. Mar., *a*: 51.3 *c*: 52.0; *p*: 51.9); *ii*) the manufacturing PMI declined further, in contraction territory (PMI Manuf. Mar., *a*: 47.6 *c*: 49.5; *p*: 49.3); *iii*) consumer confidence remained negative (Feb., *a*: -7.2; *c*: -7.1; *p*: -7.4); while *iv*) economic sentiment improved (Economic Sentiment Mar., *a*: -2.5; *c*: -18.7; *p*: -16.6) following the ECB's announcement of new liquidity-enhancing measures.

**In Turkey**, the TRY weakened (-0.4% w-o-w to USD/TRY 5.478) due to *a*) decline in CBT's FX reserves (-USD6.8bn); and *b*) deterioration of the relations with the US after Presidents' Trump and Erdogan statements on the Golan Heights. As a result, the CBT increased *de facto* the policy rate to 25.5% (*p*: 24%), by suspending 1-week repo auctions and forcing banks to borrow through the O/N lending facility.

Financial Markets: Volatility Is Rising, Safe Assets Recorded Inflows

Market drivers: concerns over: *i*) the US-China trade talks; and *ii*) the yield on the 10-y UST falling below the yield on the 3-month T-bill weighed on investor sentiment; yet, the Fed's dovish stance helped US stocks trim losses.

**In the EZ**, negative PMI readings hampered the stock market.

**Global stocks w-o-w fell** (MSCI ACWI, -0.6%) driven by the EZ (Euro Stoxx 50, -2.4%) and—to a lesser extent—by the US (S&P 500, -0.8%). Volatility rose to its 52w average (VIX S&P 500, +3.6 points to 16.5, 52w avg.: 16.6; 10y avg.: 17.8).

**Fixed-income indices:** w-o-w, bonds delivered positive returns (BAML Global index, +0.8%) driven by DM bonds (S&P Global, USD, +0.7%). **In Turkey**, the treasury borrowed USD1bn in the re-opening of a 10y Eurobond priced at 7.15%, with a bid-to-cover ratio of about three, mostly from investors from the US, UK, and Turkey. **Emirates NBD** issued a USD1bn perpetual 6-year bond with a yield of 6.125%, with a bid-to-cover ratio of about four, below the initial price guidance of 6.375-6.5%.

**Currencies:** the USD rose w-o-w (DXY, +0.1%), while the EUR and GBP weakened (EUR/USD, -0.1% to 1.131; GBP/USD, -0.6% to 1.321).

**Commodities:** Brent crude prices were almost flat for the week (Brent, -0.2% to 67.0 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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