

MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
By Brunello Rosa



Divergences Begin Emerging Within The Synchronised Global Slowdown

A couple of weeks ago, we reported [our impressions of the IMF meetings in Washington](#). The April edition of the [World Economic Outlook](#) put an official seal on the ongoing synchronised global economic slowdown, though with [a hoped-for rebound in H2 this year](#). Within that context, some differentiations are starting to emerge. In China, the monetary, regulatory and fiscal stimulus provided by the authorities in response to the growth slowdown that occurred in H2 last year has managed to stabilise economic activity, with growth in Q1 coming out at 6.4% y/y, slightly stronger than the 6.3% anticipated by consensus expectations. As the economy shows signs of recovery, last week the PBoC offered banks USD 39.8bn of “lower profile, more targeted medium-term loans,” signalling a shift away from broad-based easing. The stabilisation of Chinese growth is among the factors underpinning the risk-on sentiment prevailing in financial markets, with equity valuation close to their historical highs.


In the US, recent data are more of a mixed bag. Q1 GDP growth came out at 3.2% quarterly annualised, much stronger than the 2.3% that had been expected. However, this unexpected strong performance came more from net exports and a build-up in inventories, with underlying consumption remaining weak (final sales to private domestic purchasers decelerated). This week, the April Non-Farm Payroll figures (with 180K additional jobs expected, compared to 196K in March) will show whether the deceleration in economic activity will start to have an impact on the labour market. The Fed will also hold its April FOMC meeting, and the language of the statement and the press conference by Chair Jay Powell will clarify what the most recent take of the central bank is regarding the current economic and financial situation in the US.

Japan and Europe are providing a less reassuring picture. In Japan, given the deterioration in trade and manufacturing indicators (with April industrial production falling more than the expected -4.6% y/y), Q1 growth is expected at 0% y/y. While inflation (Tokyo CPI) has recently risen to its highest rate in four years, it remains well below the 2% target, so the [BOJ has re-affirmed its commitment to low rates at least until the spring of 2020](#), and tweaked its policy tools to signal that more easing is possible should economic conditions worsen further.

In Europe, Q1 GDP growth (at 0.3% q/q, 1.1% y/y) is expected to remain broadly in line with Q4 2018 readings, but the economic and political landscape continues to provide worrying signals. In Germany, the March [IFO business expectations sub-index declined to 95.2 from 95.6](#), sending the 10y bund yield back into negative territory. For the time being, [talks of the possible merger between Deutsche Bank and Commerzbank have collapsed](#). The deceleration in economic activity and the need to invest is reportedly [prompting a shift in economic thinking](#), with a possible relaxation of the stringent fiscal rules. In France, President Macron’s list [of promised actions](#) resulting from “[Le Grand Débat National](#)” might be read as an act of defiance by the *Gilets Jaunes*. In Italy, political instability and budget uncertainty are putting BTPs under renewed stress, with the 10y BTP-bund spread returning to 270bps recently. In Spain, the election has failed once again to [provide a majority to support a government in parliament](#), where the alt-right movement Vox has entered for the first time with 24 seats. The UK remains mired in its Brexit mess.

Given this background, [all the G10 central banks apart from Norges Bank](#) have turned dovish, following [January’s pivot by the Fed](#). In Sweden, the [Riksbank has returned towards its traditionally dovish positions](#). In Canada, the [BOC has announced a long pause in its normalisation process](#). In Australia, following a collapse of inflation in March, the RBA might cut rates in May. While for now rate cuts are off the table in the US, the market-derived probability of a Fed rate-cut in 2019 has increased this week to 74%, versus 43% last week. [In a recent study](#), we discussed whether the US could decouple from Europe if the EZ ended up in recession, and established that they can, so long as the EZ shock is mild. But if the shock to the EZ is large, even the US will not be able to escape it.


Our Recent Publications

 [Review: The BoJ Re-Commits to Its Current Policy Framework by Updating Its Forward Guidance](#), by A. Water, 25 April 2019

 [Review: Ultra-Dovish Riksbank Lowers Its Repo Rate Path And Extends QE to End-2020](#), by Brunello Rosa, 25 April 2019

 [Brazil The Pension Reform Is The Crucial Test For Bolsonaro](#), by A. Magnoli Bocchi and Farah Aladsani, 24 April 2019

 [Review: Bank Of Canada Removes Its Tightening Bias](#), by Brunello Rosa, 24 April 2019

 [US Can Temporarily “Decouple” From The EZ \(If The Shock to EZ is Mild\)](#), by Alex Waters and Brunello Rosa, 23 April 2019

Looking Ahead

The Week Ahead: US Trying To Resist Global Slowdown, Slow Economic Activity in The EZ

The US labor market is expected to remain resilient to the global growth slowdown (Nonfarm payrolls Apr. c: USD 180k; p: 196k; Avg. hourly earnings, c: 3.4% y-o-y; p: 3.2).

In the US, the Fed is expected to keep interest rates unchanged at its April FOMC meeting (p: 2.5%).

In the EZ, economic activity is expected to remain slow (GDP Q1, c: 1.1% y-o-y; p: 1.1). According to the ECB, risks are to the “downside, as global headwinds continue to weigh on EZ growth”.

In Japan, given the deterioration in trade and manufacturing indicators (Industrial production Apr., a: -4.6% y-o-y; c: -0.6; p: -1.1), Q1 growth is expected at 0% y-o-y, and the BoJ is likely to cut its 0.9% GDP growth forecast for FY19.

The Quarter Ahead: Geopolitical Tensions (I.E. US-China Trade Disputes, Brexit) Weigh On Growth

As US-China trade talks restart in Beijing, a draft agreement is expected by the end of May. Yet, trade tensions will keep taking a toll on global growth: the export-driven **South Korean economy** is suffering the largest contraction in a decade (GDP Q1, a: -0.3%; c: 0.3; p: 1.0). The S&P Global report warned that **in Europe** corporate rating downgrades could outnumber rating upgrades.

In the UK, PM May is considering: *i*) bringing a ‘Withdrawal Agreement bill’ to a vote in the House of Common after the local elections on May 2nd; and *ii*) allowing her opponents to make amendments to her proposal. If successful, the UK could leave before the EU parliamentary elections in May.

In DMs, monetary policy will remain supportive, with all the major G10 central banks having turned dovish after the Fed’s pivot in Jan.

In the US, the market-probability of a Fed rate-cut in 2019 has increased to 74% (p: 43%).

The **BoJ** predicts inflation below the 2% target for the next three years, justifying a loose monetary stance.

Turkey will likely enter a recession, while inflation will remain high, just below 20%, as the economy will suffer the non-renewal of the US Iran sanctions waiver. Last week, the central bank remained on hold, leaving the policy rate at 24%.

Last Week’s Review

Real Economy: Protectionism Is Taking A Toll On Growth, Monetary Policy On Hold

In the US, economic growth accelerated to 3.2% (GDP Q1, c: 2.1; p: 2.2), driven by net exports and a build-up in inventories; however, underlying consumption remains weak: final sales to private domestic purchasers decelerated (a: 1.3%, p: 2.1%). Inflation softened to 0.6% (PCE Q1; c: 1.3 q-o-q; p: 1.5).

In the EZ, sentiment indicators declined further (Consumer confidence a: -7.9; c: -7.0; p: -7.2).

In Japan, inflation rose to its highest rate in four years, yet remaining below the BoJ 2% target (Tokyo CPI Apr., a: 1.3%; c: 1.1; p: 1.1). The BOJ kept its policy rate unchanged at -0.1%.

In China, as the economy shows signs of recovery, the PBoC offered banks USD 39.8bn of “lower profile, more targeted medium-term loans”, signaling a shift away from broad easing.

In Ukraine, Mr. Volodymyr Zelenskyy, a comedian, won the presidential election against the incumbent Poroshenko, with 73% of the votes. Inflation remains subdued.

Financial Markets: US Stocks Hit Record High, As Earnings Surprised To The Upside

Market drivers: US earnings lift most markets, as 80% of S&P500 companies reported results that exceeded estimates.

Stocks: w-o-w, global stocks rose (MSCI ACWI, 0.4%) led by the US (S&P500, +1.2%). Volatility was unchanged and remains below historical averages (VIX S&P 500, +0.6 points to 12.7, 52w avg.: 16.0; 10y avg.: 17.5).

Bonds: w-o-w, indices displayed positive returns (BAML Global bond index, +0.3%). The 10y USTs yields declined 5bps to 2.50%.

FX: the USD gained against a basket of currencies (DXY, +0.6%), hitting a 2.5 week high. Weak growth prospects continue to weigh on the EUR (EUR/USD, -0.9% at 1.115). EM currencies suffered losses (MSCI EMs, -0.7% to 1638) with the Turkish lira (USD/TRY, -2.1% to 5.937; -10.9% y-t-d) and the Argentine peso (USD/ARS, -8.8% to 45.809) hampered by both a recession and high inflation.

Commodities: President Trump has called on OPEC to increase production, as the price of crude continues its streak of weekly gains (Brent, +0.3% to 72.2 USD/b). OPEC - which controls about a third of the world’s oil - decreased production by 0.5mn bpd m/m in March, to an average of 30mn bpd. The US announced it will not renew waivers to the Iran sanctions, which allow China and other major economies to buy 1.4 mn barrels a day from Iran.



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The picture in the front page comes from [this website](#)



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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