MAKING SENSE OF *THIS* WORLD 13 *May 2019*

R&R Weekly Column
By Brunello Rosa

In This Volatile Macroeconomic and Geopolitical Environment, G10 Central Banks Embark on Diverging Policy Paths

Last week we discussed the renewed trade tensions between China and the US. We feared that President Trump's threat to increase the tariffs imposed on *all* goods imported from China to 25% would eventually materialise (reportedly due to China backtracking on a number of commitments made in previous stages of the negotiations) – as in fact did occur. These trade skirmishes might still lead to an eventual agreement, but we might also witness a repeat of what happened during the US negotiations with North Korea, which were also abruptly interrupted by Trump. There is now no deal in sight in that case, Kim Jon Un having reportedly started a new series of tests of tactical weapons. In the case of the trade negotiations with China, it is similarly not clear now how or when a deal could be reached. For the time being China will test whether or not President Trump is courageous enough to open a second front of his trade wars by imposing tariffs on the EU, and in particular, on Germany, in the auto sector.

According to one line of thought, this interruption in the negotiations was a result of Trump's decision to use the window of opportunity he has to create new international tensions; a window being provided by a combination of the strong US economy, tight labour market, low inflation and buoyant equity markets thanks to the Fed's pivot. Other analysts believe instead that it was China that misread Trump's call for a 100bps cut to Fed funds rate, seeing it as a sign of weakness of the US economy, thereby inducing an unwarrantedly tougher Chinese stance in the final stage of the negotiations. Whatever the reason, a deal that seemed at hand fell apart last week.

These types of miscalculations also seem to be taking place in the renewed tensions between the US and Iran. Iran has announced a partial withdrawal from the nuclear deal in response to the US decision to withdraw from the JCPOA months ago. In a typical tit-for-tat strategy reaction, the US has deployed the aircraft carrier Lincoln in the Middle East, further destabilising the region (where currency pegs to the USD have come under severe stress). All this is occurring while Turkey's fragility is again becoming more prominent, the Lira having risen above 6 versus the US dollar, in spite of the central bank's increase in policy rates from 24% to 25.5%, as international investors doubt the real firepower of the country to defend its currency in the event of a speculative attack.

Some believe that Trump's trademark ability is making deals, which might well be the case. Nevertheless, politics is more complicated than business, and the examples above show that the potential for geopolitical miscalculation is huge, as is the possibility of starting a conflict by accident. As historian Christopher Clark masterfully wrote, Europe "sleepwalked" its way into World War I.

These geopolitical tensions and lack of international coordination is leading to higher oil prices, which are contributing the global macro-economic environment becoming volatile and uneven, with some regions growing robustly with rising inflation, while others are weakening. To counter these developments, fiscal policy has been relaxed in the US, EU and China. Central bankers, observing this uneven scenario (which is leading to market volatility) are responding in different ways, depending on domestic circumstances. Within the G10 some central banks followed the Fed and turned dovish: the ECB, the BOJ, the BOC, the Riksbank, the Reserve Bank of Australia and the Reserve Bank of New Zealand, the latter of these becoming, in the past week, the first G10 central bank to cut its policy rate during this cycle. On the other side of the spectrum there is the BOE, and above all Norges Bank, which last week increased its degree of hawkishness by pre-announcing a rate hike in June; this is likely to be indicative of an acceleration in its rate normalisation process.

Our Recent Publications

- *FLASH REVIEW: Norges Bank Surprises Markets And Signals A Rate Hike In June*, by Brunello Rosa, 9 May 2019
- *FRANCE: The Social Crisis Lingers, While European Alliances Are Being Questioned*, by Rémi Bourgeot, 9 May 2019
- *Review: RBNZ Is The First G10 Central Bank to Cut Rates In This Cycle*, by Alex Waters and Brunello Rosa, 8 May 2019
- *TRAVEL NOTES - CHINA: Growth Is Stabilizing at the Cost of Renewed Financial Imbalances*, by N. Roubini, 7 May 2019
- *RBA Review: Cash Rate Held Steady, Labour Market Key to Rate Outlook*, by Alex Waters and Brunello Rosa, 7 May 2019

Looking Ahead

The Week Ahead: Further Indications Of Global Slowdown

In the US, retail sales are expected to slow to 0.3% m-o-m (p: 1.6%).

In the EZ, the industrial sector is likely to remain weak (industrial production: c: -2.1% y-o-y; p: -0.3) and growth stagnant (GDP Q1, c: 1.2% y-o-y; p: 1.1). Still in the EZ, headline inflation is expected to increase to 1.7% y-o-y (p: 1.4).

In China, the government is likely to retaliate with "necessary countermeasures" to the US tariff-hike.

The Quarter Ahead: Trade Tensions Will Remain High

In DMs, monetary policy will remain supportive. Global inflation is likely to remain low, leaving little scope for DM CBs to raise rates.

In the US, the market-probability of a Fed rate-cut in 2019 rose to 57% (p: 47%).

The UK confirmed the participation in the May 23 EU elections.

If a ***US-China trade*** deal is not reached by June, the US will place a 25% tariff on another USD325bn of Chinese exports. After the US and EU threatened each other over the Boeing-Airbus disputes, EU ministers signaled their willingness to resume trade negotiations. The removal of transatlantic tariffs on industrial goods could expand: *i)* US exports by 13%, and *ii)* the EU's shipments by 10%.

In China, a mild increase in inflation (CPI Apr., a: 2.5%; p: 2.3) is unlikely to reverse PBoC's easing policies, given the escalation in trade tensions and the recent sharp drop in stock prices.

In Turkey, the High Electoral Board nullified the Istanbul elections, in which the ruling AKP had lost, and set a new vote for June 23. The TRY is likely to weaken, despite the recent CBT decisions to: *i)* tighten liquidity, forcing banks to borrow TRYs at the higher overnight rate of 25.5%; and *ii)* increase the RRRs for FX liabilities by 100bps, for all maturities.

In Iran, the government stated its intention to resume uranium enrichment unless Europe stops the country's economic isolation, following: *i)* the US's re-imposition of sanctions; *ii)* the expiration of waivers that allowed Iran's oil exports; and *iii)* the US deployment of forces in M.E.

Last Week's Review

Real Economy: Geopolitical Risks Are Rising, The US Imposes Tariffs On Chinese Goods Despite Negotiation Efforts

In the US, a strong Q1 lifted import growth (US trade balance Mar., a: -50.0bn; c: -50.2bn; p: -49.3bn); President Trump declared "China broke the deal we negotiated" and the administration raised trade tariffs on USD200bn of yearly imports from China, from 10 to 25%. Inflation rose (CPI Apr., a: 2.0% y-o-y; c: 2.1; p: 1.9).

In the EZ, the EC warned against escalating trade tensions and revised downwards its 2019 growth forecasts for: *i)* the EZ (a: 1.2%; p: 1.3), as consumption slowed (EZ retail sales Mar., a: 1.9% y-o-y; c: 1.8; p: 3.0); *ii)* Germany (a: 0.5; p: 1.1), as German manufacturing weakened (Industrial production Mar., a; -0.9% y-o-y; c: -2.8; p: 0.2); and *iii)* Italy (a: 0.1%; p: 0.2).

In China, the trade surplus dropped (a: USD 13.8bn; c: 35.0bn; p: 32.7bn) due to lower external demand, a global tech down-cycle, and trade tensions.

In Australia, the RBA kept its policy rate unchanged (a: 1.5%), while CBs cut policy rates in New Zealand (a: 1.25%; p: 1.50), the Philippines (a: 4.50%; p: 4.75) and Malaysia (a: 3.25%; p: 3.00).

Financial Markets: Trade Uncertainty Increases Caution For Investors

Market drivers: in response to renewed trade uncertainty, investors looked for safe-haven assets.

Stocks: w-o-w, global stocks fell (MSCI ACWI, -2.6%), led by the EZ (Euro Stoxx 50, -4.0%). EM tumbled (MSCI EMs, -4.6%). Volatility rose to its 52w average (VIX S&P 500, +3.1 points to 16.0, 52w avg.: 16.0; 10y avg.: 17.5).

Bonds: w-o-w, globally, indices remained flat (BAML Global bond index, 0.2%). The US yield curve inverted for the second time in 2019, as the 10y UST yield fell below the 3m UST yield. Bahrain sold debt worth USD348mn through the issuance of 3m, 6m T-bills.

FX: the USD declined against a basket of currencies (DXY, -0.2%) and the EUR (EUR/USD, +0.3% at 1.123) but rose against the GBP (GBP/USD, -1.3% at 1.300). EM currencies declined (MSCI EMs, -0.5% at 1630).

Commodities: Oil prices fell (Brent, -0.3% to 70.6 USD/b) as the escalating trade battle outweighed upward price pressure due to a decline in US inventories.

Farah Aladsani *contributed to this Viewsletter.*

The picture in the front page comes from this website

@RosaRoubini Rosa & Roubini Rosa&Roubini Associates

For more information, please call us on +44 (0)207 1010 718 or send us an email to info@rosa-roubini-associates.com

www.rosa-roubini-associates.com

118 Pall Mall, London SW1Y 5ED

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*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*		