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R&R Weekly Column
By Brunello Rosa

With A Slowing Global Economy, Monetary Policy's Tide Is Turning

The global economy is now in the middle of an asynchronous slowdown, which is occurring mostly as a result of prolonged, intensifying trade tensions, rising geopolitical risks, and tightness in the labour market in a number of countries. Let us briefly examine the three major economic regions of the global economy.

In the US, Q1 GDP growth was surprisingly positive, but domestic demand weakened substantially, providing little comfort for the economy's future performance. The non-farm payrolls figures for May 2019, released last week, were weaker than expected; only 75,000 jobs were added, as opposed to the consensus expectation of 185,000 jobs or the previous reading of 224,000 jobs. This weaker figure was accompanied by slower growth in average hourly earnings: 3.1% y/y, versus a consensus expectation and previous reading of 3.2%. In a recent interview, Fed's Vice-Chair Richard Clarida said that tariffs are expected to have a one-off effect on price levels, but a more lasting impact on economic activity. Therefore, if trade tensions do not subside, the negative demand shock to the economy from those tensions will eventually be larger than the negative shock to supply.

In the Eurozone, Q1 GDP also surprised mildly to the upside, but the latest ECB projections suggest that economic activity will decelerate in Q2 and Q3, so the much-hoped for rebound in Q2 is unlikely to materialise. This is mostly because the largest European economy, Germany, is fighting to exit a prolonged period of stagnation (it has been flirting with recession), while the third largest Eurozone economy, Italy, has temporarily exited its technical recession in Q1 but risks entering a new one in Q2 2019. For the time being, France and Spain are the main drivers of economic growth in the Eurozone.

In China, the policy stimulus of 2018 allowed the economy to also surprise to the upside in Q1, but the reignition of trade tensions this year have meant a new slowdown, which the authorities are fighting with fiscal, monetary and regulatory stimulus. Going forward, US tariffs are expected to continue weighing on exports and push inflation higher. All other regions in the world closely depend on developments from these three economic and geo-strategic giants, so economic activity is likely to decelerate globally.

Facing this situation, and waiting for fiscal policy to provide a larger counter-cyclical contribution (even as most government are busy "fixing their fiscal roof" now that "the sun is still shining"), central banks have already begun to act. In a number of jurisdictions, monetary policy, which had at least had a tightening bias, has now become neutral if not overtly more accommodative. In developed markets, last week the Reserve Bank of Australia cut (after a long debate) its main policy rate to a record low of 1.25%, following the neighbouring RBNZ by a month. During its latest press conference, President Draghi said that the ECB's Governing Council has discussed possible easing measures. While the BoJ has never abandoned its accommodative stance, the elephant in the room is clearly the Fed. The markets now price in the likelihood, indeed almost the certainty, that the Fed will cut rates in coming months.

In Emerging Markets, central banks have been even more proactive. In China, the PBoC Governor announced "there is tremendous room to adjust monetary policy if the trade war deepens." In India, a marked slowdown in the economy led the Reserve Bank of India to cut interest rates by 25bps (to 5.75%) for a third time this year, and suggest further cuts are in the pipeline. The central banks of the Philippines and Malaysia also recently cut their policy rates by 25bps, to 4.5% and 3% respectively.

Our Recent Publications

- Review: ECB Is Not As Dovish As The Market Expected, But Is Ready To Ease, *By Brunello Rosa, 6 June 2019*
- MACRO PICTURE - Argentina: Elections To Test The Austerity Measures, *by Alessandro Magnoli Bocchi, Farah Aladsani, Fawaz Sulaiman Al Mughrabi and Lapo Fioretti , 5 June 2019*
- Review: RBA Cuts Its Cash Rate Due to Uncertainty On The Global Outlook, *By Alex Waters, 4 June 2019*
- ECB Preview: Don't Expect Too Much Substance, But Still a Dovish Tone, *by Brunello Rosa and Nouriel Roubini, 3 June 2019*

Looking Ahead

The Week Ahead: US Retail Sales To Pick Up, China's Exports To Drop Sharply

In the US, inflation is expected to remain subdued (CPI May, c: 1.9% y-o-y; p: 2.0%) while retail sales are expected to pick-up (Retail sales May, c: 0.6% m-o-m; p: -0.2%).

In China, exports are expected to drop sharply due to higher US tariffs (c: -3.8% y-o-y; p: -2.7); inflation is likely to rise (CPI May, c: 2.7% y-o-y; p: 2.5%), while remaining below the PBoC's 3% target.

The Quarter Ahead: Trade Tensions To Weigh On Global Growth

US-China, trade talks are unlikely to resume until the June 28 G-20 summit.

In the EZ, a stronger EUR—by reducing import costs—may dampen inflation expectations below the ECB 2% target. The ECB announced that "funds under TLTRO3" will: *i)* start in September 2019 and end in March 2021, with a 2y maturity; *ii)* be offered quarterly, to preserve bank lending conditions and support the ECB's accommodative stance; and *iii)* "be offered at 10 bps above the main refinancing rate (0%) and can fall as low as the average deposit rate plus 10 bps.

In the US, Fed Chair Powell signaled openness to cutting rates as the Fed is "closely monitoring the impact of trade developments" and would "act as appropriate to sustain economic expansion". Market expectations of a rate cut in 2019 rose to 99% (p: 94%). Barring shocks, the Fed is likely to cut between June and September (possibly in July) and – if needed – in December 2019.

In the UK, Boris Johnson—the front-runner to succeed Theresa May as PM—vowed to leave the EU "with or without a deal, on October 31" and promised to hold onto USD50bn owed to the bloc "until divorce conditions become more favorable".

In China, the PBoC governor announced "there is tremendous room to adjust monetary policy if the trade war deepens", joining US and EZ counterparts in displaying readiness to support a slowing economy.

The US warned ***Turkey***: if by July 31 it does not abandon its S-400 acquisition plans: 1) Turkish pilots currently training in the US on F-35s will be expelled; and 2) all agreements with Turkish firms sub-contracted for jet manufacturing will be cancelled.

Last Week's Review

Real Economy: Loss Of Economic Momentum Has Spread To The US Labor Market

In the US, non-farm payrolls were weaker-than-expected (a: 75k; c: 185k; p: 224k) and average hourly earnings slowed (a: 3.1% y-o-y; c: 3.2; p: 3.2).

The US and Mexico reached a deal to curb migration, defusing President Trump's threat to impose a 5% tariff on all Mexican imports.

In the EZ, the ECB left interest rates unchanged, as expected (a: 0%; p: 0%), and inflation slowed to 1.2% y-o-y (c: 1.3%; p: 1.7%).

In Germany, industrial production fell (IP Apr., a: -1.9% y-o-y; c: -1.7; p: -0.9) as trade tensions and lower demand weigh on exports.

In Turkey, inflation slowed, as a weak domestic demand caps prices (a: 18.7% y-o-y; c: 19.1; p: 19.5).

In India, a marked slowdown in the economy led the RBI to: *i)* cut interest rates by 25bps for a third time this year (a: 5.75%; p: 6.00); and ii) suggest further cuts.

In Australia, the RBA cut interest rates by 25 bps to 1.25% (c: 1.25%; p: 1.5%) due to lower housing prices and a slowdown in China, the country's largest trading partner.

Financial Markets: Prospects Of Monetary Easing Boosted Equities And Weakened The USD

Market drivers: After a weaker-than-expected US labor data, investors expect the Fed to cut interest rates in response to a weakening growth outlook and escalating trade tensions.

Stocks: w-o-w, global stocks rose (MSCI ACWI, +3.6%), led by the US (S&P 500, +4.4%). Volatility fell (VIX S&P 500, -2.4 points to 16.3, 52w avg.: 16.3; 10y avg.: 17.4).

Bonds: globally, indices rose w-o-w (BAML Global bond index, +0.5%). The yield on a 10Y UST sank to 2.05% and the yield curve steepened.

FX: the USD weakened against a basket of currencies (DXY, -1.2%) and the EUR rose (EUR/USD, +1.5% at 1.133). EM currencies rose (MSCI EMs, +0.4% at 1,623).

Commodities: Oil prices fell (Brent, -1.9% to 63.3 USD/b), driven by doubts over the outlook for global demand.

Farah Aladsani *contributed to this Viewsletter.*

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*	*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*		