MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
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Macro and Market Outlook: Fasten Your Seatbelts

In our latest Market Update and Outlook, published last week ahead of the upcoming quarterly asset allocation, we reviewed the major macroeconomic, political, geopolitical and market events of the last six months. We then provided an outlook for the next six and next twelve months, as well as further ahead in the future. From a macroeconomic perspective, the last six months have seen a synchronised deceleration of the global economy, starting from its three main regions (US, Eurozone and China), in spite of upward surprises in Q1 GDP growth. The ongoing trade and tech war between US and China, which is likely the beginning of a new Cold War, which we called Cold War II, is taking its toll on the global economy. The US and China (ahead of a possible truce, yet short of a full deal that would resolve their economic disputes) are importing less from each other, which is likely to benefit only a few select economies, such as Vietnam, Taiwan, Chile, Malaysia and Argentina. In our recent analysis we discussed why we believe that a controlled escalation, or contained commercial warfare, is more likely for the time being than a full-scale trade war or a full deal being reached between the two countries.

But trade wars, tech wars and the disruption to global supply chains is not the only factor affecting the global economy. Geopolitical tensions are on the rise irrespective of trade tensions (with the US still being the instigator of these tensions). We discussed the risk of miscalculations and accidents taking place in the US-Iran standoff, and last week there was indeed an attack on two oil tankers in the Gulf of Oman, the gateway for over a third of the world's shipped oil. Even if the situation in the region is set to remain tense for some time, oil prices still fell on a weekly basis, in response to the slowdown in the global economy. Also in the Middle East, the Turkish government confirmed its S-400 arms deal with Russia, after Turkey's Defense Minister stated that "the language used in a letter sent by the US regarding Turkey's removal from the F-35 fighter jet program does not suit the spirit of alliance". Finally, the regional geopolitical mess that is Brexit, with its potential global implications (the Fed quoted it among the most relevant cross-currents recently weighing on market sentiment), could deteriorate further, if the UK were to go for a no-deal exit following the arrival of the country's new prime minister (Boris Johnson is the frontrunner). In fact, last week the House of Commons rejected (with a 309-298 vote) a motion designed by the opposition intended to block a "no-deal" exit on October 31st.

With all of this taking place, and as fiscal policy remains constrained, central banks are already on the move. Joining the Fed, ECB, PBoC and BOJ, the Swiss National Bank (SNB) also claimed last week to have room to further ease its policy stance, and, also for this purpose, introduced its own SNB Policy Rate, in substitution of the 3m Libor target range. This week, the Fed will provide further indication as to whether or not it wants to proceed with its precautionary cuts, which the market now considers certain to be implemented by year end, considering the various cyclical and structural factors dampening upward pressures on US inflation. At the same time, Norges Bank will likely confirm that it will remain at odds with all other G10 central banks, and will likely proceed with its pre-announced 25bps increase in its policy rate.

After a very volatile semester, the price of risky assets (primarily equities) and the price of long-dated government bonds are supported by this renewed dovishness of central banks. However, if the damage to the global economy proves to be larger than is currently estimated, central banks will have to do much more than a few insurance-based cuts to prevent a recession and severe market correction in the next few months.

Our Recent Publications

- US-China Trade & Tech War Scenarios: A Controlled Escalation Is More Likely Than A Full Deal or A Full-Scale War, *by Nouriel Roubini, 14 June 2019*
- Preview: Norges Bank Set To Increase Rates In Spite Of Dovish Fed and ECB, *by A. Waters and B. Rosa, 14 June 2019*
- Fasten Your Seatbelts: Financial Markets' Review and Outlook, *by A. Magnoli, F. Aladsani. and F.Al Mughrabi, 14 June 2019*
- SNB Introduces A New Policy Rate (and Claims To Have Space To Ease), *by B. Rosa and Alex Waters, 13 June 2019*
- MACRO PICTURE - US Inflation: Several Factors Dampening Structural Upward Pressures, *by F. Panelli , 13 June 2019*
- **Geopolitical Corner:** Beyond The Wishful Headlines, Europe's Chronic Decline Gathers Pace, *by John Hulsman, 4 June 2019*

Looking Ahead

The Week Ahead: Fed On Hold And PMI Likely To Remain Stable

In the US, the Fed is expected to remain "on hold", with policy rates unchanged at 2.50%.

In the EZ, the PMI is likely to remain stable (Markit PMI composite June, c: 51.7; p: 51.8).

In the UK, the BoE is expected to leave interest rates unchanged at 0.75%.

The Quarter Ahead: Geopolitical Tensions To Weigh On Global Growth, Cbs To Ease

Despite the ***US-Mexico*** deal, the threat of new tariffs is still pervasive. ***In the US-China trade dispute***, the meeting between the US Treasury secretary and the PBoC Governor did not deliver progress, leaving investors "in a wait and see mode" until the G-20 Summit. So far, the trade tensions resulted in: 1) the US and China importing less from each other, especially of the goods subject to higher levies; and 2) a few countries – i.e.: Vietnam, Taiwan, Chile, Malaysia and Argentina - becoming major beneficiaries.

In the UK, a hard-Brexit is more likely, as the House of Commons rejected (309-298) a motion designed by the opposition to block a "no-deal" exit on October 31st.

Central Banks are likely to ease policies. Responding to a deteriorating global outlook and rising risks (largely from US trade policy), key CBs – i.e.: the Fed, ECB, BOJ and PBOC - made clear their readiness for monetary accommodation; possible measures include: *i)* liquidity injections; *ii)* funding support; *iii)* interest rate cuts; and *iv)* restarting QE.

In the US, the Fed is likely to shift its stance towards easing, due to a slowing global economy. Market expectations of a rate cut in 2019 stayed at 99% and the probability of one rate cut in July rose to 68%.

In the EZ, the ECB stated that it is "ready to combat any further slowdown that threatens (…) price stability", and is "willing to cut interest rates and resume bond purchases, if necessary".

In Japan, the BoJ will: *i)* deliver "a bigger monetary stimulus if necessary"; and *ii)* consider easing further if momentum toward its 2% inflation target is lost.

In China, to maintain stable market liquidity in H2-2019, the PBoC: *i)* injected USD14.51bn into the financial system through open market operations; and *ii)* pledged to "keep its monetary policy prudent, neither too tight nor too loose".

In Turkey, the government is likely to confirm the S-400 deal, after the Turkish Defense Minister stated that "the language used [in a letter sent by the US regarding Turkey' removal from the F-35 fighter jet program] does not suit the spirit of alliance".

Last Week's Review

Real Economy: Low US Inflation Fuels Fed Rate-Cut Expectations

In the US, softer-than-expected inflation in May (a: 1.8% y-o-y; c: 1.9%; p: 2.0%) led the markets to expect the Fed to cut rates, especially if escalating trade tensions continue to weigh on the outlook. Yet, retail sales rose, showing an improved consumer sentiment (Retail sales May, a: 0.5%; c: 0.6%; p: 0.3%).

In China, exports beat expectations, led by shipments - brought forward to anticipate a potential tariff increase (Exports May, a: 1.1% y-o-y; c: -3.9%; p: -2.7%). Inflation rose for the third straight month in May to a 15-m high (CPI May, a: 2.7% y-o-y; c: 2.7%; p: 2.5%).

In Turkey, the MPC kept the policy one-week repo rate unchanged, at 24.0%.

Financial Markets: Expectations Of CB Monetary Easing Is Driving The Markets

Market drivers: Interest rate indicators, if viewed in isolation, seem to be signaling adverse scenarios. The 10Y/3M UST spread has been inverted for the past 21 days (10 days is seen as a "recession threshold"). However, the markets expect major CB to step in to: i) support growth; ii) cushion downside risks; and iii) engineer a soft landing. Going forward, "bad economic news" – being perceived to increase the chances of CB stimuli - will become "good news" for asset prices.

Stocks: w-o-w, global stocks rose (MSCI ACWI, +0.3%), led by the US (S&P 500, +0.5%). Volatility fell (VIX S&P 500, -1.0 points to 15.3, 52w avg.: 16.4; 10y avg.: 17.3).

Bonds: globally, indices rose w-o-w (BAML Global bond index, +0.1%).

FX: the USD strengthened against a basket of currencies (DXY, +1.1%) and the EUR fell (EUR/USD, -1.1% to 1.121). EM currencies stalled (MSCI EMs, 0.0% at 1,623).

Commodities: Oil prices fell w-o-w (Brent, -2.0% to 62.0 USD/b), despite an attack on two oil tankers in the Gulf of Oman, the gateway of over a third of the world's shipped oil, increasing tensions between the US and 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*	*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*	*MPC*	*Monetary Policy Committee*
bpd	*Barrels per day*	*NAFTA*	*North-American Free Trade Agreement*
bps	*Basis points*	*NATO*	*North Atlantic Treaty Organization*
BS	*Balance sheet*	*OECD*	*Organization for Economic Cooperation and Development*
c	*Consensus*	*Opec*	*Organization of Petroleum Exporting Countries*
C/A	*Current account*	*p*	*Previous*
CB	*Central bank*	*P2P*	*Peer-to-peer*
CBB	*Central Bank of Bahrain*	*PBoC*	*People's Bank of China*
CBK	*Central Bank of Kuwait*	*PCE*	*Personal Consumption Expenditures*
CBT	*Central Bank of Turkey*	*PE*	*Price to earnings ratio*
CDU	*Christian Democratic Union, Germany*	*PM*	*Prime minister*
CNY	*Chinese Yuan*	*PMI*	*Purchasing managers' index*
CPI	*Consumer Price Index*	*pps*	*Percentage points*
DJIA	*Dow Jones Industrial Average Index*	*pw*	*Previous week*
DJEM	*Dow Jones Emerging Markets Index*	*QCB*	*Qatar Central Bank*
d-o-d	*Day-on-day*	*QAR*	*Qatari Riyal*
DXY	*US Dollar Index*	*QE*	*Quantitative easing*
EC	*European Commission*	*q-o-q*	*Quarter-on-quarter*
ECB	*European Central Bank*	*RE*	*Real estate*
ECJ	*European Court of Justice*	*RBA*	*Reserve Bank of Australia*
EIA	*US Energy Information Agency*	*RRR*	*Reserve Requirement Ratio*
EM	*Emerging Markets*	*RUB*	*Russian Rouble*
EP	*European Parliament*	*SWF*	*Sovereign Wealth Fund*
EPS	*Earnings per share*	*tn*	*Trillion*
EU	*European Union*	*TRY*	*Turkish Lira*
EUR	*Euro*	*UAE*	*United Arab Emirates*
EZ	*Eurozone*	*UK*	*United Kingdom*
Fed	*US Federal Reserve*	*US*	*United States*
FOMC	*US Federal Open Market Committee*	*USD*	*United States Dollar*
FRB	*US Federal Reserve Board*	*USD/b*	*USD per barrel*
FX	*Foreign exchange*	*UST*	*US Treasury bills/bonds*
FY	*Fiscal Year*	*VAT*	*Value added tax*
GCC	*Gulf Cooperation Council*	*VIX*	*Chicago Board Options Exchange Volatility Index*
GBP	*British pound*	*WTI*	*West Texas Intermediate*
GDP	*Gross domestic product*	*WTO*	*World Trade Organisation*
IMF	*International Monetary Fund*	*w*	*Week*
INR	*Indian Rupee*	*w-o-w*	*Week-on-week*
IPO	*Initial public offering*	*y*	*Year*
IRR	*Iranian Rial*	*y-o-y*	*Year-on-year*
JPY	*Japanese yen*	*y-t-d*	*Year-to-date*
k	thousand	*ZAR*	*South African Rand*
KSA	*Kingdom of Saudi Arabia*	*2y; 10y*	*2-year; 10-year*