

MAKING SENSE OF *THIS* WORLD

17 June 2019



R&R Weekly Column
By Brunello Rosa



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](#)  [SNB Introduces A New Policy Rate \(and Claims To Have Space To Ease\)](#), by B. Rosa and Alex Waters, 13 June 2019
-  [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
-  [MACRO PICTURE - US Inflation: Several Factors Dampening Structural Upward Pressures](#), by F. Panelli, 13 June 2019
-  [Fasten Your Seatbelts: Financial Markets' Review and Outlook](#), by A. Magnoli, F. Aladsani. and F. Al Mughrabi, 14 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.



@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

Farah Aladsani contributed to this Viewsletter.



The picture in the front page comes from [this website](https://www.gettyimages.com/detail/photo/young-woman-smiling-joyful-people/120077777)

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	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



Rosa & Roubini Associates Ltd is a private limited company registered in England and Wales (Registration number: 10975116) with registered office at 118 Pall Mall, St. James's, London SW1Y 5ED, United Kingdom. VAT registration number GB 278 7297 39. **Analyst Certification:** We, Brunello Rosa and Nouriel Roubini, hereby certify that all the views expressed in this report reflect our personal opinion, which has not been influenced by considerations of Rosa & Roubini Associates's business, nor by personal or client relationships. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the views expressed in this report. **Disclaimer:** All material presented in this report is provided by Rosa & Roubini Associates-Limited for informational purposes only and is not to be used or considered as an offer or a solicitation to sell or to buy, or subscribe for securities, investment products or other financial instruments. Rosa & Roubini Associates Limited does not conduct "investment research" as defined in the FCA Conduct of Business Sourcebook (COBS) section 12 nor does it provide "advice about securities" as defined in the Regulation of Investment Advisors by the U.S. SEC. Rosa & Roubini Associates Limited is not regulated by the FCA, SEC or by any other regulatory body. Nothing in this report shall be deemed to constitute financial or other professional advice in any way, and under no circumstances shall we be liable for any direct or indirect losses, costs or expenses nor for any loss of profit that results from the content of this report or any material in it or website links or references embedded within it. The price and value of financial instruments, securities and investment products referred to in this research and the income from them may fluctuate. Past performance and forecasts should not be treated as a reliable guide of future performance or results; future returns are not guaranteed; and a loss of original capital may occur. This research is based on current public information that Rosa & Roubini Associates considers reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. Rosa & Roubini Associates, its contributors, partners and employees make no representation about the completeness or accuracy of the data, calculations, information or opinions contained in this report. Rosa & Roubini Associates has an internal policy designed to minimize the risk of receiving or misusing confidential or potentially material non-public information. We seek to update our research as appropriate, but the large majority of reports are published at irregular intervals as appropriate in the author's judgment. The information, opinions, estimates and forecasts contained herein are as of the date hereof and may be changed without prior notification. This research is for our clients only and is disseminated and available to all clients simultaneously through electronic publication. Rosa & Roubini Associates is not responsible for the redistribution of our research by third party aggregators. This report is not directed to you if Rosa & Roubini Associates is barred from doing so in your jurisdiction. This report and its content cannot be copied, redistributed or reproduced in part or whole without Rosa & Roubini Associates' written permission.

