



R&R Weekly Column
By Brunello Rosa



“Black Swans” Abound In Fragile Environments

In the beginning there was Minsky. According to Hyman [Minsky’s financial instability hypothesis](#), during the expansionary phases of business cycles, the financial position of economic agents – companies, households, sometimes even governments – becomes increasingly fragile, as they move from relatively secure “hedge” positions towards speculative or, in extreme cases, “ultra-speculative” positions; the latter not dissimilar from infamous [Ponzi schemes](#). In a more fragile environment, even a small shock to the system, such as a small increase in interest rates, has the potential to render the most exposed positions illiquid or even insolvent. This eventually leads to a downturn in the financial cycle, not dissimilar to the debt-deflation spiral described by [Irving Fisher](#). In turn, this collapse of financial positions triggers a downturn in the business cycle, which moves from expansion to slowdown and eventually into contraction. From a Shumpeterian perspective, this period of “[creative destruction](#)” is very healthy, as this process of selection and “[survival of the fittest](#)” allows the system to restore itself, shedding previous excesses that existed and therefore readying itself for the subsequent economic recovery.

The particular segment of the business cycle when the cycle turns as a result of a financial shock [has been popularised with the name “Minsky moment.”](#) This is considered a real pity by those who are actually [scholars of the great post-Keynesian economist](#), as the term completely misses the fact that Minsky’s analysis is a theory of the business cycle: its most interesting part is not the “moment” of shock, but rather is the recovery phase of the cycle, when the financial fragility of the system increases, completely undetected, thus preparing the ground for the later, inevitable downturn. Economic analysis has preferred to focus on the conditions (including shocks) that could trigger these “Minsky moments.” For example, Nassim Nicholas Taleb has written convincingly about “[black swans](#)”, extremely rare events that could trigger major changes in prevailing economic, financial and social conditions.


Moving from theory to practice, [press reports](#) recently reported that market participants currently fear many black swans, with a potential spike in oil prices deriving from the [US-Iran-Saudi Arabia tensions](#) adding itself to a list that already included [a possible collapse in US-China trade talks](#) or [UK-EU negotiations regarding Brexit](#). In [his latest column for Project Syndicate](#), Nouriel Roubini spoke about four collision courses that could derail the global economy, adding to this list the victory by Alberto Fernandez in Argentina’s primary presidential election, which has triggered [yet another debt restructuring](#) by the Latin American country.


But the list of these potential triggers could be expanded even further. In the US, an [impeachment of Trump](#) ahead of the 2020 presidential race could lead, under certain circumstances, to a severe market correction. In Europe, Germany’s recession could deepen, potentially leading to a government collapse and further political fragmentation. In Italy, Matteo Renzi’s [newly formed party](#) could pull the plug on Conte’s government, paving the way for a return of Salvini to power. In Asia, an increase in the Japanese consumption tax could lead to an economic contraction, deepening the global slowdown. And other examples could be made for Brazil, China, Russia, etc.


What about the policy response? In the recent decision by the Fed to [adopt “insurance cuts”](#) there is a reminiscence of Minsky’s theory, insofar as the central bank decided not to increase rates further at a time when the economic and financial system seemed already to be fragile – to avoid providing a shock that might have triggered a downturn. After years of experimenting with monetary policy, [there is now a great consensus among economists](#) that fiscal policy should take up the responsibility of being the main counter-cyclical policy instrument. In effect, in Minsky’s theory, the policy prescription could be [simplified with the expression “Big Government”](#) – in other words, making sure that public expenditure is a large component of national income, so as to stabilize business cycles. As [Richard Koo convincingly argued](#), in a balance sheet recession following a debt-deflation episode, the system needs at least one large borrower that can compensate for the deleveraging of the private sector, and that must be the government.

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Looking Ahead

The Week Ahead: Weak Manufacturing Persists Worldwide

In the US, the labor market is likely to remain healthy (NFP Sep., c: 162K; p: 130K; Avg. hourly earnings, c: 3.1% y-o-y; p: 3.2).

Globally, signs of weak manufacturing activity are expected to continue (Japan IP Aug., c: -1.8% y-o-y; p: 0.7; China NBS Manuf. PMI Sep., c: 49.6; p: 49.5).

In the EZ, inflation is expected to remain subdued (CPI Sep., c: 1.0% y-o-y; p: 1.0).

In Turkey, inflation is expected to slightly accelerate (c: 15.5% y-o-y; p: 15.0), after the stronger-than-expected monetary easing.

In Australia, the RBA is expected to cut its key policy rate by 25 bps to 0.75% (p: 1.00).

The Quarter Ahead: Global Growth Slowing, Trade Tensions, Potential Impeachment Of President Trump, Brexit Risks

As the **global economy** is hampered by trade tensions and the disruption of key value chains, the US economic momentum is likely to suffer lower consumer spending and reduced investments.

In the US, congress speaker Nancy Pelosi announced an impeachment enquiry on President Trump, following allegations that Trump improperly solicited the help of Ukrainian President Voldymyr Zelenskiy to investigate a political rival, the Democratic presidential contender Joe Biden. Over the next few weeks, Democratic lawmakers will likely draft one or more articles of impeachment, which require a simple majority vote by the House (where Democrats hold 235 of the 435 seats). In the unlikely case of a support of two-thirds of the Senate (where Republications hold a majority), the President would be forced to step down.

On the trade front, **US-China** tensions intensified following news that the Trump administration is likely to limit US portfolio flows into the Chinese economy.

In the UK, after the Supreme Court overruled PM Johnson's decision to suspend parliament ahead of the October 31 deadline, Brexit's outcome depends on: a) the PM securing a deal with the EU at the October 17-18 summit; and b) the UK parliament supporting the deal. The EU is unlikely to grant another Brexit delay without a clear rationale. In the event of no agreement with the EU in October, a UK snap general election is likely.

Last Week's Review

Real Economy: Political Uncertainties (Trump Impeachment, Brexit, Trade) Drag On Global Growth

In the US, manufacturing activity was stronger-than-expected (Markit PMI Comp. Sep., a: 51.0; c: 49.6; p: 50.7); however, concerns about the economy remain as: a) consumer spending – a key driver of GDP growth, accounting for more than two-thirds of total output – has weakened to its slowest pace since February (a: 0.1%; c: 0.3; p: 0.5); and b) a closely-watched proxy for business investment contracted (Nondefense capital goods orders ex. aircrafts, a: -0.2%; c: 0.0; p: 0.0). The Fed's preferred inflation gauge – the PCE – stagnated in August (PCE, a: 1.4% y-o-y; c: 1.3; p: 1.4; Core PCE, a: 1.8% y-o-y; c: 1.8; p: 1.6).

Still in the US, driven by new UST issuances, the "liquidity-squeeze" continued; the New York Fed was pressured to: a) increase the size of its overnight REPO to USD 100bn (p: 75 bn); and, b) raise the limit on its 14-day REPO operation to USD 60 bn (p: 30 bn).

In the EZ, economy activity is likely to weaken further (Markit PMI Comp., a: 50.4; c: 51.9; p: 51.9), driven by the ongoing contraction in the manufacturing sector (Markit Manuf. PMI, a: 45.6; p: 47.3; c: 47.0) – particularly in the German industrial sector (Markit Manuf. PMI, a: 41.4; c: 44.0; p: 43.5).

In Japan, inflation remains subdued and weaker-than-expected (Tokyo CPI Sep., a: 0.4%; c: 0.8; p: 0.6)

Financial Markets: Geopolitical Uncertainties Drove Risk-Off Sentiment, Bonds Up

Market drivers: risk-off sentiment supported fixed-income assets. Equities and EM assets suffered weak economic data and a dwindling optimism over trade negotiations.

Stocks: w-o-w, global equity indices fell (MSCI ACWI, -0.7% to 522) driven by both DMs (S&P500, -0.8% to 2,962) and EMs (MSCI EMs, -0.4% to 1,001). Volatility rose (VIX S&P 500, +1.9 points to 17.2, 52w avg.: 17.1; 10y avg.: 17.1).

Bonds: w-o-w, global indices rose (BAML Global bond index, +0.4%). The FTSE Russell decided not to include China in its flagship government bond index, citing "market liquidity and foreign exchange concerns".

FX: w-o-w, the USD strengthened against a basket of currencies (DXY, +0.6% to 99.109). The EUR and GBP fell (EUR/USD, -0.7 to 1.094; GBP/USD, -1.5% to 1.229), EM FX weakened (MSCI EMs, -0.3% at 1,611) bar the Turkish lira (USD/TRY, +1.3% to 5.670).

Commodities: Oil prices fell (Brent, -3.7% to 61.9 USD/b) as Saudi Arabia's oil output recovered to similar levels prior to the drone attacks on its facilities.



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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



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