Rosa & Roubini

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R&R Weekly Column
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Tail Risks Diminish Globally, Yet A Fragile Economic Environment Remains

The IMF/World Bank meetings that just concluded in Washington DC were an occasion for policy makers, market participants, academics and other observers to take stock of the current worldwide macroeconomic, financial and geo-political environment. In its latest edition of the World Economic Outlook, the IMF warned about the synchronised global slowdown now taking place - the opposite of the global synchronised expansion that occurred in 2017-18. The outlook for the global economy has been downgraded, with the forecasts for growth in a number of key economies being revised downwards. The downgrade could have been even larger if it was not for the large positive contribution to growth from countries such as Brazil, Iran and Turkey (whose economy have stabilised after a severe recession). All this is happening at a time when policy makers' fears of a global recession are increasing.

In this precarious global economic environment, some of the tail risks that could have tipped this global slowdown into a global recession seems have been diminishing in the last few weeks. Just to focus on the four economic collision courses recently identified by Nouriel Roubini, we can say that the risk that such collisions actually materialise is, for the time being, slightly lower than had been the case until recently. In the US-China trade dispute, there now seems to be at least a "Phase 1" agreement, which should be finalised by the APEC meeting in November. If such finalisation does indeed occur, then perhaps the feared increase in tariffs on consumer goods that would have come into effect in mid-December is not going to occur. That would certainly help provide a respite to the global economy. Regarding Brexit, it seems that the new deal signed between the UK and the EU last week should eventually lead - even if only at the end of a tortuous path - to an outcome that does not include a hard Brexit. In the Middle East, the tensions between the US, Saudi Arabia and Iran persist, but seem unlikely to escalate further into an open military confrontation. As the decision to pull out of Syria shows, the US seems inclined to disengage further from the region, rather than engaging in a new conflict that could mean putting US boots on Middle Eastern ground yet again. Thus for now the US seems inclined to resist the temptation to respond to Iranian provocations.

Finally, as far as Argentina is concerned, it seems that Alberto Fernandez, the Peronist candidate supported by Cristina Kirchner, is aware of the need to constructively engage in a conversation with the IMF, rather than put up a fight which could lead to a nasty outcome for all sides involved. If all four of these tail risks are reduced – US-China negotiations, Brexit, the Middle East, and Argentina – the danger coming from some of these potential triggers of a global recession would be lessened as a result.

Clearly, if these four fronts become less dangerous, new ones might open up. For example, by November 17th the US administration will have to decide whether or not to start imposing tariffs on the European auto sector. Such tariffs could have a large economic impact on the European economy. For the time being, it seems that the US administration will postpone the decision for a bit longer, as the Chinese front has not closed yet. Germany's grand coalition could collapse as a result of new local elections or the change of leadership at the helm of the SPD. Older risks could resurface as well, for example if the Italian government were to collapse sooner than expected as a result of the continued tensions within its majority.

Reducing the likelihood of some of these triggers is as important as deploying a policy response to them. In this respect, the Fed and the ECB (and a number of smaller central banks, such as RBA and RBNZ) have started to do their part. More needs to be done, especially in terms of fiscal policy, but at least policy makers are alerted about the need to be vigilant and responsive, even if they are incapable of being proactive. At the same time, the IMF will begin a formal review of the effects of the unconventional monetary measures adopted by several central banks around the world, which hopefully will not lead to a sudden abandonment of such measures. In Europe, the ECB will carry out its own review of strategy, tools and communication, with the arrival of Christine Lagarde at the helm.

Given this background, risk in financial markets seems to be on rather than off. Risky asset prices are still close to their highs, long-term yields are low and credit spreads are tight. The IMF's Global Financial Stability Report, also published last week, warns about the risks posed by a mounting level of corporate debt of dubious quality. The Financial Stability Board says that it is alerted to this, but is not yet alarmed by it; early in 2020 it will publish a report where is likely to acknowledge this. At the same time, market sentiment remains vulnerable to any swings in economic, geopolitical and policy developments.

Our Recent Publications

- Flash Preview: Norges Bank To Stay On Hold With No Hiking Bias, *by Brunello Rosa, 18 October 2019*
- Brexit Negotiations Continue Amid Increasing Uncertainty, *by Brunello Rosa, 16 October 2019*
- *Russia and The EU: The Geo-Strategic Implications of The Nord Stream-2 Gas Pipeline, by Paul Martin, 15 Oct. 2019*
- **GEOPOLITICAL CORNER:** *Trump's Impeachment Would Benefit No One … But Trump Himself, by John C. Hulsman, 8 October 2019*

Looking Ahead

The Week Ahead: US Manufacturing Is Expected To Fall And EZ Indicators Are Expected To Stall Or Deteriorate

In the US, manufacturing is expected to fall towards the 50-benchmark (Markit Manuf. PMI Oct., c: 50.3; p: 51.1), while services are expected to grow (Markit Services PMI Oct., c: 51.3; p: 50.90).

In the EZ, leading indicators are likely to stall or deteriorate in October: *i)* consumer confidence (c: -6.7; p: -6.5); *ii)* manufacturing (Markit manuf. PMI Oct., c: 46.0; p: 45.7); and *iii)* services (Services PMI, c: 51.9; p: 51.6). The ECB is expected to keep unchanged its: *i)* deposit rate, at -0.50%; and *ii)* main interest rate, at 0%.

Central banks ***in Norway, Sweden, China, and Turkey*** in their upcoming meetings are expected to keep the interest rates unchanged at 1.5%, -0.25%, 4.20%, and 16.50%, respectively.

The Quarter Ahead: Trade Tensions To Linger

US and China's trade negotiators are finalizing the text of a "Phase 1 deal", to be signed at the November APEC summit by the respective Presidents. Some key issues remain unresolved, such as: *i)* intellectual property rights; and *ii)* currency controls. However, a trade truce is unlikely to be sufficient to boost global growth.

In the US, the Fed is likely to cut its policy rate at the October meeting (market-probability of 'one rate cut': 87%; p: 75%).

In the EZ, US tariffs on USD7.5bn worth of European goods took effect, proving that geopolitical tensions will remain high.

In the UK, after PM Boris Johnson and EU Commission president Jean Claude Juncker reached an agreement between the UK and EU on a new withdrawal deal, PM Johnson could not secure a majority in the UK parliament, as his proposed withdrawal agreement was considered worse than Mrs Theresa May's. An extension to the Brexit deadline is likely.

In Turkey, US Vice President Mike Pence met with President Erdogan to urge him to stop the Turkish offensive on Kurdish forces in north-eastern Syria. After a brief cease-fire, shelling resumed; yet, further sanctions on Turkey's economy are unlikely.

Last Week's Review

Real Economy: Geopolitical Tensions Keep Hindering Global Trade And Economic Activity

The IMF cut its 2019 global growth forecast from 3.2 to 3.0%, due to unresolved trade tensions. Across DMs, the manufacturing sector remains weak.

In the US, retail sales unexpectedly fell in September to a 7-month low (a: -0.3% m-o-m; c: 0.3%; p: 0.6%), and IP declined more-than-expected (IP Sep., a: -0.4% m-o-m; c: -0.1%; p: 0.6%). The Fed started purchasing USTs (USD 60bn a month) to keep short-term interest-rates in check, until 'at least into Q2-2020'.

In the EZ, IP fell below-consensus in August (a: -2.8% y-o-y; c: -2.5%; p: -2.1%) but in October economic sentiment - while remaining pessimistic - fell less than expected (a: -23.5; c: -30.0; p: -22.4). Inflation fell below-consensus to 0.8% y-o-y (CPI Sep., c: 0.9%; p: 1.0%).

In Japan, IP remained unchanged, as anticipated, at 4.7% y-o-y.

In China, growth slowed below-consensus to its slowest pace in about 30 years (GDP Q3 a: 6.0% y-o-y ; c: 6.1%; p: 6.2) hampered by a weak external sector, as trade tensions keep hindering export growth (Exports Sep., a: -3.2% y-o-y; c: -3.0%; p : -1.0%); yet, the domestic sector remains strong, driven by industrial activity (IP Sep., a: 5.8% y-o-y; c: 5.0%; p: 4.4) and consumption (Retail sales, a: 7.8% y-o-y; c: 7.8%; p: 7.5). Inflation rose moderately (National CPI ex. fresh food Sep.; a: 0.4% y-o-y; c: 0.4%; p: 0.3%). The PBoC unexpectedly injected USD 28bn of cash in the economy, due to a slow Q3 growth.

Financial Markets: Lower Trade Risks And Improved Expectations On Brexit Lifted Risky Asset Prices

Market drivers: While investors are growing increasingly cautious about the strength of the global economy, CB liquidity keeps supporting the markets. US equities rose to near record high, led by above-consensus Q3-19 company earnings and lower risk aversion.

Stocks: w-o-w, global equity indices rose (MSCI ACWI, +0.8% to 525), driven by both DMs (MSCI World, +0.7% to 2,195,) and EMs (MSCI EMs, +1.2% to 1,024). Volatility fell below historical averages (VIX S&P 500, -1.3 points to 14.3, 52w avg.: 1712; 10y avg.: 17.0).

Bonds: w-o-w, global indices fell (BAML Global bond index, -0.1% to 285.3) led by DMs (S&P Global, -0.2% to 110.5).

FX: w-o-w, the USD weakened against a basket of currencies (DXY, -1.0% to 97.282) while the EUR (EUR/USD, +1.2 to 1.117) and the GBP rose (GBP/USD, +2.6% to 1.297). EM FX strengthened (MSCI EMs, +0.3% at 1,626), the Turkish lira slightly depreciated after US VP Pence's visit (USD/TRY, +1.6% to 5.791).

Commodities: Oil prices fell (Brent, -1.8% to 59.4 USD/b). Gold prices stalled (Gold, 0% to 1,490 USD/Oz.).

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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*