Rosa & Roubini
ASSOCIATES

MAKING SENSE OF *THIS* WORLD

18 November 2019

R&R Weekly Column
By Brunello Rosa

Risky Assets Supported by Stabilising Macro Indicators, Low-for-Longer Rates and "Helicopter Put"

A number of economists and commentators are discussing the question of what the most effective fiscal and monetary policy response to the next global financial and economic downturn will be. There seems to be a consensus forming that, with global interest rates as low as they currently are (in some regions, nominal policy rates are negative), some form of fiscal and monetary coordination will be needed when the next crisis hits. Most recently, Gavyn Davies has discussed the role of automatic stabilisers, like indirect taxes and forms of unemployment insurance, in such a context, highlighting how this form of automatic support to aggregate demand is weaker in the US than in Europe, for example.

In our recent analysis, we discussed in depth what form this monetary/fiscal cooperation could take, citing the examples of "helicopter drops of money," "People's QE", "Modern Monetary Theory" and other more mainstream forms of fiscal-monetary coordination such as that which was recently proposed by former Fed's Vice Chairman Stanley Fisher and former SNB chief Philipp Hildebrand, and describing their pros and cons. Our impression is that this idea of monetising fiscal deficits, far from being new (let alone "modern"), is actually becoming mainstream, and will likely provide the theoretical foundation for the policy response to the next economic and financial downturn, especially if the next downturn is severe.

This discussion is already having a very positive impact on financial markets. As we discussed in our column two weeks ago, markets are already celebrating the reduction of tail risks (US-China trade tensions, Brexit, the IMF-Argentina confrontation, etc.) and the additional monetary stimulus (such as that which was delivered by the Fed at the end of October) that are accompanying the stabilisation of key macroeconomic indicators such as manufacturing PMIs (which seem to be bottoming out, while remaining in contractionary territory). We concluded that column by saying that markets are already pricing in some form of fiscal and monetary backstop that they expect to be provided when the next crisis hits. This is like counting on a massive "fiscal and monetary put" available at the global level.

In this imaginary bridge between where we are now (a synchronised global slowdown) and where we are likely to be in a few quarters from now (a recovery phase driven by a coordinated fiscal and monetary policy response at the global level) the question is what will take place in between. For certain, monetary authorities will be prudent, and policy rates will be kept lower than what they would have been if this recovery had taken place pre-2008 crisis. Hence, policy rates are likely to be kept low, if not lower than they are now, for longer.

This might not be enough to prevent a sudden reversal in the imbalances that are building up and will continue to build up, in part even as a result of this very prudent monetary policy. For example, in H1-2019, global debt rose above USD 250tn, with China and the US accounting for more than 60% of new borrowing (with worrisome levels in the corporate debt sector). As such, a "non-linear" event in the middle of the bridge between the current global slowdown and future global recovery seems hard to avoid at some point. A coordinated fiscal-monetary action will then occur, providing the necessary policy response.

Our Recent Publications

- Fed's Policy Into 2020-21: Lower For Longer?, *by Nouriel Roubini and Brunello Rosa, 15 November 2019*
- Helicopter Drops of Money - The Pros and Cons of Monetised Fiscal Deficits to Fight the Next Economic Slump, *by Nouriel Roubini and Brunello Rosa, 13 November 2019*
- Flash Review: RBNZ Remains On Hold, But Is Prepared to Ease More If Needed, *by Brunello Rosa, 13 November 2019*
- **GEOPOLITICAL CORNER:** The Syrian End Game And The New Rules Of The Multipolar World, *by John C. Hulsman, 5 November 2019*

Looking Ahead

The Week Ahead: Headline Inflation Likely To Accelerate In Japan And The PBoC Likely To Leave Its Rates Unchanged

In Japan, inflation is likely to accelerate on account of higher energy costs (National CPI Oct., c: 0.3% y-o-y; p: 0.2).

In China, the PBoC is expected to keep its key lending rate – the loan prime rate – unchanged at 4.20%.

The Quarter Ahead: Downside Risks To Keep Hampering The Global Economy, Global Debt On The Rise

In H1-2019, global debt rose above USD 250tn, with China and the US accounting for more than 60% of new borrowing.

In the US, the 'House Judiciary committee' will draft the 'article of impeachment'; President Trump is likely to be impeached in the Democratic-controlled House, but is unlikely to be removed from office in the Republican-controlled Senate, as more than 20 Republican senators would have to vote to convict him.

In the US, Fed Chair Powell said that low interest rates may be a permanent part of the current economic landscape, due to "long-run structural factors, unlikely to change". The Fed warned that a prolonged period of low interest rates could dent US bank profits and lead to "a risk-on behavior that might threaten financial stability". As a result, the market probability of: 1) 'no further rate cuts in 2019' increased to 99.3% (p: 95.6); however; 2) 'no further rate cuts in 2020' decreased to 32.0% (p: 50.1).

On the trade-front, according to the White House "talks over the first phase of an agreement with China are moving to the final stages". Both sides removed bilateral trade bans on poultry products and signaled the intent to reach a deal. At 'the final stages', however, the most complex issues will be debated – including IP protection and Chinese imports of US agricultural goods. Further complicating trade talks, the US Senate is preparing a law to support pro-democracy protestors in Hong Kong, by placing under review the city's special trading status.

In Hong Kong, months of protests took a toll on growth: the government revised downwards its 2019 GDP forecast to -1.3% y-o-y (p: 0 to 1%), following a second consecutive quarter of contraction (Q3 GDP, a: -2.9% y-o-y; p: -0.4).

In the UK, polls indicate that the Conservative's lead over Labour keeps widening – up to 13-point as of November 13.

In the EZ, following better-than-expected growth in Germany, the chances for a significant fiscal push by the EZ's largest economy narrowed, adding pressure on the ECB.

Last Week's Review

Real Economy: Growth Remains Stagnant, But The Manufacturing Recession Is Bottoming

In the US, key indicators of economic activity showed: *a)* above-consensus retail sales (Oct., a: 0.3% m-o-m; c: 0.2; p: -0.3), as wage gains and a steady labour market support consumer spending; and *b)* a weaker-than-expected manufacturing-sector (IP Oct., a: -0.8% m-o-m; c: -0.4; p: -0.3). Inflation rose faster-than-expected (CPI Oct., a: 1.8% y-o-y; c: 1.7; p: 1.7), stemming mostly from higher energy costs (CPI core, a: 2.3%; c: 2.4; p: 2.4).

In the EZ, industrial output recorded a second month of recovery (IP Sep., a: -1.7% y-o-y; c: -2.3; p: -2.8), indicating that the downturn may be moderating.

In Germany, the economy grew at 0.1% q-o-q (GDP Q3, c: -0.1; p: -0.2), as higher government and household spending helped offset the downturn in the manufacturing sector.

In the UK, Brexit-related concerns weighed on economic activity (GDP Q3, a: 1.0% y-o-y; c: 1.1; p: 1.3) as a key driver of growth, household consumption, softened (Retail sales Oct., a: 3.1%; c: 3.7; p: 3.1).

In Japan, the economy grew at its slowest pace in a year (GDP Q3, a: 0.2% y-o-y; c: 0.8; p: 1.8), given weakness in external demand; however, the manufacturing sector is showing signs of recovery (Machinery Orders Sep., a: 5.1% y-o-y; c: 7.9; p: -14.5; IP Sep., a: 1.3% y-o-y; c: 1.1; p: -4.7).

In New Zealand, the RNBZ kept its key cash rate unchanged at 1.00%, against market expectations of a 25bps rate cut.

Financial Markets: DMs Rallied, EMs Hurt By Weaker Growth And Ongoing Trade Tensions

Market drivers: Improved economic data and revived hopes for a US-China trade deal supported the markets. Investors favoured DMs assets, as trade-related concerns and country-specific events (i.e., HK, Chile, Lebanon protests) dim the EM outlook.

Stocks: w-o-w, global equity indices rose (MSCI ACWI, +0.4% to 545), led by DMs (MSCI World, +0.6% to 2,283; S&P 500, +0.9% to 3,120); EM stocks fell (MSCI EMs, -1.5% to 1,049). In the US, stocks hit fresh record highs: 1) after four weeks of gains, the Dow hit 28,000 for the first time; while 2) the S&P500 rallied for a sixth week, its longest streak since November 2017.

Bonds: DM yields fell (10y UST -10bps to 1.83%; 10y German -7bps to -0.33).

FX: w-o-w, the USD weakened against a basket of currencies (DXY, -0.4% to 97.999), while the EUR (EUR/USD, +0.3% to 1.105) and the GBP (GBP/USD, +1.0% to 1.290) strengthened. EM FX fell (MSCI EM, -0.4% to 1,636).

Commodities: Oil prices rose (Brent, +1.3% to 63.3 USD/b).

@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

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*