Rosa & Roubini ASSOCIATES

MAKING SENSE OF *THIS* WORLD

30 December 2019

R&R Weekly Column
By Brunello Rosa

A More Balanced Policy Mix And Helicopter Put Are Likely To Support Risky Asset Prices In 2020

In our column last week, we discussed some of the key points of our Global Economic Outlook and Strategic Asset Allocation for 2020. This week we want to focus on what we can expect from a policy perspective in the year ahead, and on policy's implications for markets.

A number of key equity indices in the US have reached their all-time highs during the past few days. The NASDAQ, for example, touched the 9,000 mark for the first time ever on Friday 27th December. The question is whether this rally in risky asset prices is being driven by fundamentals, or whether it is being driven rather by policy intervention (or the anticipation policy intervention), in particular the large liquidity injections made by both the Fed (with the re-increase in the Fed's balance sheet to stabilise the repo market, which some have labelled QE-4) and the ECB (which has recently re-started its own QE program).

In our Outlook we discussed how, from the monetary policy side of the equation, after the three "insurance cuts" implemented by the Fed in 2019, we now expect the US central bank to remain on hold during the 2020 electoral year, remaining open to further easing only if the economy materially worsens. We also discussed how the ECB is now undertaking open-ended QE and has an easing bias on policy rates (but its strategic review might induce a less accommodative stance). The BOJ will remain extremely accommodative; it might even add a further level of modest accommodation to accompany Japan's fiscal stimulus. The BoE will react to Brexit developments, but is mulling over the possibility of rate cuts. The PBOC is likely to continue to provide modest monetary stimulus to cushion the Chinese economy, given trade frictions and disruptions in global supply chains.

On the other hand, fiscal policy remains constrained but is becoming modestly expansionary. In the US, the divided Congress means that no fiscal stimulus is likely in 2020; in the Eurozone some additional fiscal flexibility is underway, especially to accompany its "green deal" and "energy transition" plans that may be attempted. Japan has approved a large fiscal stimulus (as a headline figure), which could be the basis for an effective initial version of "helicopter money". China will keep providing some additional fiscal stimulus, despite its high fiscal deficits.

Given these considerations, we believe that in 2020 there will likely be a moderately 'risk-on' environment, given the improving chances that growth will stabilize, inflation will remain under control, and monetary and fiscal policies will be supportive, as well as the fact that some significant tail risks have diminished recently. Additionally, the anticipation by market participants that "helicopter drop" policies could eventually be introduced when the next economic recession and severe market downturns occur (a situation that we have labelled a "helicopter put") is keeping the markets happy for the time being, and even frothy in some instances.

At the same time, we warned how geopolitical and domestic political tensions, a possible re-intensification of trade wars, the continued disruption of global supply chains, tighter financial conditions, and market valuations disconnected from underlying macro fundamentals could cause sudden market corrections that investors should be wary of during the new year ahead.

Our Recent Publications

- 2020 GLOBAL OUTLOOK AND ASSET ALLOCATION - Despite The Improved Outlook, Beware of The Cracks, *by Nouriel Roubini, Brunello Rosa, Alessandro Magnoli Bocchi, 16 December 2019*
- **GEOPOLITICAL CORNER** - *Macron Rolls The Dice Over French Economic Reform And The Leadership Of Europe, by John C. Hulsman, 17 December 2019*

Looking Ahead

The Week Ahead: Chinese Manufacturing To Remain Stagnant

In China, manufacturing PMI is likely to remain stagnant (NBS Manuf. PMI, c: 49.8; p: 50.2;).

The Quarter Ahead: Fundamentals Will Remain Weak, But Subsiding Tail Risks And Supportive CBs Will Lift Market Sentiment

Globally, the perception of diminished tail risks (i.e. the phase one trade deal, a conservativity majority in the UK, etc.) combined with CB easing is likely to deepen the disconnect between the: 1) health of the real economy; and 2) performance of most financial markets. In H1-2020, while data from the US are likely to point to an improvement in the manufacturing outlook, data from the EZ, Germany, Japan and China are likely to signal a persisting, if not worsening, slowdown. Moreover, the impact of the current "capex, exports and manufacturing slowdown" will likely be transmitted to services and employment - through manufacturing-service sector linkages.

Globally, key risks are likely to persists, such as: a) geopolitical tensions and proxy wars; b) disruption of global supply chains, as a result of trade wars; c) social tensions and civil unrest; d) lower oil prices and deflation; e) faster-than-expected inflation that leads to monetary policy tightening; f) financial instability, market turbulence, and volatility; and g) weaker consumer and business confidence, as a result of the above-mentioned risks.

In the US, a Republican Senator expressed concerns over the promise of the Senate majority leader of 'total coordination with the White House on impeachment proceedings' against President Trump. The comment increased political risks and marked a rare dissent within the Republican party, which holds a thin 53-47 majority in the Senate. The Fed's balance sheet will likely expand by USD 60bn a month for: a) 'reserve management purposes'; and b) to 'more permanently increase liquidity in the financial system' ahead of an end to short-term repo operations.

Last Week's Review

Real Economy: Despite Weak Fundamentals, Lower Uncertainty And Eased Financial Conditions Improve The Outlook

In the US, manufacturing and business investment showed weakness: against expectations of a 1.5% increase, durable goods orders contracted in November by -2.0% m-o-m (p: 0.6), driven by lower-than-expected military equipment orders. Excluding the volatile defense category, durable goods orders rose by 0.8% m-o-m (p: 0.0; c: 0.0), after the end of the General Motors strike. New orders for 'nondefense goods excluding aircrafts'–a proxy for business investment–rose by only 0.1% (c: 0.2; p: 1.1). Yet, low unemployment and rising wages keep supporting consumer spending. Between November 1 and December 24 (Christmas eve), retail sales–a key driver of growth–rose by 3.4%, compared to the same period in 2018. The New York Fed added liquidity of USD 25.8bn with a two-day repo agreement.

In Japan, economic activity showed signs of recovery, from both: 1) last month's typhoon; and 2) the slowdown induced by the recent consumption tax, as: i) the IP contraction slowed (a: -0.9% m-o-m; c: -1.4; p: -4.5); and ii) retail sales rebounded, albeit short of expectations (m-o-m, a: 4.5%; c: 4.6; p: -14.2). Inflation accelerated above consensus (Tokyo CPI, a: 0.9% y-o-y; c: 0.6; p: 0.8).

In China, ahead of the signing of the "phase one trade deal", imports of US soybeans rose in November to the highest in 20 months, up to 2.6mn tons of 'total inbound shipments' - from 1.1mn the previous month.

Financial Markets: Risk-On Sentiment Led By Robust Consumer Spending And Lower Tail Risks

Market drivers: Strong holiday retail sales and eased trade tensions supported equities.

Stocks: w-o-w, global equity indices rose (MSCI ACWI, +0.7% to 567), led by US – where the S&P500 hit a record high (S&P 500, +0.6% to 3,240) and the Nasdaq broke through the 9,000 mark for the first time (Nasdaq, +0.9% to 9,049) – and by EM stocks (MSCI EMs, +1.0% to 1,119).

Bonds: w-o-w, returns rose (BAML Global, +0.2% to 285). In 2019, demand for US IG corporate bonds saw the fixed-income asset class returning 14.8% y-t-d according to Bloomberg Barclays data, considerably higher than DM sovereign bonds (S&P Global, +3.1% y-t-d) as the asset class offers investors an alternative to both lower-yielding sovereign debt and the relatively more volatile equities.

FX: w-o-w, the USD weakened against a basket of currencies (DXY, -0.8% to 96.919). Japan's currency, the world's third most traded after the USD and EUR, strengthens during risk-off periods and weakens when investors' optimism rises.

Commodities: Oil prices continue to rise (Brent, +3.1% to 68.2 USD/b) due to: i) lower US stockpiles; ii) improved demand outlook; and, more recently, iii) news that KSA and Kuwait have agreed to resume oil production in the neutral zone, after 4 years of hiatus.

@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*