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MAKING SENSE OF *THIS* WORLD

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By Brunello Rosa

US Foes Will Take Advantage Of The 2020 Election And Impeachment Trial

At the end of last year, in our paper on the six Grey Swans facing the global economy, and in our 2020 Global Economic Outlook, we said that geopolitical instability was set to increase during the US election year ahead. The strategic calculus by Trump to secure his re-election, going into 2020, was to make sure that the US economy was as strong as possible (perhaps with a bit of help from the three insurance rate cuts "independently" delivered by the Fed in 2019, which came after plenty of pressure was put on the Fed by the President), while closing some of the open geopolitical fronts, in particular the trade dispute with China.

In fact, Trump's "art of the deal" consists of brutally shaking his counterpart before inviting it to the negotiation table and concluding a deal on more favourable terms for himself. Following this paradigm, Trump had a window of opportunity from the mid-term elections until 2020 to unsettle the system and shake his opponents, in order to then use 2020 as the period to reach compromises with his negotiating partners that he could "sell" as victories to the US public during the electoral campaign. But, as we mentioned in previous analysis, while this tactics might work in the corporate sector, where an aggressively confrontational approach could lead the counterpart to the brink of bankruptcy and therefore make it more willing to accept the harsh terms that Trump offers, in public affairs things are not that simple. States do not go bankrupt that easily, and opponents can react in unexpected ways.

So, while Trump's preferred choice could have been that of having a strong economy and some tail risks reduced (risks such Brexit; during Trump's intrusion in the recent electoral campaign in the UK, he basically "ordered" Nigel Farage to step back and allow Johnson's victory), his opponents saw a clear opportunity in 2020 to "mess things up" in order to jeopardise Trump's re-election. Domestically, the Democrats have launched an impeachment trial, which is unlikely to succeed but will still keep Trump on his toes and will expose him on a number of fronts. The delay in sending the impeachment article to the Senate, while being borderline acceptable, has prevented Trump from having the news on the impeachment obfuscated by escalating tensions with Iran that would have otherwise occurred at the same time as one another.

Internationally, Iran is clearly at the forefront of the historical foes that would like to see Trump go, hoping to get a Democratic president to deal with instead. This is the reason why we believe that Iran will do much more in coming months to retaliate against the killing of Qassem Suleimani, and why we believe the market is under-pricing the risk of a further escalation down the line, closer to the election date. According to press reports, Kim Jong UN sacked its "moderate" foreign minister Ri Yong Ho, replacing him with the more hawkish Ri Son Gwon. This is seen by the intelligence community as a signal that a season of testing of ballistic missiles (launching them over key regional allies such as Japan) is about to re-start, after a period of pause.

China remains the big unknown: signing the Phase-1 deal certainly gives Trump a trophy to show during the electoral campaign, and gives China the much needed break in the escalation of tariffs. At the same time, it is clear that the trade, technological and geo-strategic dispute between the two countries will continue. One possible interpretation is that China, instead of wanting to see Trump leave office, might prefer having him remain for a second term, given the damage he is doing to the US and their international relations.

All this is to say that the historical foes of the US will use the opportunity of this electoral year and Trump's impeachment trial to take advantage of the difficulty Trump will face in providing anything other a constrained response to any moves they may make. If Trump goes from disputes to battles to open wars, he would tip the economy into recession, thus jeopardising his re-election. As such, his options this year will be relatively limited. 2020 will be most likely "a year lived dangerously" for the world.

Our Recent Publications

- Flash Preview: Bank of Japan To Keep Its Cool And Let Fiscal Policy Do The Heavy-Lifting, *by N. Roubini and B. Rosa, 17 January 2020*
- Flash Preview: Norges Bank To Remain On Hold In January, While Keeping Its Modest Hiking Bias, *by Brunello Rosa and Nouriel Roubini, 17 January 2020*
- Getting Ready For The Brexit "Adjustment", *by Brunello Rosa and Nouriel Roubini, 17 January 2020*
- Flash Preview: As The Economy Stabilises, Bank of Canada Remains on Hold, *by B. Rosa and F. Aladsani, 17 January 2020*
- Bank of England Moving Closer To Cutting Rates, *by Brunello Rosa and Nouriel Roubini, 16 January 2020*
- **GEOPOLITICAL CORNER:** Over Impeachment, The Democrats' Hatred Is Backfiring, *by John C. Hulsman, 14 January 2020*

Looking Ahead

The Week Ahead: Manufacturing PMIs Expected To Recover In US, EZ and Japan, Loan Prime Rates To Fall In China

In the US, January PMI data are expected above the 50-benchmark, and are likely to show: *i)* an improvement in manufacturing to 52.5 (p: 52.4); and *ii)* a weakening in services to 51.9 (p: 52.8).

In the EZ, manufacturing PMI data is expected to show a recovery in January (c: 47.3; p: 46.3), while the services PMI is likely to show a decline (c: 52.0; p: 52.8). The ECB is expected to keep its interest and deposit rate unchanged at 0%, and -0.5% respectively.

In Japan, November's IP is expected to remain unchanged at -8.1% y-o-y, while January's manufacturing PMI data is anticipated to improve to 48.7 (p: 48.4), remaining below the 50-benchmark. The BoJ is expected to leave its interest rate unchanged at -0.1%, but stated its "willingness to cut rates in order to accommodate for economic expansion".

In China, to boost lending, support the financial sector, the PBoC is expected to cut its loan prime rate by 20bps to 3.95% (p: 4.15%).

The Quarter Ahead: Geopolitical Risks Recede, But Remain Elevated

The ***US and China*** signed the "phase one trade deal", effective next month. The deal commits China to: 1) buy an additional USD 200bn of US goods and services during 2020-21, over "its 2017 baseline purchases"; 2) refrain from currency manipulation; 3) expedite financial sector liberalization; 4) tighten "oversight against IP theft"; and 5) refrain from "forced technology transfer". In return, the US has agreed to halve - to 7.5% - tariffs on USD 120bn worth of Chinese imports, but kept "unchanged the 25% duties on USD 250bn worth of goods".

In the US, the House of Representatives voted to "send the articles of impeachment against President Trump to the Senate", taking the procedural step necessary for the trial to begin. In the third presidential impeachment in US history, President Trump is overwhelmingly expected to be acquitted and remain in office, supported by the Senate's Republican majority.

In the US, the Fed expressed confidence with borrowing costs being "at the right level to sustain growth, and lift inflation to healthier levels" – inducing the market-probability of a 'one rate cut' in 2020 to decline to 54% (p: 66%).

In the EU, the UK is set to leave the EU on January 31, but the post-Brexit arrangements remain unclear. The EU commission is likely to take a firm stance, as "Brussels has never done a 'zero-tariff' deal with another major economic power". To prepare, the EU negotiating team is holding a series of seminars for diplomats from the 27-member states.

In Turkey, the MPC's cut of the one-week repo rate by 75bps to 11.25%, combined with the increase in headline inflation to 11.8% y-o-y in December, reduced Turkey's real interest rate to -0.6%; according to Fitch Ratings "the large reduction since last summer in real interest rates continues to weigh on Turkey's sovereign rating of BB-/Stable". The negative real interest rate also increases risks of "renewed pressure on the TRY, and greater stress on bank and corporate balance sheets".

Last Week's Review

Real Economy: Global Economic Sentiment Improves, Global Trade To Reignite

In the US, retail sales remained flat (Dec., a: 0.3% m-o-m; c: 0.3; p: 0.3), while IP declined more-than-expected in December (a: -0.3% m-o-m; c: -0.2; p: 0.8). December's CPI data strengthened in line with expectations, to 2.3% y-o-y (p: 2.1).

In the EZ, November's IP data strengthened less than expected, remaining in contractionary territory (a: -1.5% y-o-y; c: -1.1; p: -2.6).

In China, Q4-2019 GDP stalled at 6%, in line with expectations (p: 6.0).

In Turkey, the MPC cut its policy rate by 75bps to 11.25%, leaving the door open for "further measured rate cuts".

Financial Markets: After The Improvement In Economic Conditions, The Risk-On Mood Is Back

Market drivers: Over the week, most markets rose across all asset classes; US and EZ equities hit record highs, and bond saw limited gains.

Stocks: w-o-w, global indices rose to a record high (MSCI ACWI, +1.5% at 579), driven by DMs (S&P 500, +2.0% to 3,330; Eurostoxx 50, +0.5% to 3,808); EMs also rose to new highs (MSCI EMs, +1.2% to 1,147).

Bonds: w-o-w, returns rose slightly (BAML Global, +0.1% to 285.7); across DMs the upside in yields was limited, suggesting that investors feel the current economic conditions remain supportive of fixed-income (10y UST, +1 bps to 1.84%; 10y German bund, +2 bps to -0.21%).

FX: w-o-w, the USD strengthened against other currencies (DXY, +0.3% to 97.606), the EUR depreciated slightly (EUR/USD, -0.3% to 1.109) and the JPY fell to a seven-month lows (USD/JPY, -0.6% to 110.140).

Commodities: w-o-w, oil prices fell slightly (Brent, -0.2% to 64.9 USD/b), as well as gold (-0.4% to 1,556 USD/Oz.) hampered by the risk-on mood.

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*