

MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
By Brunello Rosa



With News From the US and Japan, Brexit Talks Enter The “Tunnel Phase”

Months ago, UK PM Boris Johnson said that unless an agreement between the UK and the EU was found by the [October 15th EU Summit](#), both sides should start preparing for a “no deal” scenario at the end of the transition period on 31 December 2020. The EU Summit ended without such an agreement, and Johnson said that negotiations will be over unless the EU becomes ready for [a “fundamental change” in perspective](#). In effect, the UK government has been repeatedly telling companies and individuals [to prepare for a no-deal environment](#).


After a few more days of back-and-forth declarations from the two sides, negotiations have in fact re-started in London in [“submarine mode”](#), i.e. with *sherpas* from the two sides aiming at preparing a joint text, without consulting with their political stakeholders and without briefing the press as to the level of progress they have made. At the end of this “tunnel phase” of the negotiations, a joint text agreed by the two sides may emerge.


There are three main areas of contention here: fisheries, state aid and dynamic regulatory alignment. Regarding fisheries, the EU would want EU boats (mostly from France, Spain and Ireland) to continue fishing in British waters, whereas the UK wants exclusive access. Regarding state aid, the UK wants to be able to subsidise its industries, [which will need to adjust](#) (sometimes heavily) post Brexit, whereas the EU wants the UK government to follow EU rules that forbid countries (outside of the current Covid-19 emergency) to provide state aid to private companies, so as not to distort the existing “level playing field”. For the same reason, the EU wants the UK to continue aligning also in the future (i.e. “dynamically”) with EU regulations even after the end of the transition period, something the UK will resist as much as possible as it attempts to reap the benefits of Brexit.


At the same time as these talks proceed, a number of other major events are occurring that could have an effect on the positions of Britain and the EU. In the US, the presidential race is entering its last phase ahead of the November 3rd vote. [As discussed in our preview](#), we currently expect Joe Biden to win the race, even if perhaps after a nasty legal battle. If Biden wins, [Johnson’s negotiating strategy might fail](#), as he needs the support of Donald Trump to show that the UK has a viable alternative to trading with the EU (however credible the threat of severing trade ties with Europe might actually be). Meanwhile [the UK has managed to strike a trade deal with Japan](#), which – [according to the UK government](#) – will be able to “secure additional benefits beyond the EU-Japan trade deal, giving UK companies exporting to Japan a competitive advantage in a number of areas... The deal is also an important step towards joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).”

Given this background, the EU and the UK will now have to decide whether to make at least a “skinny deal” in order to avoid a cliff edge at the end of December, without which major disruptions could possibly occur in the financial industry, in transportation and trade. Room for compromise exists: the UK can give in on fisheries and state aid in exchange for the freedom to diverge from the EU from a regulatory standpoint. Indeed, the UK will never be able to absorb all the fish available in its seas with its small domestic market, and has never been particularly keen on state aid since the Thatcher’s liberal revolution. At the same time, for Brexit to be a success, obtaining regulatory divergence over time ([especially on new areas such as data collection, management and protection](#)) is absolutely essential for the UK. The EU might accept this trade-off, as long as the UK does not become a *de facto* offshore financial centre and does not engage in savage regulatory competition. If such a compromise does eventually emerge, it will still be “hard Brexit,” but perhaps less hard than it otherwise could be.

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Looking Ahead

The Week Ahead: Data To Show Post-Collapse Rebound and Still-Subdued Inflation, While Central Banks Remain Accommodative

In the US, Q3 GDP growth is expected at 30.8% q-o-q SAAR (p: -31.4%) and durable goods orders are likely to increase by 0.7% m-o-m (p: 0.5%). September's PCE Price Index is expected to decline to 1.3% y-o-y (p: 1.4%).

In EZ, Q3 GDP growth is expected at 9.0% q-o-q (p: -11.8%) and at -14.0% y-o-y (p: -14.7%). October's inflation is expected to remain unchanged at -0.3% y-o-y.

The ECB (p: 0.00%), BoJ (p: -0.10%), and BoC (p: 0.25%) are expected to keep their policy stance mostly unchanged.

The Quarter Ahead: COVID-19 Second-Wave, Global Recovery To Lose Steam; Central Banks To Remain Supportive

Both the US and the EZ are suffering a second-wave of coronavirus infections; the US broke its daily record (84k new infections). Treasury Secretary Mnuchin and House Speaker Pelosi have still not reached an agreement on the 'coronavirus stimulus deal', as both the parties continue negotiating.

In several countries the recovery will lose steam, especially in the EZ. With monetary policy operating at its limits, most economies need fiscal policy support. China's economy is likely to remain supported by lending, investment and rising consumer spending.

In the US, 10 days before the elections the polls show the Democratic candidate Joe Biden (51.4%) ahead of President Trump (42.7%).

Amid rising strains in the Western pacific, the US plans to deploy coast-guard patrol ships - to counter "China's destabilizing activities" in the region. In turn, China threatened to retaliate against "the US USD1.8bn arms sale to Taiwan".

After negotiations stalled at the summit in Brussels, both sides will seek an agreement to govern the post-Brexit transition period. EU chief negotiator Mr. Michel Barnier stated it was "important to be back at the table".

ECB President Lagarde warned: i) that "Europe's recovery is uncertain and risks running out of steam" amid a second wave of COVID-19 infections – hinting towards more policy action; and ii) against the most serious effects of the pandemic: job losses.

Last Week's Review

Real Economy: Virus Cases Soar, Downside Risks Weigh On Growth, Fiscal Stimuli Needed

In the US: i) manufacturing PMI rose slightly to 53.3 (c: 53.4; p: 53.2), the fourth straight month of growth in factory activity and the highest level since January 2019; and ii) services PMI increased to 56.0 (c: 54.0; p: 54.6), the third consecutive month of expansion and the sharpest rise since February 2019.

In the EZ: i) manufacturing PMI increased to 54.4 (c: 51.9; p: 53.7), the biggest increase in factory activity since August 2018, driven by output and new orders growth; while ii) services PMI decreased to 46.2 (c: 50.5; p: 48.0), the second successive month of contraction and the sharpest fall since May.

In Japan: i) manufacturing PMI slightly increased to 48.0 (c: 47.3; p: 47.7), the slowest deterioration since January; and ii) services PMI fell slightly to 46.6 (c: 46.2; p: 46.9), the weakest decline in three months.

Among the major economies, China is the only to have returned to pre-virus levels of output.

In China, the PBoC kept its benchmark interest rate unchanged at 3.85%.

In Turkey, the CBT kept its key policy rate unchanged at 10.25% – surprising the markets, which had been expecting a 175 bps rate hike.

Financial Markets: Sentiment Weakens As COVID-19 Cases Rise; Oil Falls; Gold Flat

Market drivers: as investors will avoid placing big bets before the US election, financial markets will lack clear direction. Last week, weakness and volatility stemmed from: i) surging virus infections in key DMs; ii) stalled US stimulus-negotiations; and iii) the upcoming Q3 corporate earnings reports. Global stocks fell slightly w-o-w (MSCI ACWI, -0.2%, to 582), along with the S&P 500 (-0.5% to 3,465), driven by technology. EZ stocks fell (Eurostoxx 50, -1.4% to 3,199) on signs of a stalling economic recovery, due to: i) tighter restrictions; and ii) upcoming lockdowns.

Fixed income: w-o-w global bonds fell slightly (BAML Global, -0.4% to 297.3); in the US, hopes for a stimulus deal lifted UST yields to their highest level since June (UST, +10 bps to 0.84%).

FX: w-o-w, the USD weakened against most currencies (DXY, -1.0% to 92.768; EUR/USD, +1.2% to 1.186); the TRY fell further (USD/TRY -0.4% to 7.961) as the CBT refrained from a much-anticipated interest rate hike.

Commodities: oil prices fell (Brent, -2.7% to 41.8 USD/b), as rising COVID-19 cases threaten future global demand. Gold rose slightly (+0.1% to 1,901 USD/Oz.) – maintaining is safe-haven appeal.



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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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