



R&R Weekly Column  
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## Clouds Are Gathering On The Horizon

As we discuss in greater detail on page two of this *ViewsLetter*, clouds start gathering on the global economy. In the US, the stalemate in Congress regarding the budget (and in particular the controversial USD 5bn financing for the wall at the border between US and Mexico) has caused a [government shutdown that is now entering its fourth week](#) (becoming the longest in the US history). Apart from the obvious collapse in the provision of services (in airports, national parks, museums and other publicly-managed organisations), the pain starts being felt by 420,000 government employees, whose [payslips are showing “zero salaries” for most of them](#). All this will have eventually a macroeconomic impact, when the figures for Q4 2018 and Q1 2019 growth will be released in coming months. In Europe, the situation is not much rosier: [industrial production in the largest Eurozone economies \(Germany, France, Italy\)](#) has collapsed recently, partly as a result of the difficulties of German car manufacturers to adapt to new emission standards. In France, the [protest of the Yellow Vests continues](#) to be intense and to put pressure on President Macron. In Italy, after the contraction recorded in Q3, there is a serious risk that also Q4 2018 GDP growth will witness a negative figure: that would mark the beginning of a technical recession (so much for the supposedly expansionary policies of the new populist government). In the UK, it is almost certain that [Theresa May’s deal with the EU will be voted down by parliament](#), marking the beginning of a political crisis that is likely to be protracted for weeks, and that will likely have severe economic repercussions.

In Emerging Markets, the situation remains problematic: [China’s economic slowdown](#) resulting from the trade tensions of 2018 has yet to be reversed, in spite of the expansionary (fiscal, monetary and credit) policies adopted by the authorities. Glimmer of hopes derive from the unexpected extension of trade talks with the US: but make no mistake – whatever deal can be agreed on, will only be partial and temporary; the cold war with the US is set to continue for decades. In Brazil, [Bolsonaro’s government has yet to show its true colours](#), but the market is giving him the benefit of the doubt. Regarding Turkey, our [latest scenario analysis](#) discusses the evolution of the country over the next few years, but we don’t expect a real stabilisation to begin before the local elections in March. Given this background, it’s not a surprise that the World Bank ([whose Chief departure](#) has opened a complicated transition phase) [has revised lower its global growth forecasts](#). How are policymakers and financial markets reacting to all this?

As one could expect, an endogenous policy response has already begun. The Fed has signaled that [it can be more patient in implementing its policy tightening cycle](#), making a pause in March more likely. The [Bank of Canada](#) has kept on hold its policy rate in January, as it did in December. The ECB and BOJ are currently on auto pilot, and the BOE is ready to react any way needed to Brexit developments, so [its tightening cycle is on pause until May at the earliest](#). With central banks more cautious in the withdrawal of liquidity, risky asset prices could take a breath: equity prices are slowly recovering the losses suffered in the last few weeks of December. This is what 2019 is likely to be: a transition year between the 2017-18 expansion and [a possible crisis and recession in 2020](#). Financial markets are likely to be cushioned from the effects of bad news coming from the macroeconomy and geopolitics by the endogenous policy response.

### Our Recent Publications

 [MACRO PICTURE: Turkey: Economic Stabilization After The March Local Elections](#), by Alessandro Magnoli Bocchi, 11 January 2019

 [PREVIEW: BOC Likely To Remain on Hold, While Sounding Upbeat](#), by Alex Waters and Joseph Shupac, 7 January 2019

 [REVIEW: BOC Remains on Hold, With Hawkish Undertones](#), by B. Rosa, A. Waters, J. Shupac, 9 January 2019



Looking Ahead

Global Outlook: Lower Growth And Rising Risks, Monetary Tightening On Hold

**Next week in the EZ, headline and core inflation are expected to remain stable** (CPI December, c: 1.6% y-o-y; p: 1.6%; CPI Core December, c: 1.0% y-o-y; p: 1.0%).

**Next week in Japan, headline inflation is expected to decrease** (CPI December, c: 0.8% y-o-y; p: 0.9 %).

**In the US, government's political gridlock makes a fiscal boost unlikely in coming weeks.** The better than expected recent labor data improved market sentiment, reducing the market expectations of no hikes in 2019 to 85% (pw: 96%).

**An improved outlook for the US-China dispute is expected over the next few weeks.** The latest round of US-China trade talks showed signs of progress, increasing the likelihood of an agreement before the end-March deadline.

**The World Bank cut its 2019 forecast for global growth to 2.9%** (from 3.0%), down from 3.0% in 2018 (previously 3.1%) due to slowing trade and investment flows, and rising interest rates.

**In the EU, recession fears are rising:** in Germany, industrial production fell by -1.9% in November (a y-o-y low of -4.6 percent); France, the EZ's second largest economy, is also facing difficulties. The fragile Greek and Italian economies are likely to suffer. Political tensions are also rising as the UK Parliament is expected to vote on PM May's Brexit proposal on January 15: a "no" vote would increase the likelihood of a "hard Brexit".

**In Turkey,** declining inflation forecasts brought about expectations about a 50bps cut in Q1.

Last Week's Review

Real Economy: Disinflation Support A Pause In Monetary Policy Normalization

**In the US, political uncertainty remains high** as the government shutdown extends into its fourth week.

**Inflation moved in line with expectations:** headline inflation decelerated (CPI December, a: 1.9% y-o-y; c: 1.9%; p: 2.2%), while core inflation remained stable (CPI ex. food and energy December, a: 2.2% y-o-y; c: 2.2%; p: 2.2%).

**In China, December's inflation declined below expectations** (CPI December, a: 1.9% y-o-y; c: 2.1%; p: 2.2%).#

**In the GCC, PMIs hint to deceleration:** Saudi Arabia's PMI fell to 54.5 in December from 55.2 in November. In UAE, PMI dipped to 54.0 in December from 55.8 in November.

Policy: Monetary Policy Normalization On Hold

**In the US,** the Chairman of the Fed talked about a "pause" in the tightening cycle and reemphasized that they would exercise "patience", reducing the likelihood of a hike in March.

Financial Markets: Global Stocks Rise On Improving US-China Relations, Higher Corporate Earnings, And Slower Policy Normalization, Oil Up Again On Declining Supply

Global stock markets rose after: *a*) the US-China talks were extended for an unscheduled third day, fuelling optimism that the world's largest and second-largest economies can strike a trade deal; *b*) corporate earnings are expected to beat overly-negative forecasts; and *c*) the Fed reaffirmed its commitment to pause further tightening.

**Global stocks rose w-o-w** (MSCI ACWI, +2.9%) driven by the US (S&P 500, +2.5%). Volatility decreased towards its long-term average (VIX, -3.2 points to 18.2; 52w avg.: 17.0; 10y avg.: 18.4).

**Bonds indices fell w-o-w** (BAML Global bond index, -0.1%), driven by the US (Reuters US bond index, -0.3%). Sovereign bond yields rose in the US (10y yield, +4bps to 2.70%) and fell in Germany (10y yield, -3bps to 0.18%). Demand for EM bonds remains strong: Turkey borrowed USD2bn through a 10y USD bond at 7.68% yield.

**In the GCC, fixed income issuance is expected to grow,** as from January 1st, 2019 J.P. Morgan has included into its Emerging Market Bond Index (EMBI) sovereign and quasi-sovereign bonds from Saudi Arabia, UAE, Bahrain, Kuwait, and Qatar. The inclusion could potentially bring approximately USD60bn of active and passive inflows. In Saudi Arabia, the government has started to market a dual-tranche US dollar bonds with price guidance set at 200bps above 10y UST and 235bps above 30y UST.

**Currencies:** w-o-w, the USD fell against a basket of currencies (DXY, -0.5%), and the GBP rose (GBP/USD, +0.9% to 1.284) on hopes of a Brexit delay.

**Commodities: Brent prices rose** by 6.0%, to 60.5 USD/b, as production cuts by major oil producers continue to materialize.



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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	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	NAFTA	North-American Free Trade Agr.
bpd	Barrels per day	NATO	North Atlantic Treaty Organizat.
bps	Basis points	OECD	Organization for Economic Cooperation and Development
BS	Balance sheet	Opec	Organization of Petroleum Exporting Countries
c	Consensus	p	Previous
C/A	Current account	P2P	Peer-to-peer
CB	Central bank	PBoC	People's Bank of China
CBB	Central Bank of Bahrain	PCE	Personal Consumption Expenditures
CBK	Central Bank of Kuwait	PE	Price to earnings ratio
CBT	Central Bank of Turkey	PM	Prime minister
CDU	Christian Democratic Union, Germany	PMI	Purchasing managers' index
CNY	Chinese Yuan	pps	Percentage points
CPI	Consumer Price Index	pw	Previous week
DJIA	Dow Jones Industrial Average Index	QCB	Qatar Central Bank
DJEM	Dow Jones Emerging Markets Index	QAR	Qatari Riyal
d-o-d	Day-on-day	QE	Quantitative easing
DXY	US Dollar Index	q-o-q	Quarter-on-quarter
EC	European Commission	RE	Real estate
ECB	European Central Bank	RBA	Reserve Bank of Australia
ECJ	European Court of Justice	RRR	Reserve Requirement Ratio
EIA	US Energy Information Agency	RUB	Russian Rouble
EM	Emerging Markets	SWF	Sovereign Wealth Fund
EP	European Parliament	tn	Trillion
EPS	Earnings per share	TRY	Turkish Lira
EU	European Union	UAE	United Arab Emirates
EUR	Euro	UK	United Kingdom
EZ	Eurozone	US	United States
Fed	US Federal Reserve	USD	United States Dollar
FOMC	US Federal Open Market Committee	USD/b	USD per barrel
FRB	US Federal Reserve Board	UST	US Treasury bills/bonds
FX	Foreign exchange	VAT	Value added tax
FY	Fiscal Year	VIX	Chicago Board Options Exchange Volatility Index
GCC	Gulf Cooperation Council	WTI	West Texas Intermediate
GBP	British pound	WTO	World Trade Organisation
GDP	Gross domestic product	w	Week
IMF	International Monetary Fund	w-o-w	Week-on-week
INR	Indian Rupee	y	Year
IPO	Initial public offering	y-o-y	Year-on-year
IRR	Iranian Rial	y-t-d	Year-to-date
JPY	Japanese yen	ZAR	South African Rand
k	thousand	2y; 10y	2-year; 10-year
KSA	Kingdom of Saudi Arabia		