MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
By Brunello Rosa

Who Checks On "The Boss" in Washington?

Last week, the Fed implemented the widely expected 25-bps increase in the Fed funds target range: the FOMC delivered a "relatively" hawkish hike, accompanied by an upward revision to the growth, inflation, employment and policy rate outlook. The main reason why the overall message was only "relatively" hawkish (in line with our preview), is that the new Fed Chair, Jeremy Powell, performed a very convincing press conference (his first), in which he abundantly caveated the FOMC forecasts, arguing that the future is so uncertain that effectively anything can happen, to the point that there is no urgency to start indicating already in March that four Fed funds hikes in 2018 are necessary. Powell was appointed by President Trump to provide continuity with his predecessor, the dovish Janet Yellen, and make sure that the Fed would not undo all the efforts the US administration is making to further boost economic activity (with the risk of "over-heating") with a faster monetary policy tightening. And, as a corollary, make sure that the dollar does not strengthen too much in spite of the rate normalisation, but actually remains relatively weak (even in presence of tariffs on steel, aluminum and now intellectual property rights). With a gradual monetary policy tightening, a Fed's balance sheet reduction effectively on auto-pilot, and by keeping a low profile, Jay Powell is delivering on the job he was given and can be considered with reason a good choice by Trump.

Less reassuring, though, are other changes that have been taking place within the US administration in recent weeks. The departure, for various reasons, of respected figures such as Gary Cohn as Director of the National Economic Council, Rex Tillerson as Secretary of State, H.R. McMaster as National Security Advisor give the impression that the team of experts that was advising the President on key strategic matters (of both economic and geopolitical nature) and to some extent "moderating" some of his more extreme intentions and policy plans is now being dissolved, in favour of more hawkish figures (chiefly the neo-Con John Bolton as new National Security Advisor). One can reasonably wonder when the other two former generals that currently are in key government positions (James Mattis as Defense Secretary and John F. Kelly as Chief of Staff) will also depart, leaving the room to less moderate substitutes. As the example of Jay Powell shows, the choice of people in charge determine the credibility, policy direction and the ability to deliver of the institutions. The choice of the US administration to start imposing tariffs on key inputs for the globalised economic system, exposing the US to the risk of retaliations and a potential trade war, suggests that the new course of action in DC (likely shaped by new advisors) is less favourable for the global economy and even financial markets (as shown by the sell-off in equity markets last week, the worst in more than two years. In mid-February, we warned this could be the case). It is not a mystery that geostrategic and macrofinancial issues are now intimately interrelated: the geopolitical tensions between US and North Korea (ahead of a foreseen meeting between Trump and Kim) and the trade war with China, still one of the largest holders of US Treasuries, are all parts of the same complex jigsaw. Equally, the relationship with Russia has both economic and geopolitical ramifications.

As discussed in our previous columns, the rise of authoritarian leaders at the time protectionism and trade wars are re-emerging does not bode well for the global economy and financial markets (even if those risks might crystallise only in the medium term). In this dangerous environment, it is legitimate to question whether or not the US want to remain the global champion of liberal democracy and free markets, as they have been for the last several decades.

Our Recent Publications:

- ***Russia: An Impressive Normalisation Towards Modest Growth***, *by Rémi Bourgeot, 23 March 2018*
- ***Fed Review: Fed Delivers A Relatively Hawkish Hike*** *by Brunello Rosa, 22 March 2018*
- ***Fed Preview March 2018: A "Relatively Hawkish" Hike*** *by Brunello Rosa and Nouriel Roubini, 19 March 2018*

The Week Ahead

US - Inflation and GDP Data. Inflation data will be available in the US (February PCE y-o-y; *c:* 1.7%; *p:* 1.7%). Q4 2017 GDP data will be published in the US (ann. q-o-q, *c:* 2.6%; *p:* 2.5%).

Europe – German Inflation and UK GDP. Inflation data will be available in Germany (preliminary March CPI y-o-y; *c:* 1.6%; *p:* 1.4%). Q4 2017 GDP data will be published in the UK (y-o-y; *c:* 1.5%; *p:* 1.4%).

Egypt - President Sisi will be re-elected in the first round of the presidential elections (March 26-28), as no real opposition candidates will be able to run. Mr Sisi's second term will end in 2022.

Turkey - The TRY will likely depreciate further, on concerns about global trade and a rising current account deficit. Last week the TRY weakened by 1.6% w-o-w and 5.1% m-o-m (to USD/TRY 3.98). Our target for end-2018 is currently at USD/TRY 4.10. Q4 2017 GDP is expected at 10.0% y-o-y (*p:* 11.1%), as growth in domestic demand and investment decelerate, reducing concerns of overheating.

The Quarter Ahead

US - The risk of a triggered trade war will remain high. On Thursday, President Trump announced plans to levy a 25% tariff on at least USD 50bn of imports from China (about 10% of China's total exports to the US) targeting aerospace, ICT, machinery and textiles. The EU, Argentina, Australia, Brazil, Canada, Mexico and South Korea will be temporarily exempted from the recent steel and aluminium tariffs. The EU announced plans to impose a 3% revenue tax on digital companies (such as US' Amazon and Facebook) with global annual revenues above EUR 750 mn and taxable EU revenue above EUR 50 mn.

The US Fed will continue to normalize monetary policy. GCC countries will replicate most, but not all, of the upcoming Fed hikes. Last week, Bahrain, Kuwait and the UAE followed the Fed hike.

Brazil - The government will struggle to enact its economic reform agenda to bolster investor sentiment ahead of the October elections, as reforms are facing resistance.

UK - The UK will de facto extend its EU membership until end-2020. On March 23, EU leaders agreed on the terms of a transition period after Brexit. The UK will allow the free movement of EU goods, capital, labour and services until at least end-2020. Eventually, both parties seems on course to negotiate a Canada-style free trade deal. ***The BoE seems on course to hike rates in May,*** to keep a lid on inflation pressures, despite the decline in February's inflation data (*a:* 2.7% y-o-y, *c:* 2.8% *p:* 3.0%; *BoE target:* 2.0%).

China - Xi Jinping will tighten his grip on power. Recent political changes will streamline decision-making and smoothen policy implementation, but increase the risk of policy missteps.

Appetite for EM bonds will remain strong. Last week, a total of USD 8.9bn and EUR 3.6bn were raised (*pw:* 19.0 and 3.8). In the GCC, Emirates Airlines issued a USD 600mn bond with a yield of 4.6%, due in 2028.

Despite recent rises, oil prices are likely to decline. Last week, oil prices increased by 6.3% to USD/bbl. 70.4, due to geopolitical concerns and a slide in Venezuela's output. However, prices are likely to decline in Q2, due to rising US shale output.

Last Week's Review

US - The Fed delivered a "relatively hawkish" hike. The FOMC: *i)* raised the policy rate by 25 bps to 1.50-1.75%; *ii)* upgraded its GDP growth expectations for 2018 (2.7%; *p:* 2.5%) and 2019 (2.4%; *p:* 2.1%); and *iii)* hinted at additional hikes for 2019 and 2020. Yet, the dovish tone of the economic assessment partially reassured financial markets.

US - President Trump approved the USD 1.3tn government budget, averting a new government shutdown at the last minute.

Stock markets suffered losses, driven by the fear of trade wars and the fall in tech stocks (due to the Facebook data-breach case): the S&P500 fell by 6.0% w-o-w, turning negative in y-t-d terms (-3.2%). Volatility rose from 15 to 25 points, above its long-term average of 22 points. The USD fell against a basket of currencies (DXY fell by 0.9%) and against the EUR (EUR/USD rose by 0.5% to 1.235). In DMs, bond yields declined w-o-w, with the 10-y UST yield falling by 4 bps, to 2.81%.

Russia - President Putin was reelected with 76.7% of the votes, for a fourth term in office ending in 2024.

***Pablo Gallego Cuervo** and **Renata Bossini** contributed to this Viewsletter.* *The picture in the front page comes from this website*

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Abbreviations, Acronyms and Definitions

a	*Actual*
ann.	*annualized*
bn	*Billion*
BCB	*Central Bank of Brazil*
BoC	*Bank of Canada*
BoE	*Bank of England*
BoJ	*Bank of Japan*
bpd	*Barrels per day*
bps	*Basis points*
c	*Consensus*
C/A	*Current account*
CB	*Central bank*
CBK	*Central Bank of Kuwait*
CBO	*US Congressional Budget Office*
CBR	*Central Bank of the Russian Federation*
CBT	*Central Bank of the Republic of Turkey*
CDU	*Christian Democratic Union of Germany*
CNY	*Chinese Yuan*
CPI	*Consumer Price Index*
CPC	*Communist Party of China*
CSU	*Christian Social Union in Bavaria*
DFMGI	*Dubai Financial Market General Index*
DJIA	*Dow Jones Industrial Average Index*
d-o-d	*Day-on-day*
DXY	*US Dollar Index*
EC	*European Council*
ECB	*European Central Bank*
EIA	*US Energy Information Agency*
EM	*Emerging Markets*
EP	*European Parliament*
EU	*European Union*
EU27	*EU members (except the UK)*
EUR	*Euro*
EZ	*Eurozone*
Fed	*US Federal Reserve*
FOMC	*US Federal Open Market Committee*
FRB	*US Federal Reserve Board*
FX	*Foreign exchange*
FY	*Fiscal Year*
GCC	*Gulf Cooperation Council*
GBP	*British pound*
GDP	*Gross domestic product*
GOP	*Grand Old Party (US Republican Party)*
ICT	*Information and Communication Technology*
IMF	*International Monetary Fund*
IPO	*Initial public offering*
JPY	*Japanese yen*
k	*thousand*
KRG	*Kurdistan Regional Government*
M5S	*Five Star Movement*
m-o-m	*Month-on-month*
mb/d	*Million barrels per day*
MENA	*Middle East and North Africa*
mn	*Million*
MPM	*Monetary Policy Meeting*
M5S	*Five Star Movement*
OECD	*The Organization for Economic Cooperation and Development*
Opec	*Organization of Petroleum Exporting Countries*
p	*Previous*
pw	*Previous week*
PCE	*Personal Consumption Expenditures*
PM	*Prime minister*
PMI	*Purchasing managers' index*
pps	*Percentage points*
QCB	*Qatar Central Bank*
QE	*Quantitative easing*
q-o-q	*Quarter-on-quarter*
RBA	*Reserve Bank of Australia*
SAAR	*Seasonally Adjusted Annual Rate*
SAMA	*Saudi Arabian Monetary Authority*
SHCOMP	*Shanghai Stock Exchange Composite Index*
tb/d	*Thousand barrels per day*
tn	*Trillion*
TRY	*Turkish Lira*
UAE	*United Arab Emirates*
UK	*United Kingdom*
US	*United States*
USD	*United States Dollar*
USD/bbl.	*USD per barrel*
UST	*US Treasury bills/bonds*
VAT	*Value added tax*
VIX	*Chicago Board Options Exchange Volatility Index*
w-o-w	*Week-on-week*
y-o-y	*Year-on-year*
y-t-d	*Year-to-date*
YPG	*People's Protection Units (Kurdish militia in Syria)*
ZAR	*South African Rand*
10-y	*10 year*