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MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
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Maritime Routes and Positions Still Have A Massive Geo-Strategic Role To Play

In this world of de-materialised data, where the control of the cyber space and the most advanced communication and information technologies seems necessary to gain a strategic advantage versus the geo-political rivals, it is quite dystonic to learn how global and regional powers still consider the control of the sea as a key factor for asserting dominance over a geographical area.

We have discussed many times how the new Cold War between US and China was increasingly driven by the technological competition between the two world's super-powers, in particular in the fields of artificial intelligence, big data and 5G technologies, with the US trying to at least slow down China's Agenda 2025, foreseeing the Asian giant becoming the world's first country in the most technologically advanced sectors of the future. More recently, we have discussed how Russia, the world leader in cyberwarfare techniques, was using the Covid-induced crisis to make geo-strategic advances by using its competitive advantage in the field.

But exactly when all the advanced world is making the greatest use of online technologies to carry on its economic activities and circumvent the restrictions imposed by the lockdowns, we learn how the *good old* control of key maritime routes and straits, or the acquisition of naval basis is still considered a key ingredient for asserting geo-strategic dominance.

In the G2 heightening rivalry between US and China, the disputes over the east and south China sea have acquired absolute prominence in determining how the rivalry will evolve, including regarding the still unresolved trade dispute. As discussed in our recent report, roughly $5 trillion of trade passes through the South China Sea (SCS) each year, including oil and natural gas. It's clear that controlling SCS enables China to potentially choke off these routes and severely impair neighboring economies and global trade.

Press reports suggest that Beijing has steadily fortified seven islands or reefs, equipping them with military bases, airfields and weapons systems. This means, that while US President Donald Trump might be trying to apply the Art of The Deal in the negotiations, China might be applying the Art of War by general Sun Tzu, implying that any comprehensive trade deal with China might need to include a resolution of SCS sovereignty issues, potentially an unachievable result. Clearly, China's difficulty in projecting its geopolitical influence by controlling the seas is a massive constraint, compared to the US historical prevalence over the Atlantic and Pacific oceans. The Belt and Road Initiative (where the "Road" is a maritime route) is a way for China to break that constraint disguised behind commercial interests.

In other reports, we have discussed how the control of the strait of Hormuz was considered by Iran as a key to re-assert its authority in the Persian/Arabian gulf, potentially impairing global trade of oil from the region. Finally, in our recent report, we have discussed how geopolitical tension was rising in the Mediterranean sea, with two open fronts in Syria and Libya, where regional powers are playing their chess game. Turkey and Russia seem now close to reach an agreement on the two fronts, with Tukey having completed its "Open Sea Training" operations (thus extending its maritime influence from the Dardanelles to Cyrenaica), and Russia getting closer to achieve its most cherished goal: naval bases in the west Mediterranean sea (in Bengasi – together with the air base in Al Jufra), to complement its historical posts in Latakia and Tartus in Syria. Controlling what the Romans called *Mare Nostrum* ("Our Sea") seems to be, two thousand years later, still a desirable strategic objective.

Our Recent Publications

- Flash Previews: BOE Likely To Expand QE, While SNB and BOJ Remain On Hold, *by Brunello Rosa, Farah Aladsani, Fawaz Sulaiman Al Mughrabi, Karmen Meneses and Luca Bandello, 12 June 2020*
- China and the US: The Art of War Versus the Art of the Deal, *by Peter Cecchini, 11 June 2020*
- Flash Review: Fed To Keep Its Current Pace of QE, While Mulling YCC, *by Brunello Rosa, 10 June 2020*
- Flash Preview: FOMC To Stay on Hold While Mulling Next Steps of Unconventional Policies, *by Nouriel Roubini and Fawaz Sulaiman Al Mughrabi, 8 June 2020*
- *Geopolitical Tension Mounting In The Mediterranean Sea, by Marco Lucchin, 9 June 2020*
- Beyond the Frenzy: A First Take on Donald Trump for the History Books, Part 2—The Failures, *by John C. Hulsman, 2 June 2020*

Looking Ahead

The Week Ahead: US Retail Sales Expected to Bounce Back, BoE Expected to Increase its Asset Purchases

In the US, May retail sales are expected to surge by 8.0% m-o-m (*p:* -16.4) as: *i)* many states 'reopened' their economy; and *ii)* 'forced savings' begin to be spent.

In the UK, the BoE is set to increase its asset purchases target by GBP 100bn, to 745bn.

In Switzerland and Japan, the SNB and the BOJ are expected to remain on hold.

The Quarter Ahead: Delayed Recovery and Financial Repression

Global confirmed cases continue to increase: *1)* ***South America*** is the new epicenter, and Brazil the second-most infected country; and *2)* ***in the US,*** as virus-related hospitalizations rose, selected cities may need to '*reimpose measures if cases surge dramatically*'. US virus-related spending is likely to be renewed. Infection growth started to slow in: *i)* ***Europe***–in particular in Italy, Spain, and France; and *ii)* larger ***EMs***, including Russia and Turkey.

The US government is facing deadlines for the renewal of stimulus measures, such as: *i)* enhanced unemployment benefits - due to expire on July 3; *ii)* deferred tax payments - due on July 15; and *iii)* annual budgets for state and local governments - due on June 30. Treasury Secretary Steven Mnuchin said that '*a fourth round of fiscal stimulus'* should include help for '*travel, retail and leisure businesses, and possibly more cash for American families'*. Yet, Congress faces a partisan divide, as Republicans prefer to await more data before widening the federal deficit. The Fed's *Summary of Economic Projections,* showed: *a)* GDP contracting by -6.5% in 2020 and expanding at 5.0% in 2021; and *b)* unemployment falling to 9.3% in 2020 from 13.3% in May. Mr. Powell reiterated the Fed's: *i)* support for the economy; and *ii)* willingness to adjust policy '*as needed',* and stated '*the Fed is not thinking about raising rates'* even if the recovery were '*better than expected*'. The FOMC included an implicit "forward guidance" in its dot-plot: 15 out of 17 members forecasted the Fed fund rate to be on hold through 2022. On asset purchases, the FOMC stated it will continue to purchase USTs and MBSs '*at least at the current pace over the next few months."*

The Turkish Ministry of Finance agreed with Euroclear–a Belgium-based securities clearing house–to allow international investors easier access to the TRY bond market, at a time when the share of foreign holdings of TRY bonds has fallen. TRY-issuers will: *i)* have access to wider liquidity pools; and *ii)* benefit from less volatile borrowing costs.

Last Week's Review

Real Economy: Recovery At Risk, Due To Damaged Incomes And Second Wave Worries

In the US, the number of initial jobless claims recorded its lowest level since March; yet, with 1.5m applications recorded last week (*c:* 1.6m; *p:* 1.9m), the number of insurance filings is at historical highs – well above the 1982 pre-pandemic peak of 695k. May core consumer prices fell for the third consecutive month (*a:* 1.2% y-o-y; *c:* 1.3; *p:* 1.4), as retailers faced declining consumer demand. Falling energy prices pushed the headline reading down to 0.1% y-o-y (*c:* 0.2; *p:* 0.3). The Fed kept its policy stance unchanged and stressed the Fed's determination '*to restore full employment and stable prices'.*

In the UK, the economy contracted sharply in April (GDP, *a:* -20.4% m-o-m; *c:* -18.4; *p:* -5.8). As the UK reports monthly national output, the figure offers a glimpse of the cost of nationwide closures and stay-at-home orders.

Financial Markets: Risky Assets Hit By Concerns Over Virus Resurgence; Bonds Flat, Oil Falls

Market drivers: The run driven by stimulus measures and economic reopening was halted by: *i)* concerns about second waves of COVID-19; and *ii)* the Fed's warning of a slow economic recovery.

Stocks: w-o-w, global indices fell (MSCI ACWI, -4.2%, to 517), driven by the US (S&P 500, -4.8% to 3,041, the sharpest weekly loss since March) and the EZ (Eurostoxx 50, -6.8% to 3,154). EMs also fell, at a lower pace (MSCI EMs, -1.6% to 987). Volatility rose by 11.6 bps to 36.1, above historical averages (VIX S&P 500, *52w avg.:* 22.4; *10y avg.:* 17.2).

Bonds: w-o-w, returns remained flat (BAML Global, +0.8% to 294.5); the yield on a 10y UST fell by 21 bps, to 0.70%.

FX: w-o-w, the USD strengthened (DXY, +0.4% to 97.319) as other haven currencies (USD/JPY, +2.1% to 107.340; USD/CHF, +1.1% to 0.952).

Commodities: Oil posted its first weekly loss since April (Brent, -8.4% to 38.7 USD/b), triggered by macroeconomic uncertainty combined with renewed worries about a supply glut. Gold rose (Gold, +2.6% to 1,720 USD/Oz.).

Farah Aladsani *contributed to this Viewsletter.*

The picture in the front page comes from this website

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Abbreviations, Acronyms and Definitions

a	*Actual*
AKP	*Justice and Development Party, Turkey*
ann.	*annualized*
ARS	*Argentinian Peso*
avg.	*Average*
bn	*Billion*
BoC	*Bank of Canada*
BoE	*Bank of England*
BoJ	*Bank of Japan*
bpd	*Barrels per day*
bps	*Basis points*
BS	*Balance sheet*
c	*Consensus*
C/A	*Current account*
CB	*Central bank*
CBB	*Central Bank of Bahrain*
CBK	*Central Bank of Kuwait*
CBT	*Central Bank of Turkey*
CDU	*Christian Democratic Union, Germany*
CNY	*Chinese Yuan*
CPI	*Consumer Price Index*
DJIA	*Dow Jones Industrial Average Index*
DJEM	*Dow Jones Emerging Markets Index*
d-o-d	*Day-on-day*
DXY	*US Dollar Index*
EC	*European Commission*
ECB	*European Central Bank*
ECJ	*European Court of Justice*
EIA	*US Energy Information Agency*
EM	*Emerging Markets*
EP	*European Parliament*
EPS	*Earnings per share*
EU	*European Union*
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*
IMF	*International Monetary Fund*
INR	*Indian Rupee*
IPO	*Initial public offering*
IRR	*Iranian Rial*
JPY	*Japanese yen*
k	thousand
KSA	*Kingdom of Saudi Arabia*
LN	*Northern League, Italy*
M5S	*Five Star Movement, Italy*
m-o-m	*Month-on-month*
mb	*Million barrels*
mb/d	*Million barrels per day*
MENA	*Middle East and North Africa*
MHP	*Nationalist Movement Party, Turkey*
mn	*Million*
MPC	*Monetary Policy Committee*
NAFTA	*North-American Free Trade Agreement*
NATO	*North Atlantic Treaty Organization*
OECD	*Organization for Economic Cooperation and Development*
Opec	*Organization of Petroleum Exporting Countries*
p	*Previous*
P2P	*Peer-to-peer*
PBoC	*People's Bank of China*
PCE	*Personal Consumption Expenditures*
PE	*Price to earnings ratio*
PM	*Prime minister*
PMI	*Purchasing managers' index*
pps	*Percentage points*
pw	*Previous week*
QCB	*Qatar Central Bank*
QAR	*Qatari Riyal*
QE	*Quantitative easing*
q-o-q	*Quarter-on-quarter*
RE	*Real estate*
RBA	*Reserve Bank of Australia*
RRR	*Reserve Requirement Ratio*
RUB	*Russian Rouble*
SWF	*Sovereign Wealth Fund*
tn	*Trillion*
TRY	*Turkish Lira*
UAE	*United Arab Emirates*
UK	*United Kingdom*
US	*United States*
USD	*United States Dollar*
USD/b	*USD per barrel*
UST	*US Treasury bills/bonds*
VAT	*Value added tax*
VIX	*Chicago Board Options Exchange Volatility Index*
WTI	*West Texas Intermediate*
WTO	*World Trade Organisation*
w	*Week*
w-o-w	*Week-on-week*
y	*Year*
y-o-y	*Year-on-year*
y-t-d	*Year-to-date*
ZAR	*South African Rand*
2y; 10y	*2-year; 10-year*

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