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R&R Weekly Column
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Towards A New Geo-Strategic Equilibrium In the Middle East

The Abraham Accords Peace Agreement, signed between United Arab Emirates, Bahrain and Israel in Washington last week, is aimed at the normalisation of the former two countries' diplomatic relations with Israel. It marks the shift towards various new geo-strategic equilibria being reached in the Middle East.

This process had begun in 2011, when the Obama administration started to withdraw US troops from Iraq. It continued in 2014, with the end of the US fighting mission in Afghanistan, and was then epitomised in 2015 by the Joint Comprehensive Plan of Action (JCPOA) signed between Iran and the five permanent members of the UN Security Council, plus Germany and the EU. Obama's aim, following Metternich's and (more recently) Kissinger's example, was that of creating a "balance of power" among the major countries in the region, to allow a gradual withdrawal of the US from the Middle East, which had become less strategically important since the beginning of the shale oil and gas revolution. To achieve that goal, Obama aimed at creating a balance of power between NATO (represented by Turkey), Sunni Muslims (Saudi Arabia), Jews (Israel) and Shia Muslims (hence the JCPOA with Iran).

The plan failed for two main reasons. First, as soon as the US started to withdraw from the region, Russia entered it with full force, becoming a decisive player. Second, the new US administration led by Trump reneged on the JCPOA and marginalised Iran in favour of the traditional US alliances with Israel and Saudi Arabia. This has led to an escalation of tensions with Iran, culminating in the assassination of General Suleimani by the US at the beginning of 2020.

Between 2016 and 2020, the only two countries that managed to make serious advances in the region were Russia and Turkey, the two deciding in effect to partition between themselves spheres of influence in Syria, Libya and the Easter Mediterranean.

The Abraham Agreement marks the beginning of a new phase. First of all, the notion that in order to achieve a durable peace in the region, the Palestinian question needs to be addressed first, with the creation of two states between the Jordan River and the sea (deriving from the 1993 agreements in Oslo) has been wiped out. The logical order has been seemingly inverted. Rather than Palestinian statehood being a prerequisite to Sunni Arab states recognizing Israel, Sunni countries of the region will instead start normalising their relationship with Israel first, and this normalisation might eventually lead to the creation of a proper Palestinian state in the future.

Second, the fact that the US administration was actively involved in the mediation process via its secretary of State Mike Pompeo, and the fact that the agreement was signed in Washington, means that the US is still actively engaged in the process. In other words, only when a new geo-strategic regional equilibrium is reached the US may start to dis-engage. The Democratic candidate Joe Biden has committed to continuity of this approach as well.

Third, Turkey, as a NATO member, will be less able to play its own game in the region, having to abide by the superior interests of the US and of the alliance generally. Fourth, for the first time since 2015, Russia has been placed on the backfoot, and could not dictate its conditions. Finally, as it seems that many other countries in the region are now aiming at normalising their relationship with Israel as well, it is possible that this new, more pragmatic approach to a seemingly unsolvable problem might have the ability to lead to a new geo-strategic equilibrium being reached in the Middle East.

Our Recent Publications

- A Brave New World: Why US Equity and Corporate Credit Markets are Overvalued and Overextended, *by Peter Cecchini, 18 September 2020*
- Italian Regional Elections and Referendum Pose a Threat to The Government, *by Brunello Rosa, 14 September 2020*
- Reviews: Fed, BoJ and BoE Leave Policy Stance Unchanged, But Add Important Twists To Language, *by Brunello Rosa and Karmen Meneses , 17 September 2020*
- Flash Preview: US Federal Reserve Gradually Transitioning to a New Regime, *by Nouriel Roubini and Farah Aladsani, 14 September 2020*

Looking Ahead

The Week Ahead: US, EZ, Germany And Japan Manufacturing PMIs Continues To Expand, Whilst US Labor Market Weakens

In the US, EZ, Germany and Japan manufacturing and services PMIs are expected to remain in 'expansion'.

In the US, weekly data are likely to show a weakening labor market, with jobless claims rising to 3,500k (*p:* 860k). August durable goods orders are expected to decline to 1.5% m-o-m (*p:* 11.2%).

The Quarter Ahead: Geopolitical Risks Continue To Rise While CBs Remain Accommodative

Globally, inflation is likely to remain subdued over the next two years, but policy stimuli could lift it in the longer run.

Driven by COVID-19, new global patterns are emerging and will likely drive behavioral change: *1)* working from home is on the rise; *2)* online shopping is increasing; and *3)* business travel is decreasing. The pandemic is further widening the rift between China and US.

In the US, the government banned the download of two popular Chinese-owned apps: *i)* TikTok, for video-sharing; and *ii)* WeChat, for messaging and electronic payments. According to US officials, the move - which drew objections for limiting free-speech rights - arises from *"national security concerns"*. *Presidential candidate Joe Biden* is leading the polls, with the support of 50% of registered voters - while President Trump remains at 43%. The same polls suggest that: *i)* the Democrats are forecast to win both houses; and *ii)* Mr. Biden is ahead in Michigan, Pennsylvania and Wisconsin - three industrial states his Republican rival won in 2016 by a very thin margin, i.e.: less than 1%. The Fed will refrain from rising interest rates, until: *1)* the economy reaches full employment; and *2)* inflation hits the 2% target (likely to be years away), on track to *"moderately exceed the target for some time"*.

In the EZ, a second wave of COVID-19 infections is likely to hamper confidence and slow the recovery; individual countries' performance will diverge, with Germany ahead of Italy or Spain.

In the UK, *"if the EU fails to agree on a deal by December"*, President Boris Johnson intends to introduce a new legislation to *"limit the EU's ability to influence customs arrangement and subsidies in Northern Ireland"*. In the BoE's meeting minutes the Bank stated it *"would engage with UK regulators on how it might implement negative rates"*.

In China, the government launched a large-scale air and naval exercise in the South China sea, just as the US undersecretary Keith Krach was due to meet Taiwan's President Tsai Ing-wen. China's defense minister justified the action as *"necessary to safeguard national sovereignty"*.

Last Week's Review

Real Economy: DM Consumption And Production Are Softening, China Rises. Central Banks Remained On Hold

In the US, in August retail sales increased by 0.6% m-o-m (*c:* 1.0; *p:* 0.9); July sales were revised downwards to 0.9% (*c:* 1.0), due to reduced unemployment benefits and lower policy support for small businesses. In August, IP decreased to a weaker-than-expected 0.4% m-o-m (*c:* 1.0; *p:* 3.5) and 7.7% y-o-y (*p:* 7.4), marking the 12th consecutive month of decline. The Fed kept its Fed funds target range unchanged at 0.0-0.25%.

In China, as the economy recovers from the COVID-19-induced shock, IP rose by 5.6% y-o-y (*c:* 5.1; *p:* 4.8) and *retail sales* increased by 0.5% y-o-y (*c:* 0.0; *p:* -1.1).

In Japan, the kept its policy stance unchanged, including its deposit rate at -0.1%.

In the UK, the BoE left the key interest rate unchanged at 0.1%.

Globally, all central banks reiterated their willingness to support the economic recovery, as necessary.

Financial Markets: S&P500's Third Consecutive Week Of Losses. Bonds Stable. Oil And Gold Up

Market drivers: risky assets made very gradual w-o-w gains - driven by EM equities and currencies, due to investors' concerns about the Fed's lack of guidance on how it will: *1)* support the economic recovery; and *2)* generate inflation through its balance sheet policy.

Global stocks remained flat w-o-w (MSCI ACWI, 0.0%, to 2,368), while US equities closed lower (S&P 500, -0.6% to 3,319), on declines in shares of technology companies. In Europe, despite positive economic data, stocks fell (Eurostoxx 50, -1.0% to 3,284), hampered also by renewed fears of a hard Brexit.

Fixed income: w-o-w, bonds were unchanged (BAML Global, 0.0% to 297.9), as well as the yield on US Treasury notes (10y UST, -0.1bps to 729.5).

FX: w-o-w, the USD, still suffering from unfavorable interest rate differentials, depreciated slightly against most currencies (DXY, -0.4% to 92.926; EUR/USD, -0.1% to 1.184).

Commodities: oil prices rose (Brent, 8.3% to 43.2 USD/b), after Saudi Arabia hinted at new production cuts. Gold rose (+0.4% to 1,950 USD/Oz.), supported by safe heavens inflows. Driven by China's economic revival, most industrial metals prices are above their pre-COVID-19 levels.

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Farah Aladsani *contributed to this Viewsletter.*

The picture in the front page comes from this website

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*