

MAKING SENSE OF THIS WORLD

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R&R Weekly Column
By Brunello Rosa



Brazil-Argentina Currency Union Signals Further Steps in The World's Polarisation

A few [weeks ago](#), we discussed how the geopolitical landscape was in flux, with the re-organisation of international alliances and [a new world order emerging](#) as a result of the war in Ukraine. In particular, with Russia siding with China in a Cold War II between the US and China, a polarisation of the world has emerged.

As part of this broader re-arrangement of the world order, we discussed how a new gathering of seven countries, formed around the BRICS group, emerged; [we labelled this the EM G7](#). Besides China, Russia, India, Brazil and South Africa, two additional countries were invited as observers. One is Saudi Arabia, with which China has just formed a new strategic partnership, as we discussed [in our recent column](#).

The other country is Argentina. As discussed in [our recent in-depth analysis](#) of the country, Argentina is undergoing a difficult macroeconomic period, characterised by slow growth, high inflation and high interest rates, with political turmoil on the horizon given the presidential election occurring at the end of the year.

As we said, the main reason to have Argentina in the group is because Argentina has recently joined China's Belt and Road Initiative (BRI). With Argentina in the BRI and Brazil in the BRICS, China has extended its influence over the entire Latin American region, through its two largest countries. Among others, Chile and Peru are also part of the BRI, giving China influence over the entire west coast of South America.

Now Brazil and Argentina have announced that they [intend to enter a currency union](#), by creating an additional currency that would run in parallel to the Brazilian real and the Argentinian peso. According to estimates by the Financial Times, this would be the second largest currency union (representing around 5% of the world GDP) after the Euro (14% of the world's GDP), and ahead of the France's inspired CFA franc, which is shared by several African countries and is pegged to the euro. The new currency would be yet another attempt by countries that are not totally aligned with the US to reduce their dependence on the US dollar.

All of the factors above suggest that the polarisation of the world continues and was accelerated by the war in Ukraine. Some countries are backtracking from their previously held positions. As we discussed last week, China is shifting from some of its recent positions, first on the zero-Covid policy, then on distancing itself somewhat from some of the most extreme positions of Russia, and finally on re-opening a dialogue with the private sector, after the witch-hunting of the country's tech companies and private-led education that took place during the last couple of years.

On the other side of the equation, Germany has announced that before sending more of its Leopard tanks to Ukraine, [it will want to run a full analysis of its inventory](#). This is a way of buying time and sending a signal to Russia that it does not want to espouse the most extreme position of NATO countries. So, while China puts some distance between itself and Russia, Germany gets a bit closer to Russia, or at least reduces its distance.

These are all proofs that the geopolitical environment is in flux, but is solidifying towards a polarisation of the world, symbolised by the ongoing Cold War II between the US and China.

Our Recent Publications

- [An Outlook On 2023's Key Elections: What We Know So Far On This Year's Most Significant Elections](#), by London Politica, 20 January 2023
- [Flash Review: BOJ Surprised The Market Again, And Left Its Policy Unchanged In January](#), by Brunello Rosa and Nato Balavadze, 18 January 2023



- [Positive Start Of The Year, With Good News From China And Europe](#), by Filippo Ramigni, 17 January 2023
- [Preview: BOJ To Continue Its Journey Out Of Ultra-Loose Policy As The Choice of a New Governor Looms](#), by Nouriel Roubini, Brunello Rosa and Nato Balavadze, 16 January 2023

Looking Ahead

The Week Ahead: US QoQ GDP To Slow Down; US Core PCE To Decrease; Composite PMIs To Increase In DMs

In the US, in Q4, GDP is expected to slow down to 2.6% q-o-q (*p*: 3.2%). Core PCE is seen falling to 4.4% (*p*: 4.7%). In December, according to flesh estimates, S&P Global Services PMIs is likely to increase to 45 (*p*: 44.7), while Manufacturing PMI is seen remaining unchanged at 46.2. In January, Michigan Consumer Sentiment is expected to surge to 64.6 (*p*: 59.7).

In the EZ, in December, according to flesh estimates, S&P Global/CIPS Manufacturing and Services PMIs are likely to edge up to 48.5 (*p*: 47.8) and 50.2 (*p*: 49.8) respectively. Composite PMI is seen increasing too to 49.8 (*p*: 49.3). In January, according to a flesh estimate, consumer confidence is expected to recover slightly to -20 (*p*: -22.2).

In the UK, in December, according to flesh estimates, S&P Global Manufacturing and Composite PMIs are seen rising to 45.5 (*p*: 45.3) and 49.3 (*p*: 49.0) respectively. Services PMI is expected to stay the same at 49.9.

The Quarter Ahead: Davos Pushes for Cooperation in A Fragmented World

Davos 2023 took place 16-20 January under the theme “Cooperation in a fragmented world”. The discussions on the global economy were filled with caution, focusing on inflationary pressures from China's reopening and rising debt distress in the developing world. IMF's Gopinath sees China's reopening as a positive sign and said that China recovery could be very quick. Doubling down on better weapons and financial support to Ukraine dominated the discussions held in Davos 2023.

Tech Layoffs continue. Google is cutting approximately 12,000 jobs, constituting 6% of the company's global workforce. As Google CEO Sundar Pichai reported job cuts are the part of an effort to refocus on the company's core business, as well artificial intelligence projects. Microsoft will also cut 10,000 jobs, affecting 5% of its global workforce and cost the business \$1.2 bn in severance and reorganization costs.

Last Week's Review

Real Economy: EZ And UK Headline Fell; Core Inflation Rose In EZ; UK Unemployment Rate Stayed Unchanged; UK Retail Sales Shrank

In the US, December's retail sales were unchanged and stayed at 6.0% y-o-y.

In the EZ, in December, the headline inflation rate decreased to 9.2% y-o-y (*c*: 9.2%; *p*: 10.1%), whereas core inflation increased to 5.2% y-o-y (*c*: 5.2%; *p*: 5.0%). Monthly inflation rate fell by -0.4% (*c*: -0.3%; *p*: -0.1%). In January, ZEW Economic Sentiment Index recovered to 16.7 (*p*: -23.6).

In the UK, in December headline inflation fell slightly to 10.5% y-o-y (*c*: 10.5%; *p*: 10.7%), whereas core inflation stayed the same at 6.3% y-o-y (*c*: 6.2%). Monthly inflation remained the same at 0.4%. In November, the unemployment stayed unchanged at 3.7% as expected. In December, retail sales shrank by -5.8% y-o-y (*p*: -5.7%) and -1.0% m-o-m (*p*: -0.5%). In January, Gfk Consumer Confidence deteriorated to -45 (*c*: -40; *p*: -42).

In Japan, the BOJ kept intact its YCC targets and maintained its guidance allowing 10-year bond yield to move 50 bps.

Financial Markets: Stock Prices Fell; Bond Yields Fell In US And Rose In EZ; US Dollar Is Down; Oil And Gold Prices Increased

Market Drivers: Investors were increasingly concerned about recession fears that weighed on sentiment. As a result, the major US indexes fell. In Europe, shares weakened as the investors fear that ECB will keep raising rates aggressively, causing prolonged economic slowdown.

Global Equities: Decreased w-o-w (MSCI ACWI, -0.3%, to 636.4). The US S&P 500 index fell (-0.7% w-o-w, to 3,972.61). In the EZ, share prices were down (Eurostoxx 50, -0.7% w-o-w, to 4,119.90). In EMs, equity prices moved up (MSCI EMs, +0.6%, to 1,036.24). Volatility fell to 21.0 (VIX S&P 500, 52w avg.: 26.1; 10y avg.: 18.5).

Fixed Income: w-o-w, the 10-year US treasury yields were down (-2 bps to 3.48%). The 2-year US Treasury yields fell (-5 bps to 4.18%). The German 10-year bund yield increased (-3 bps to 2.17%).

FX: w-o-w, the US Dollar Index was down (DXY, -0.2%, to 101.7; EUR/USD +0.3%, to 1.09). In EMs, currencies fell (MSCI EM Currency Index, -0.3% w-o-w, to 1,697.30).

Commodities: w-o-w, oil prices increased (Brent, +2.8% to 87.66 USD/b). Gold prices increased w-o-w (+0.3% to 1,927.70 USD/Oz).



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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	M5S	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 Rial
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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