

## **MAKING SENSE OF THIS WORLD**

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R&R Weekly Column By Brunello Rosa



### **G7 Summit: Is De-Risking The Softer Version of Decoupling?**

There will be a G7 summit in Hiroshima this week, where world leaders will meet to discuss the most topical issues of the moment. There is no shortage of subject matters for them to focus on. The <u>elections in Turkey</u> have shaken the political, and perhaps institutional, system of one of the world's pivotal countries: an <u>electoral democracy</u> flirting with autocracy, a Muslim country at the gateway between Christian Europe and the Islamic Middle East, a NATO country with a "special relationship" with Russia, which would like to be a mediator in the conflict between Russia and Ukraine.

The war between Russia and Ukraine itself is entering a decisive state, with Ukraine <a href="having possibly begun its counter-offensive">having possibly begun its counter-offensive</a>, perhaps making progress on the <a href="Bakhmut front">Bakhmut front</a>. Ukrainian President <a href="Volodymir Zelensky">Volodymir Zelensky is currently in Rome</a> to meet with President Sergio Mattarella, Prime Minister Giorgia Meloni, and Pope Francis, who is himself committed to a <a href=""esecret" peace effort">"esecret" peace effort</a> through the diplomatic channels of the Vatican.

On the financial front, the ongoing banking crises in the US and in Europe, and the approaching deadline for the increase in the debt ceiling in the US in order to avoid a default, will certainly be part of the discussions at the G7 summit as well.

Underlying all this, there will be the overarching theme of the <u>incipient Cold War between the US and China</u>, which, in diplomatic circles goes under the name of "decoupling", between the two world's super-powers.

There is no better place to discuss this issue than Japan, and in particular Hiroshima. Japan is currently the closest ally of the US in the Indo-Pacific, part of the Quadrilateral Security Dialogue with US, India and Australia. It has a strong economic relationship with China, but at the same time it has a territorial dispute over islands in the East-China Sea. This comes as a result of a reversal in the alliances that existed during WWII. Then, the US was allied with China to defeat Japan, which of course was acheived following the atom bombs dropped on Hiroshima and Nagasaki in 1945.

The visits by <u>German Chancellor Scholz</u> and <u>French President Macron</u> to China in the last couple of months represented an attempt to re-build diplomatic and commercial ties between European countries and China. But, as we discussed in our column, the head of the European Commission Ursula Von Der Leyen marked a different tone during her visit to China together with Macron. She spoke about "de-risking", referring to European countries needing to reduce their dependency on China-dominated supply chains.

<u>Press reports</u> suggest that Germany may be tempted to adopt the theme of "smart de-risking" and include it in the final communique at the G7 summit, while excluding the idea of more fully decoupling from China. That may well occur, but we believe that de-risking may be just the initial phase of a more profound decoupling that will take place in coming decades. Clearly, it is also not in China's interest to break its economic ties with the West too soon, as South-East Asia, Africa and Latin America are not yet wealthy enough to be able to substitute the US and Europe as China's preferred destination for its exports.

That is also the reason why China is itself increasing its efforts to end the war between Russia and Ukraine, by way of diplomatic, rather than belligerent, means. This is the reason why China is sending a special envoy to Ukraine and Russia to try to find some common ground, and why Xi finally made his long-awaited telephone call to Zelensky at the end of April.

#### **Our Recent Publications**

- Sudan Civil War: Causes And Geopolitical Implications, by London Politica, 12 May 2023
- Flash Review: BOE Hikes Rates by 25bps and Maintains a Hawkish Bias, by Brunello Rosa and Nato Balavadze, 11 May
- Mounting Tensions in Tunisia, by London Politica, 11 May 2023
- Major Changes in Saudi Arabia's Foreign Policy, by Gulf State Analytics, 10 May 2023
- The UK's Shifting Political Landscape: British Local Elections, Inflation and Its Political Impact, and The ECHR's Decision, by London Politica, 9 May 2023





#### **Looking Ahead**

#### The Week Ahead: EZ QoQ GDP To Advance Slightly, EZ Headline Inflation To Rise; UK Unemployment To Stay The Same

*In the US,* in April, retail sales are expected to recover by 0.7% m-o-m (p: -0.6%).

In the EZ, in Q1 2023, according to the second estimate, the economy is seen advancing by 0.1% q-o-q (p: 0.0%). On a yearly basis, the GDP is likely to decelerate to 1.3% (p: 1.8%). In April, headline inflation is expected to increase to 7.0% y-o-y (p: 6.9%), while core inflation is likely to ease off slightly to 5.6% y-o-y (p: 5.7%). On a monthly basis, inflation is seen cooling off to 0.7% (p: 0.9%). In March, IP is expected to decelerate to 1.5% y-o-y (p: 2.0%).

*In the UK*, in March, the unemployment rate is likely to stay unchanged at 3.8%. In May, Gfk Consumer Confidence is expected to improve to -27 (p: -30).

The Quarter Ahead: Turkey's Elections; The War In Ukraine; UK Finance Minister Comments On Economy; China Tops The G7 Agenda

*Elections in Turkey*. The cycle of Presidential and Parliamentary elections starts on May 14. The incumbent President Erdogan is faced by opposition leader Kemal Kilicdaroglu.

**The War in Ukraine.** Russia denies Ukraine's push in Bakhmut. On Victory Day, Putin claimed that the Ukraine war was "unleashed" on Russia and blamed "Western global elites". In the meantime, the UK has become the first country to supply Storm Shadow missiles to Ukraine for defence against Russian invasion. Moscow threatens "adequate response" over UK missile pledge.

UK finance minister Hunt signals the UK's inflation remains too high. Hunt supported the BoE's decision in which the Bank delivered another rate hike in an attempt to tame inflation. According to the minister, while the high growth projections indicate a strong comeback, the UK economy remains challenged by the aftermath of the COVID-19 pandemic and the energy price shocks. Discussing the possibility of reducing the supply-chain dependence on China tops the G7 agenda. Germany will push the theme of minimizing risks in economic ties with China while saying that a total "decoupling" will not be on the table. Japan takes the lead in diversifying supply chains away from China. The G7 may also discuss the U.S. debt crisis.

#### Last Week's Review

#### Real Economy: UK GDP Rose QoQ but Decelerated YoY; US Headline Inflation Fell, While Core Increased; BoE Rose Its Bank Rate

*In the US,* in April, the headline inflation rate eased off slightly to 4.9% y-o-y (p: 5.0%). Core inflation edged down to 5.5% (c: 5.5%l p: 5.6%) as expected. In May, consumer sentiment fell to 57.7 (c: 63; p: 63.5).

Among largest EZ economies, the inflation rate: i) ease off to 7.2% y-o-y in Germany (c: 7.2%: p: 7.4%); and ii) increased to 5.9% y-o-y in France (c: 5.9%: p: 5.7%).

In the UK, according to the preliminary estimates, in Q1, GDP growth rose by 0.1% q-o-q (p: 0.1%) as expected and decelerated 0.2% y-o-y (c: 0.2%; p: 0.6%). Still in Q1, the business investment increased by 0.7% q-o-q (c: -0.4%; p: -0.2%). In March, IP shrank by 2.0% (c: 2.9%: p: -2.7%).

Still in the UK, the BoE increased its Bank Rate (BR) by 25 bps to 4.50%.

### Financial Markets: Stock Prices Decreased; US Bond Yields Were Up, Together with the Dollar Index; Oil And Gold Prices Fell

*Market Drivers:* Stock prices slipped as US consumer sentiment fell to a 6-month low in May. The markets and consumers worry about the economic outlook. The dollar rose, as uncertainty around the U.S. debt ceiling and monetary policy prompted a shift to safe havens. *Global Equities:* Decreased *w-o-w* (MSCI ACWI, -0.5%, to 649.22). The US S&P 500 index edged down (-0.3% w-o-w, to 4,124.08). In the EZ, share prices were down (Eurostoxx 50, -0.5% w-o-w, to 4,317.88). In EMs, equity prices moved down (MSCI EMs, -0.9%, to 973.00). Volatility fell to 18.6 (VIX S&P 500, 52w avg.: 24.6; 10y avg.: 18.5).

*Fixed Income:* w-o-w, the 10-year US treasury yields were up (+3 bps to 3.46%). The 2-year US Treasury yields also increased (+7 bps to 3.99%). The German 10-year bund yield edged down (-2 bps to 2.28%).

*FX:* w-o-w, the US Dollar Index increased (DXY, +1.5%, to 102.7; EUR/USD -1.5%, to 1.1). In EMs, currencies decreased (MSCI EM Currency Index, -0.4% w-o-w, to 1,687.50).

Commodities: w-o-w, oil prices decreased (Brent, -1.5% to 74.17 USD/b). Gold prices fell w-o-w (-0.4% to 2,015.90 USD/Oz).



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#### **Abbreviations, Acronyms and Definitions**

| а     | Actual                                | LN Nor  | 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                          |  |
| ВоС   | Bank of Canada                        | MHP     | Nationalist Movement Party, Turkey                    |  |
| BoE   | Bank of England                       | mn      | Million   |  |
| ВоЈ   | 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 |  |
| С     | Consensus                             | Орес    | Organization of Petroleum Exporting Countries         |  |
| C/A   | Current account                       | р       | Previous  |  |
| CB    | Central bank                          | P2P     | Peer-to-peer  |  |
| СВВ   | Central Bank of Bahrain               | PBoC    | People's Bank of China                                |  |
| СВК   | 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 Riyal  |  |
| 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               | у       | Year  |  |
| IRR   | Iranian Rial                          | у-о-у   | 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                                       |  |
|       |                                       | 00 1    |   |  |
|       |                                       |         |   |  |

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