



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 [elections in Turkey](#) have shaken the political, and perhaps institutional, system of one of the world's pivotal countries: an [electoral democracy](#) 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 [having possibly begun its counter-offensive](#), perhaps making progress on the [Bakhmut front](#). Ukrainian President [Volodymyr Zelensky is currently in Rome](#) to meet with President Sergio Mattarella, Prime Minister Giorgia Meloni, and Pope Francis, who is himself committed to a ["secret" peace effort](#) 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 [incipient Cold War between the US and China](#), 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 achieved following the atom bombs dropped on Hiroshima and Nagasaki in 1945.

The visits by [German Chancellor Scholz](#) and [French President Macron](#) 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.

[Press reports](#) 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.

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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% | *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

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	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
DIJA	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	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