# Tortoise QuickTake Credit Podcast

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**Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, senior members of Tortoise provide a timely update on trending topics in the market.**

Hi, this is Graham Allen, Senior Portfolio Manager with Tortoise Credit. Welcome to the podcast. When James Carville famously said of the 1992 election, ‘It’s the economy stupid’, the expression was deemed so prescient, that it became part of the political lexicon.

Fast forward to today and one would be forgiven for thinking that the global economic outlook was healthy and that the markets have little to fear in the near term, at least from a growth perspective. Here’s why:

The IMF recently forecast that the world recovery is broad-based, and should continue to expand through 2020 at +3.9% a year. The U.S. economy is forecast to grow at between 4-5% in 3Q 2018 with possible tailwinds from further stimulus next year in the form of a second tax cut and an infrastructure spending bill, should the Republicans retain the house in the fall. Elsewhere, the Chinese economy’s growth rate continues to slow but may well re-accelerate in response to significant stimulus by the government ahead of a possible protracted trade dispute with the U.S. Europe’s recovery is well underway and although strained, is still forecast to grow at +2.2% for 2018 (per the IMF). Even the emerging markets growth outlook, despite their currency problems, is reasonably positive for now. Even Turkey was growing at 7% before the recent crisis emerged.

On the face of it therefore, current market nervousness seems to be about anything other than growth, given that in the near-term at least there appears to be significant growth momentum globally.

So why are the markets so worried? Previously in these podcasts we have discussed many reasons why market confidence is threatened in the near-term. If you had to name today’s four horsemen of the apocalypse, it would likely be Emerging Markets, BREXIT, Italy and the U.S. dollar, not necessarily in that order.

Given that each situation is evolving rapidly, let us review each one and examine the extent of the threat.

Emerging market concern is growing rapidly with currency depreciation spreading to Brazil and South Africa from countries such as Argentina and Turkey. The latter is now beginning to experience the secondary effects of a rapid currency collapse. As of this broadcast, the Turkish Lira was down by 42% against the U.S. dollar year-to-date. Although it had a healthy pre-crisis GDP growth rate of 7%, it was offset by a 15% inflation rate that is now forecast to rise to almost 20% by 2020 due in large part to the Lira’s fall. Argentina’s economy will also remain challenged with positive GDP growth not expected to return until 2020. The disastrous effects of hyper-inflation can presently also be seen in Venezuela which has all but economically collapsed. Continuing EM currency weakness therefore will undoubtedly threaten the integrity of those economies’ and could ultimately bleed through into the developed world, either by restricting growth or even a full-blown debt crisis.

A BREXIT agreement remains front and central on the threat front. It’s worth recalling that immediately after the BREXIT vote the U.S .10-year yield fell to its lowest ever level of +1.36% on July 8th 2016, so agreement or not, it has the potential to impact world markets. With recent political developments in the UK the eventual outcome of negotiations between the UK and the EU remains ever more uncertain. New risks have emerged including the possibility of a general election in the UK before the March 29th, 2019 deadline. These include a direct challenge by ex-foreign minister Boris Johnson to Theresa May’s leadership raising the prospect of a general election. The outcome of which is far from certain with the UK’s Labour Party also battling an internal split. It’s worth recalling that the last general election was a gross miscalculation by Theresa May who assumed the Conservatives would win outright, which they did not. Optimism derived from recent rumors of an agreement between the UK and Germany abandoning key demands for now, may be premature if Theresa May is gone before the March deadline.

Italy's problems are about to get worse as budget submissions to the EU become due. The new coalition governments so far has been muted in its anti-EU rhetoric but it is almost certain that its budget proposals, which include a minimum income for the poor as well as tax cuts, will meet with EU disapproval. Blame for the recent bridge collapse has also been shamelessly directed by the Italian government at EU policies that were only indirectly a cause. The truth is that since the inception of the Euro in 1998, Italy's economy has hardly grown at all and in fact declined by 3.8% in the last 10 years according to Eurostat. In short, Italy's economic problems stem from a chronic lack of growth. Without growth, and the subsequent generation of budget surpluses, Italy will never satisfy the demands of the stability pact, and risk being further penalized by the EU, which all points to an eventual breakdown between the EU and the Italian government.

Putting politics aside let's review Italy's economic malaise in a nutshell. As described, growth has been poor and is forecast to be barely positive for 2018. Its debt-to-GDP ratio is presently around 130% and rising. Its banking system is purported to be concealing as much as €250bn in non-performing loans and perhaps more importantly it owes the rest of the EU €471bn in the form of target2 balances held at the ECB. Most of this is to Germany and would need to be paid off if Italy ever decided to leave the Euro; and there's the rub. If the Italian government ever decided to follow through on its threats to leave the Euro, it is as much Europe's problem as Italy's.

Finally, the world shortage of dollars, which we have covered in earlier podcasts is not getting better. The Fed's QE withdrawal, trade tariffs and corporate profit repatriations are causing a dollar squeeze globally, forcing entities to purchase U.S. dollars in the open market with ever-weaker local currencies. Historically this vicious cycle has been the cause of EM debt crises. Of course, rising U.S. interest rates and the strong U.S. economy has also exacerbated U.S. dollar strength.

To conclude therefore, maybe in these times James Carville's famous quote should more appropriately be adjusted to 'It's not the economy stupid'

Thanks for listening.

**Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at info@tortoiseadvisors.com.**

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