

## MAKING SENSE OF *THIS* WORLD

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*R&R Weekly Column*  
By Brunello Rosa



### Yet another European Crisis is Looming

We have discussed in a number of papers the various dimensions of the European political economy debate. From the [prospects of further EU and EZ integration](#) to [the Brexit saga](#), from the [Catalonia independence](#) issue to [Macron's efforts to promote a faster unification process](#), from the [rise of populist parties in Italy](#) to the attempt by [Germany to revive the political centre ground](#), not to mention our [deep dive into the Balkans](#), or [Russia's influence on the region](#) - and we will soon publish the second part of our trip report to Germany, a comment on the [recent evolution of Italy's political crisis](#) and our latest update on the customs union options for the UK, post-Brexit. In this column, we try to make sense of all these moving parts, and find the *fil rouge* connecting all these dots.

Since Europe is still enjoying a generalised economic expansion, with GDP growing above potential in many countries (including the traditional laggards, such as Italy), inflation finally grinding higher and unemployment (slowly) falling, it would be easy to discard all the above-mentioned issues as individual pieces of the messy European jigsaw, relevant domestically, but irrelevant at global level, and from a micro-financial perspective. We wouldn't agree with this interpretation, for a number of reasons.

*First*, it is true that economic expansion eases most socio-political tensions, but if they remain in place when the next recession hits (sooner or later, it *will* happen), they could deflagrate in a less controllable fashion, also from an economic standpoint. *Second*, if European countries haven't found a *modus operandi* in a more integrated union, when the next crisis hits, the asymmetric shocks that would hit the continent could stall any form of further integration process and potentially send it into reverse. *Third*, Europe has been the epicentre of two world wars in the 20<sup>th</sup> century, and that was the origin of the European integration process. If that fails, Europe could become again the epicentre of global geopolitical tensions.

So, the question is: how likely is that Europe will experience another severe crisis sooner rather than later? At this juncture we would say: quite likely, with the June 28-29 EU Council meeting being the first step in that direction. In fact, unless a compromise (or a fudge) is found on the Irish border issues, the possibility of a disorderly Brexit with no deal and no transition in 2019 will increase significantly; on the European banking union very little progress will be made, meaning that any form of risk mutualisation will be pushed into the distant future; and now, the euro-redenomination risk will come back on the table, after Italy has adopted another technocratic government which populist parties will use as their target to gain even more votes at the next general election, in September/October 2018 or February/March 2019 at the latest. Additionally, Spain is facing its own political crisis, which could also lead to snap elections, and Greece will have to deal with a complex exit from the Troika program. All this, while Germany's willingness and ability to do "whatever it takes" to save Europe (or at least the Eurozone) has severely diminished. The risk is that summer 2018 will be very hot, not just for climatic reasons.

### Our Recent Publications

 [TRAVEL NOTES: GERMANY: An Economic Powerhouse Trying to Revive the Political Centre Ground](#)  
By Rémi Bourgeot and Brunello Rosa, 23 May 2018

 [WORKING PAPER SERIES: Italy: Political Crisis Intensifies and Becomes Institutional](#)  
By Brunello Rosa, 29 May 2018



*The Week Ahead*

**US - Data will likely confirm the economy's strong momentum**, with expected accelerations of: a) GDP (Q1, y-o-y ann., c: 2.4%; p: 2.3%); b) inflation (core PCE, April, y-o-y, c: 2.0%; p: 1.9%); and c) the labour market (nonfarm payrolls, May, c: 185k; p: 164k; average hourly earnings, c: 2.7%; p: 2.6%; and unemployment, c: 3.9%; p: 3.9%).

**EZ - Inflation will likely pick up**, but remain below ECB's target of 2% (CPI, May, y-o-y, c: 1.6%; p: 1.2%).

**Canada** - The policy rate is expected to remain unchanged at 1.25%.

**China** - 234 Chinese firms will be included in the MSCI Global EM Index.

*The Quarter Ahead*

**US - The Fed will continue to tighten monetary policy**. However, rising geopolitical concerns and the dovish tone of the Fed minutes have weakened expectations on further hikes. The market-implied likelihood of a 25-bps hike at the June 12-13 FOMC meeting declined to 93% (pw: 100%), while the likelihood of "at least three" and "at least four" hikes in 2018 declined to 84% (pw: 91%) and 40% (pw: 50%), respectively (CME).

**North Korea - The country is unlikely to officially resume the development of nuclear weapons**. North Korea: a) claims to have dismantled its nuclear test site; and b) is "willing to talk at any time". To build a buffer against US pressure, Kim Jong Un will likely rely more on South Korea and China.

**Turkey - Ahead of the June 24 presidential and parliamentary election, it will remain vulnerable**. Last week, the depreciation of the TRY against the USD accelerated (+4.8% w-o-w, to USD/TRY 4.71) in spite of: i) government attempts to reassure investors; and ii) an emergency hike of 300bps of the main policy rate to 16.5%. In the next quarter: a) President Erdogan is expected to be re-elected, and an alliance led by his party AKP is likely to get majority in Parliament; b) CBT will continue to hike rates to stem off pressure on the TRY. The long-term fundamentals of the economy remain attractive for investors, as shown by the purchase, last week, of DenizBank by UAE's Emirates NBD.

**Bond issuance in MENA will remain elevated**. New MENA bonds amount to USD 49.1bn y-t-d, compared to a total 2017 issuance of USD 86.4bn (56.8% of last year's total). While demand continues to be strong, the elevated level of issuance has recently triggered yield increases.

**During the next quarter, Opec is likely to boost oil output to reduce upward pressure on prices**. Last week, Brent oil price rose above 80 USD/bbl, prompting calls for restraint from the US, and then declined (-2.9% w-o-w, to USD/bbl 76.2) on the announcement that Opec and Russia are set to boost output by up to 1m barrels a day, to offset production declines in Venezuela — where the reelection of president Maduro is likely to deter needed investments—and reductions in Iranian exports.

*Last Week's Review*

**US - Geopolitical and trade risks increased**. Trump: a) canceled the planned summit with North Korean leader Kim Jong Un, on account of the "open hostility of a recent North Korean statement"; and b) hinted at the possibility of introducing tariffs on imported autos.

**In Spain** - the main opposition party called a motion of no confidence against the government—following the convictions of past officials of the ruling party in a corruption case—, heightening expectations for early elections.

**Rising tensions created jitteriness in Europe, and increased the demand for safe haven assets**. While the S&P500 rose by 0.5% w-o-w, the Eurostoxx50 fell by 1.7%. 10y bond yields rose in Italy (+23bps w-o-w, to 2.46%) and Spain (+3bps w-o-w, to 1.47%). Safe haven assets benefitted: 10-y bond yields declined: a) in the US (-13 bps w-o-w, to 2.93%); and b) in Germany (-13bps, to 0.41%). The USD appreciated against: i) a basket of currencies (DXY +0.7% w-o-w); and ii) the EUR (EUR/USD -1.0% w-o-w, to 1.165). The JPY strengthened against the USD (+1.2% w-o-w, to USD/JPY 109.4), while the CHF appreciated against both the USD (+0.7% w-o-w, to USD/CHF 0.991) and the EUR (+1.9% w-o-w, to EUR/CHF 1.154).

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The picture in the front page comes from [this website](#)



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## Abbreviations, Acronyms and Definitions

a	Actual	JPY	Japanese yen
AKP	Justice and Development Party	k	thousand
ann.	annualized	KRG	Kurdistan Regional Government
ARS	Argentinian Peso	KSA	Kingdom of Saudi Arabia
bn	Billion	LN	Northern League
BCB	Central Bank of Brazil	MSS	Five Star Movement
BoC	Bank of Canada	m-o-m	Month-on-month
BoE	Bank of England	mb	Million barrels
BoJ	Bank of Japan	mb/d	Million barrels per day
bpd	Barrels per day	MENA	Middle East and North Africa
bps	Basis points	MHP	Nationalist Movement Party
c	Consensus	mn	Million
C/A	Current account	MPM	Monetary Policy Meeting
CB	Central bank	NAFTA	North-American Free Trade Agreement
CBK	Central Bank of Kuwait	OECD	The Organization for Economic Cooperation and Development
CBO	US Congressional Budget Office	Opec	Organization of Petroleum Exporting Countries
CBR	Central Bank of Russia	p	Previous
CBT	Central Bank of the Republic of Turkey	pw	Previous week
CDU	Christian Democratic Union of Germany	PCE	Personal Consumption Expenditures
CHF	Swiss Franc	PE	Price to earnings ratio
CNY	Chinese Yuan	PM	Prime minister
CBT	Central Bank of the Republic of Turkey	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Council	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	REER	Real Effective Exchange Rate
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	tb/d	Thousand barrels per day
EPS	Earnings per share	tn	Trillion
EU	European Union	TPP	Trans Pacific Partnership
EUR	Euro	TRY	Turkish Lira
EZ	Eurozone	UAE	United Arab Emirates
Fed	US Federal Reserve	UK	United Kingdom
FM	Future Movement	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/bbl.	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	w-o-w	Week-on-week
GOP	Grand Old Party (US Republican Party)	y-o-y	Year-on-year
IMF	International Monetary Fund	y-t-d	Year-to-date
INR	Indian Rupee	ZAR	South African Rand
IPO	Initial public offering	10-y	10 year
IS	Islamic State	ZEW	Centre for European Economic Research



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