

MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
By Brunello Rosa



Populists of All Countries, Unite!

Given recent developments, and paraphrasing the famous *incipit* of Karl Marx's Communist Manifesto, we could start this column by saying: "A specter is haunting Europe - the specter of Populism." In fact, the [clear threat to the future of the European integration process](#) is the rise of populist parties across the old continent. In spite of the proclaimed nationalism and "sovereignism" of these parties, their level of coordination is increasing, and is doing so also with the help of external forces. In January 2017, France's Le Pen, Italy's Salvini, Germany's Petry and Netherlands' Wilders [met in Koblenz to launch a sort of Populist International](#), forming an embryonic bloc of parties that would work to block, and possibly reverse, any further European integration process. In the subsequent Dutch elections of 2017, the party of Geert Wilders became the second largest party in parliament, achieving massive gains in votes and seats. In France, Marine Le Pen reached the second round during the presidential elections in 2017, where she lost to Macron. Salvini has now also entered into the government, as a Deputy Prime Minister; the AfD is now the main opposition party within the German Bundestag, having forced the CDU/CSU and the SPD again into forming an unnatural Grosse Koalition. The AfD is also, according to the polls, the leading party in East Germany. In a [recent rally in Chemnitz](#) (ironically, the city in which Marx was born) AfD and Pegida (a far right, nationalist and racist movement) marched together to protest the killing of a German-Cuban man by two immigrants.

Meanwhile, Italy's [Salvini has also established a strong relationship with Hungary's Orban](#), and sided with his Visegrad Group (together with Poland, Czech Republic and Slovakia and Hungary). Whereas populist Babis, as new Czech Prime Minister, has joined Kaczyński's Poland. In Austria, the far-right party FPÖ, led by Heinz-Christian Strache, has also made it into government, where it holds crucial ministries in Kurz's administration. Austria has in effect nearly become an additional member of the Visegrad Group. This quick recap of past events can help us to understand the most recent developments. In Sweden, for example, the [Swedish Democrats gained in the elections held on Sunday 9th September](#), reaching 18% of votes and becoming an obstacle to the formation of any new majority government, possibly forcing mainstream parties into forming a grand coalition. Most importantly, Donald Trump's controversial former advisor Steve Bannon has put together an organisation, called "The Movement", based in Europe, the purpose of which is to coordinate the activities of all the "sovereignist" and nationalist parties that aim to promote European dis-integration. [The first top-notch politician to join the movement is Italy's Salvini](#).

The Movement might be pursuing the same goals of Russia, in weakening Europe as a global geopolitical actor. And that could be Donald Trump's own goal as well, in spite of [the "Resistance" of the "Deep/Steady State" that may exist within the White House and the US government](#). All these developments are relevant not simply from a political and geopolitical standpoint, but also for their macro and market implications. The sovereignist movements might make large gains in the European elections held in May 2019, and by doing so influence the appointment of top officials of European institutions and block any further European integration efforts, in spite of Macron's and others' efforts. Just by way of example, European institutions have been critical to solving the recent euro debt crises (in the EZ periphery); thus, their weakness would imply a greater level of vulnerability for those struggling countries and for the EZ as a whole, when the next recession or crisis does occur. As the recent increase in the Italian BTP/Bund spread showed, financial market volatility due to political developments in Europe could contribute to uncertainty and macroeconomic and financial under-performance in the countries that they affect the most.

Our Recent Publications



[Working Paper: Post-Ambrosetti Forum – Bullet Points](#), by Brunello Rosa and Nouriel Roubini, 10 September 2018



[EM Global Tremors: Central Banks' Different Strategies to Defend Their Currencies](#), by Rémi Bourgeot, 4 September 2018



[Argentina: Between Disaster and Hope](#), by Brunello Rosa and Joseph Shupac, 5 September 2018



[The Geopolitical Corner – How the world really works \(Part 4\)](#), by John C. Hulsman, 4 September 2018



The Week Ahead

In the US, headline inflation is expected to soften (CPI Aug y-o-y, c: 2.7%; p: 2.9%), while core prices are likely to remain stable (c: 2.4%; p: 2.4%), above the Fed's 2.0% target.

In Europe, the ECB and the BoE will leave policy rates unchanged (ECB, c: 0.0%; p: 0.0%; BoE, c: 0.75%; p: 0.75%).

In Turkey, on September 13 the CBT is likely to hike its policy rate by 300-500bps, to around 20.75-22.75% (p: 17.75%). Over the last week, the TRY strengthened against the USD (USD/TRY 6.382, -2.1% w-o-w).

The Quarter Ahead

The US will continue to normalize policy... Last week's employment data reinforced expectations of further Fed hikes in 2018, as: 1) the unemployment rate (a: 3.9%; c: 3.8%; p: 3.9%) remained low; 2) non-farm payrolls beat consensus (a: 201k m-o-m; c: 187k; p: 157k); and 3) average hourly earnings rose to a nine-year high of 2.9% y-o-y (c: 2.7%; p: 2.7%). The likelihood of "at least 2 additional hikes in 2018" rose to 79.8% (pw: 71.1%), while the likelihood of "at least 4 additional hikes by September 2019" increased to 37.6% (pw: 29.0%).

... increasing the divergence with other DMs. In the EZ, growth will keep decelerating: in July, Germany's IP growth decreased more than expected, to 1.1% y-o-y (c: 2.6% y-o-y; p: 2.7%), down from a seven-year high of 6.2% in December 2017. Uncertainty about the growth outlook forced CBs to keep policy rates unchanged in Canada (a: 1.5%; c: 1.5%; p: 1.5%) and Australia (a: 1.5%; c: 1.5%; p: 1.5%).

Italian assets will remain under pressure. Last week, the government's pledge to respect the EU's 3% deficit rule in its 2019 budget provided respite. The 10y Italian bond rallied, with yields declining by 36bps w-o-w (to 2.84%). However, over the next few months the country will face numerous hurdles, e.g.: a possible credit rating downgrade by Moody's and S&P in October.

In Turkey, the economy will start decelerating. Q2 GDP data (c: 5.3% y-o-y; p: 7.4%) will start to show a slowdown, which will continue in Q3, when growth could decline to between 0 and 1%. In 2018, economic growth will likely decelerate to around 3%, with inflation rising close to 20% y-o-y.

EMs will continue to suffer outflows. EM stocks entered a bear market, having lost more than 20% of their value since their mid-January high. In EMs, currency weakness (last week: USD/ZAR, -3.8% w-o-w; USD/RUB -3.6%; USD/INR -1.1%), and stock market underperformance (South Africa's JSE 40, -3.1%; Indonesia's JCI, -2.8%; Mexico's MEXBOL, -1.2%) will be compounded by further outflows - driven by a combination of factors: a) the global deceleration; b) fears of a trade war; c) Fed tightening; and d) country-specific issues (e.g.: Argentina, Turkey, Russia, South Africa, etc.).

China will likely maintain an expansive fiscal policy and monetary easing to counter existing risks: a) currency weakness (USD/CNY, -5.2% y-t-d); b) corporate debt overhang; c) slowing growth momentum; d) a potential trade war; e) and Fed tightening.

In the midst of the ongoing EM sell-off, Egypt is proving stable. Despite outflows of foreign investment from T-bills denominated in local-currency (foreign ownership fell to USD 16.7bn in June, from USD 21.6bn in March), net foreign reserves at the CB rose to USD 44.4bn in August (p: USD 44.3bn), keeping the currency stable.

Brent oil price will remain above 70 USD/b. As demand softens, prices will decline: last week, prices fell 0.5% w-o-w to 77.1 USD/b, dragged by unexpected build-ups in gasoline inventories. However, a tight supply will prevent prices from falling below 70USD/b.

Last Week's Review

US and EZ stocks declined, due to concerns about a 'global trade war' and EM instability. Stock prices declined w-o-w in the US (S&P500, -1.0%) and the EZ (Eurostoxx 50, -2.9%), and volatility increased (VIX, +2.0 points to 14.9; 52w avg.: 13.6; 10y avg.: 19.5) driven by: a) the possible adoption by the Trump administration of fresh tariffs on USD 267bn of Chinese imports; and b) concerns about the ongoing sell-off in EMs (DJEM, -3.5% w-o-w). In the US, a strong jobs report increased expectations that the Fed will raise interest rates later this month; as a result, the 10-y UST yield rose by 9bps w-o-w, to 2.94%. The selloff of EM and EZ assets strengthened the USD w-o-w against: a) a currency basket (DXY +0.2%); and b) the EUR (EUR/USD 1.155, -0.4%), while the MSCI EM currency index fell by 0.8%.

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



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Abbreviations, Acronyms and Definitions

<i>a</i>	Actual	<i>k</i>	thousand
<i>AKP</i>	Justice and Development Party, Turkey	<i>KSA</i>	Kingdom of Saudi Arabia
<i>ann.</i>	annualized	<i>LN</i>	Northern League, Italy
<i>ARS</i>	Argentinian Peso	<i>MSS</i>	Five Star Movement, Italy
<i>bn</i>	Billion	<i>m-o-m</i>	Month-on-month
<i>BoC</i>	Bank of Canada	<i>mb</i>	Million barrels
<i>BoE</i>	Bank of England	<i>mb/d</i>	Million barrels per day
<i>BoJ</i>	Bank of Japan	<i>MENA</i>	Middle East and North Africa
<i>bpd</i>	Barrels per day	<i>MHP</i>	Nationalist Movement Party, Turkey
<i>bps</i>	Basis points	<i>mn</i>	Million
<i>BS</i>	Balance sheet	<i>NAFTA</i>	North-American Free Trade Agreement
<i>c</i>	Consensus	<i>NATO</i>	North Atlantic Treaty Organization
<i>C/A</i>	Current account	<i>OECD</i>	Organization for Economic Cooperation and Development
<i>CB</i>	Central bank	<i>Opec</i>	Organization of Petroleum Exporting Countries
<i>CBK</i>	Central Bank of Kuwait	<i>p</i>	Previous
<i>CBR</i>	Central Bank of Russia	<i>PBoC</i>	People's Bank of China
<i>CBT</i>	Central Bank of the Republic of Turkey	<i>PCE</i>	Personal Consumption Expenditures
<i>CDU</i>	Christian Democratic Union, Germany	<i>PE</i>	Price to earnings ratio
<i>CNY</i>	Chinese Yuan	<i>PM</i>	Prime minister
<i>CPI</i>	Consumer Price Index	<i>PMI</i>	Purchasing managers' index
<i>DJIA</i>	Dow Jones Industrial Average Index	<i>pps</i>	Percentage points
<i>d-o-d</i>	Day-on-day	<i>pw</i>	Previous week
<i>DXY</i>	US Dollar Index	<i>QCB</i>	Qatar Central Bank
<i>EC</i>	European Council	<i>QAR</i>	Qatari Riyal
<i>ECB</i>	European Central Bank	<i>QE</i>	Quantitative easing
<i>ECJ</i>	European Court of Justice	<i>q-o-q</i>	Quarter-on-quarter
<i>EIA</i>	US Energy Information Agency	<i>RBA</i>	Reserve Bank of Australia
<i>EM</i>	Emerging Markets	<i>RRR</i>	Reserve Requirement Ratio
<i>EP</i>	European Parliament	<i>RUB</i>	Russian Rouble
<i>EPS</i>	Earnings per share	<i>SHCOMP</i>	Shanghai Stock Exchange Composite Index
<i>EU</i>	European Union	<i>tb/d</i>	Thousand barrels per day
<i>EUR</i>	Euro	<i>tn</i>	Trillion
<i>EZ</i>	Eurozone	<i>TPP</i>	Trans Pacific Partnership
<i>Fed</i>	US Federal Reserve	<i>TRY</i>	Turkish Lira
<i>FM</i>	Future Movement	<i>UAE</i>	United Arab Emirates
<i>FOMC</i>	US Federal Open Market Committee	<i>UK</i>	United Kingdom
<i>FRB</i>	US Federal Reserve Board	<i>US</i>	United States
<i>FX</i>	Foreign exchange	<i>USD</i>	United States Dollar
<i>FY</i>	Fiscal Year	<i>USD/b</i>	USD per barrel
<i>GCC</i>	Gulf Cooperation Council	<i>UST</i>	US Treasury bills/bonds
<i>GBP</i>	British pound	<i>VAT</i>	Value added tax
<i>GDP</i>	Gross domestic product	<i>VIX</i>	Chicago Board Options Exchange Volatility Index
<i>GOP</i>	Grand Old Party (US Republican Party)	<i>WTI</i>	West Texas Intermediate
<i>IMF</i>	International Monetary Fund	<i>w-o-w</i>	Week-on-week
<i>INR</i>	Indian Rupee	<i>y-o-y</i>	Year-on-year
<i>IPO</i>	Initial public offering	<i>y-t-d</i>	Year-to-date
<i>IS</i>	Islamic State	<i>2y; 10y</i>	2-year; 10-year
<i>JPY</i>	Japanese yen		