

MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
By Brunello Rosa



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AKK as CDU Party Leader Ensures Short-Term Continuity, But the Political Battles Continue

The victory by Annegret Kramp-Karrenbauer (AKK, for short) in the contest to replace Angela Merkel as CDU party leader ensures a level of short-term continuity in Germany's political affairs. It is, however, unlikely to settle Germany's political situation once and for all. As we discuss in depth in our [travel notes from Berlin](#), AKK was most closely aligned to Angela Merkel of the three contenders for the party leadership, but also the least charismatic and the least able to promote the shift to the right that the party needs to carry out in order to regain the popular support and votes that have gone to the AfD in the last few years.

The other two contenders for the CDU leadership, Friedrich Merz and Jens Spahn, drove the agenda of the party conference and are likely to shape the CDU's political trajectory in coming years, for a number of reasons. First of all, AKK defeated Merz in the second round of the election only by a very tight margin, 51.75% to 48.25%. The fact that Wolfgang Schäuble decided to support Merz in his bid for the candidacy and reportedly did not applaud Merkel's final speech as CDU leader shows that the party is profoundly divided on the question of which direction to follow. Second, AKK will have to re-affirm and consolidate her power over the next few months, which will feature a number of important elections: European parliament (on May 26th, 2019), Brandenburg and Saxony (September 1st, 2019) and Thuringia (October 27th, 2019). The two defeated candidates might even hope for a poor CDU showing in these elections, to demonstrate that the party needs a radically new course of action (led by them, of course) to regain lost votes and centrality in German politics. Third, the tide of history currently appears to favour right-wing candidates (such as Merz and Spahn) able to appeal to the anti-immigrant sentiment now prevalent among the German and European population. And fourth, the anti-European forces within the EU as well as outside the EU (in America and Asia) will give AKK a hard time in the coming years, and will continue to push for the dis-integration of the EU.

Angela Merkel can rightly claim a political victory with AKK's election, following upon a number of political defeats. Merkel can now plan for her exit from German politics in less haste. She has bought a few more months to decide whether she wants to bid for a big EU job, in order to make sure the European project does not crumble following her political departure. The fact that the European People's Party (EPP) has chosen Manfred Weber as *Spitzenkandidat* for the EU Commission presidency means that Germany and the EPP more widely have already started to plan for a post-integration future, a future in which the EPP will have to deal with the populist parties now proliferating throughout Europe (as we discuss in our recent [travel notes from Italy](#)). But time is running out. As the "Gilets Jaunes" protests in France show, anti-élite, anti-establishment and inherently anti-European anti-Western sentiment is on the rise even in the country with the most explicitly pro-European leader in Europe, i.e. French President Macron. There is a risk that, if this anti-European sentiment ends prevailing, then even if Macron and Merkel/AKK were to come out with the best plan to complete the European Union and the Eurozone, that plan would still be rejected by the respective populations of European countries, thereby de facto starting the process of European dis-integration, whether the establishment likes it or not.

All the above is not just a list of interesting political considerations. As we discuss in our recent [market update](#), geopolitical events and the political economy of nations (such as those we discuss in our "[geopolitical corner](#)" column) now have a direct impact on markets' prices. So, while AKK's victory might provide a sigh of relief for market participants in the short run, it cannot prevent them from entering a rollercoaster ride in the next few months.

Our Recent Publications

RR [MARKET VIEWS: Markets Buffeted By Tailwinds and Headwinds At Year-End](#), by Alex Waters, 7 December 2018

RR [TRAVEL NOTES: ITALY: Partially Caving In, Given Market and European Pressures](#), by Brunello Rosa, 5 December 2018

RR [TRAVEL NOTES - GERMANY: A Succession Drama at a Time of Economic Weakness](#), by R. Bourgeot, 4 Dec. 2018

RR [May's intellectual confusion explains her "Hotel California" Brexit](#), by John Hulsman, 7 December 2018



The Week Ahead

In the US, inflation is expected to soften (CPI November, c: 2.2% y-o-y; p: 2.5%) driven by lower food and energy prices (US CPI ex food and energy November, c: 2.2% y-o-y; p: 2.1%).

In the EZ, the ECB will maintain its policy stance unchanged (ECB policy rate, c: 0.0%; p: 0.0%). We discussed this in [our recent ECB preview](#).

The Quarter Ahead

The US economy will remain strong. Labour market indicators show a resilient economy: last week, wage growth was unchanged (average hourly earnings November, a: 3.1% y-o-y; c: 3.1%; p: 3.1%) and the unemployment rate remained at a 49-year low (November, a: 3.7%; c: 3.7%; p: 3.7%). The number of new jobs fell below expectations (non-farm payrolls November, a: +155k m-o-m; c: +205k; p: 250k). PMIs indicate strength ahead (ISM manuf. Nov., a: 59.3; c: 58.0; p: 57.7). However, the markets continue to reduce their expectations about the likelihood of further hikes in 2019: last week, the probability of only one hike in 2019 rose from 25.4% to 33.4%.

In the EZ, political risks are likely to hamper economic performance. In a context of decreasing growth and deteriorating confidence—next week, in Germany, the main economic sentiment indicator is expected to decline further (ZEW November, c: -25.0; p: -24.1). Political risks continue to rise: a) in the UK, on December 11th, parliament will vote on the “Brexit deal” agreed with the EU; a rejection could trigger [a political crisis](#) and even elections, increasing political uncertainty in Europe; b) in Italy, next week the EC is supposed to receive a revised budget, but the Italian government—amid rumours about the resignation of the economy minister—is showing unwillingness to compromise. Germany’s Christian Democrats have chosen as their leader Annegret Kramp-Karrenbauer—a close ally of Angela Merkel—who is expected to provide continuity.

The US and China are unlikely to solve their trade dispute. The positive impact of the truce agreed at the G20 meeting last week was immediately undermined by: a) a series of tweets by President Trump threatening more duties on China if trade talks fall through; and b) Huawei’s CFO arrest, which has caused widespread resentment among Chinese authorities, reducing the likelihood of a prompt, successful resolution of the crisis.

Fixed income in the GCC will continue to overperform other regions. In the GCC, fixed income has withstood the impact of rising interest rates better than most regions in the world: year-to-date, the GCC USD Sukuk and credit indices are down by 0.2 and 0.7%, compared to -3.2% for the Global Investment Grade Debt index, -4.0% for Global Sukuk index, and -3.8% for EMs USD debt index.

GCC economies will show resilience... GCC leading indicators improved in November (Non-oil PMI Nov. KSA, a: 55.2; p: 53.8; UAE, a: 55.2; p: 53.8) as fiscal stimulus measures—e.g. KSA announced the reinstatement of public sector bonuses—are offsetting the decline in consumer confidence

... as oil prices are supported by output cuts. Opec and its allies agreed on cutting output by 1.2mb/d (of which 400k are provided by non-Opec). Cuts were marginally above market expectations, prompting a w-o-w increase of Brent oil prices of 5.0%, to 61.7 USD/b.

Last Week’s Review

Global stocks fell on renewed concerns about a US-China trade war. Tensions between the US and China rose after the CFO of the Chinese firm Huawei was arrested in Canada, over alleged violations of US sanctions on Iran. Stocks fell across the world (MSCI ACWI, -3.5%) with strong declines in DMs (MSCI DMs, -3.7%; S&P 500, -4.5%; Eurostoxx 50, -3.6%; MSCI EMs, -1.3%).

Volatility rose above its long-term average (VIX, +5.1 to 23.2; 52w avg.: 15.2; 10y avg.: 18.6). Rising uncertainty increased demand for bonds: a) sovereign bond yields fell, pushing 10y USTs below 3%, the lowest level since August, (US 10y yield, -16bps to 2.85%; Germany 10y yield, -6bps to 0.34%); and b) bond indices rose globally (S&P Global DMs index, +0.5%; EMs index, +0.7%). The USD fell—due to lower-than-expected payrolls—against a basket of currencies (DXY, -0.8%) and the EUR (EUR/USD, +0.5% to 1.138).

Francisco Quintana contributed to this Viewsletter.

The picture in the front page is from Associated Press (AP) comes from [this website](#)



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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	NAFTA	North-American Free Trade Agr.
bpd	Barrels per day	NATO	North Atlantic Treaty Organizat.
bps	Basis points	OECD	Organization for Economic Cooperation and Development
BS	Balance sheet	Opec	Organization of Petroleum Exporting Countries
c	Consensus	p	Previous
C/A	Current account	P2P	Peer-to-peer
CB	Central bank	PBoC	People's Bank of China
CBB	Central Bank of Bahrain	PCE	Personal Consumption Expenditures
CBK	Central Bank of Kuwait	PE	Price to earnings ratio
CBT	Central Bank of Turkey	PM	Prime minister
CDU	Christian Democratic Union, Germany	PMI	Purchasing managers' index
CNY	Chinese Yuan	pps	Percentage points
CPI	Consumer Price Index	pw	Previous week
DJIA	Dow Jones Industrial Average Index	QCB	Qatar Central Bank
DJEM	Dow Jones Emerging Markets Index	QAR	Qatari Riyal
d-o-d	Day-on-day	QE	Quantitative easing
DXY	US Dollar Index	q-o-q	Quarter-on-quarter
EC	European Commission	RE	Real estate
ECB	European Central Bank	RBA	Reserve Bank of Australia
ECJ	European Court of Justice	RRR	Reserve Requirement Ratio
EIA	US Energy Information Agency	RUB	Russian Rouble
EM	Emerging Markets	SWF	Sovereign Wealth Fund
EP	European Parliament	tn	Trillion
EPS	Earnings per share	TRY	Turkish Lira
EU	European Union	UAE	United Arab Emirates
EUR	Euro	UK	United Kingdom
EZ	Eurozone	US	United States
Fed	US Federal Reserve	USD	United States Dollar
FOMC	US Federal Open Market Committee	USD/b	USD per barrel
FRB	US Federal Reserve Board	UST	US Treasury bills/bonds
FX	Foreign exchange	VAT	Value added tax
FY	Fiscal Year	VIX	Chicago Board Options Exchange Volatility Index
GCC	Gulf Cooperation Council	WTI	West Texas Intermediate
GBP	British pound	WTO	World Trade Organisation
GDP	Gross domestic product	w	Week
IMF	International Monetary Fund	w-o-w	Week-on-week
INR	Indian Rupee	y	Year
IPO	Initial public offering	y-o-y	Year-on-year
IRR	Iranian Rial	y-t-d	Year-to-date
JPY	Japanese yen	ZAR	South African Rand
k	thousand	2y; 10y	2-year; 10-year
KSA	Kingdom of Saudi Arabia		



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