

MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
By Brunello Rosa



European Elections, 2019: A Key Test For The Survival Of The EU

All EU states will hold elections for the European Parliament this week, between Thursday May 23rd and Sunday May 26th. The EU Parliament will be completely renewed, with all 750 seats up for grabs. Because the UK will still take part in this election, the number of MEPs elected will not fall to 705, as had been planned to occur until the UK asked for its first extension to the Article 50 process in late March.

We have already discussed the importance of this election in a number of publications, particularly as a result of the [increase in the share of seats that “populist” parties are expected to win](#). In our [paper on the rise of the Populist International](#), we anticipated how these populist parties might eventually increase their power during this parliamentary term if an [economic and financial crisis](#) were to shatter the alliance between the European People’s Party (EPP), Socialists, Liberals, and, perhaps, the Greens, which is expected to emerge following the elections this week. In order to achieve that, the populist parties will have to make an agreement with the EPP, as, for example, has occurred in Austria, where the EPP’s Chancellor Sebastian Kurz is allied with FPÖ’s Heinz-Christian Strache. They would do this by making use of the presence of populist, authoritarian, or nationalistic parties within the EPP, such as Victor Orban’s Fidesz (which has been temporarily suspended from the EPP for its anti-Juncker campaign in Hungary).

In this respect, there have been very interesting developments, recently. A couple of weeks ago, Orban himself declared several weeks ago that he [will not support the EPP’s candidate for the European Commission](#) presidency (so-called *Spitzenkandidat*) Manfred Weber. This could be a signal of an initial rupture between Fidesz and the EPP, which would have the effect of making the EPP smaller yet less “compromised” by populist parties. On the other hand, a rupture of this kind would also make the group of populist parties larger in the new EU Parliament. This week, the Austrian government itself collapsed after the release of a video showing [Strache dealing with supposed intermediators of Russian interests](#).

So, the future of the [EU is at stake in this election](#). But the election’s importance is not only limited to its [historical and geo-strategic significance](#). The implications for future European policymaking have been discussed at length in a series of papers we wrote about the ongoing [European musical chairs game](#), in which all the most important EU positions will be filled in coming months, including the presidencies of the EU Commission, Council and Parliament and, most importantly for financial markets, the ECB. The choice of who heads these institutions will make it clear what fiscal policy stance the EU will take; crucially, at a time when [tensions over Italy’s deficit and debt are re-emerging](#). Consequently, this will determine what the ECB will be asked to do to support the fragile and uneven expansion of the Eurozone economy (which is now [slowing down](#)) or to save the euro area from a possible breakup when the next crisis hits (as the ECB did previously during the crisis of 2011-2012).

As usual, these European elections will also be read with a domestic lens within all of the EU countries. In [Germany](#), they could mark the end of Angela Merkel’s tenure as Chancellor (in favour of her successor as CDU leader Annegret Kramp-Karrenbauer), especially if Merkel decides to lead the EU Council. [In France](#), Macron will need to convince his electorate that he can still win more votes than Marine Le Pen’s party (now re-named *Rassemblement National*). [In Italy](#), this election will be a referendum on Salvini’s leadership, and could mark the collapse of the fragile M5S-Lega coalition. [In the UK](#), where the participation in this election is [considered a national humiliation](#), these elections will probably mark the [departure of Theresa May from Number 10 Downing Street](#) in the coming weeks, whether Brexit is delivered or not.

Our Recent Publications



[US-China Trade War Risks and Impact on US Inflation, Growth and Fed’s Monetary Policy](#), by Nouriel Roubini and Brunello Rosa,
16 May 2019



[MARKETS Lebanon: An ‘Unstable Equilibrium’ Supported By Capital Inflows](#), by Alessandro Magnoli Bocchi, Farah Aladsani and Fawaz Sulaiman Al Mughrabi, 14 May 2019



Looking Ahead

The Week Ahead: Uneven Growth Slowdown Continues

In the EZ, the manufacturing sector is expected to remain weak (EZ Markit manuf. PMI, c: 48.2; p: 47.9; Germany Markit manuf. PMI; c: 45.0; p: 44.4).

On May 23-26, 2019 the EU parliamentary elections are likely to register a strong performance of populist and nationalist parties – e.g.: the French National Rally (*Rassemblement National*) is ahead in the polls.

In Japan, growth is expected to remain stagnant (GDP Q1, c: 0.3% y-o-y; p: -0.3) and the industrial sector is likely to decelerate (IP: c: -4.6% y-o-y; p: -1.1).

Inflation is expected to remain subdued in Japan (c: 0.4% y-o-y; p: 0.5%) and the UK (a: 2.0%; p: 1.9).

The Quarter Ahead: Geopolitical Risks Weigh On Economic Growth And Financial Stability

In the US, the macro-conditions for Fed cuts – at the moment not in place – could start materializing. Trade tensions with the EU and Japan are likely to soften: President Trump deferred the decision to place tariffs on EU and Japanese carmakers, who “now have 180 days to agree to a deal that would ‘limit or restrict’ their exports to the US”. In the US, rising global trade tensions reinforce expectations of a rate cut in 2019: the market probability increased to 73% (p: 57%). Delayed China-US trade talks and the possibility of a trade war are likely to keep the USD supported.

The US-UK Special Relationship could be affected if the UK were to allow Huawei to build 5G infrastructure.

In the EZ, analysts are pessimistic about the economic outlook as sentiment falls (a: -1.6; c: 1.0; p: 4.5).

In the UK, a fourth vote on PM May’s Brexit plan will take place on June 3. Another defeat would increase pressure on PM May to resign.

In China, as US-China trade hostilities reignite (new tariff on USD 60bn of US imports will be effective from June 1), the PBOC is likely to retain a supportive stance (an RRR cut has already been announced for small and mid-sized banks). The USD/CNY will likely be range-bound around 6.9, after depreciating from 6.7 on trade tensions.

India remains vulnerable to capital outflows driven by trade war escalations; below-target inflation and a weak growth outlook justify the RBI’s accommodative path.

In Turkey, political tensions with the US are likely to rise, as the Turkish foreign minister stated “neither postponing nor cancelling the delivery of the Russian S-400 system, scheduled for July, is ‘on the agenda’”.

Last Week’s Review

Real Economy: Further Indications Of Global Slowdown

In the US, retail sales came in weaker-than-expected (Retail Sales Apr., a: -0.2% m-o-m; c: 0.2%; p: 1.7%), due to lower spending on clothes, appliances, and building materials.

In the EZ, Q1-2019 growth stalled (a: 1.2% y-o-y; c: 1.2%; p: 1.2%) and IP remained weak (IP Mar., a: -0.6% y-o-y; c: -0.8%; p: -0.3%).

In the EZ, inflation remained unchanged at 1.7% y/y.

In China, the government announced retaliatory tariffs on imports from the US, and all April data showed weakness: retail sales (a: 7.2% y-o-y; c: 8.6%; p: 8.7%), IP (a: 5.4% y-o-y; c: 6.5%; p: 8.5%), new home sales, and fixed asset investment declined.

In Turkey, the monthly C/A deficit rose to its lowest level since October 2015 (C/A Mar., a: USD -0.589 bn; c: -0.984bn; p: -0.718bn). Inflation remains subdued.

Financial Markets: Trade Tensions Slow Down Chinese And US Markets

Market drivers: trade tensions and disappointing economic data in both the US and China overshadowed positive indicators in Europe.

Stocks: w-o-w, global stocks fell (MSCI ACWI, -0.8%), led by the US (S&P 500, -0.8%). EM tumbled (MSCI EMs, -3.6%). Volatility remains unchanged (VIX S&P 500, 0 points to 16.0, 52w avg.: 16.1; 10y avg.: 17.4).

Bonds: Globally, indices rose w-o-w (BAML Global bond index, 0.3%). In EMs, weekly issuances have increased to USD 6.9bn (p: 5.3) and EUR 19.6 (p: 0). In MENA, debt supply stands at USD 53.7bn y-t-d compared to USD 50.8bn over the same period in 2018.

FX: the USD appreciated against a basket of currencies (DXY, +0.7%); the EUR and the GBP fell (EUR/USD, -0.7% at 1.116); (GBP/USD, -2.2% at 1.272). EM currencies declined (MSCI EMs, -1.1% at 1,612).

Commodities: Oil prices increased (Brent, 2.3% to 72.21 USD/b).



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The picture in the front page comes from [this website](http://this.website)



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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