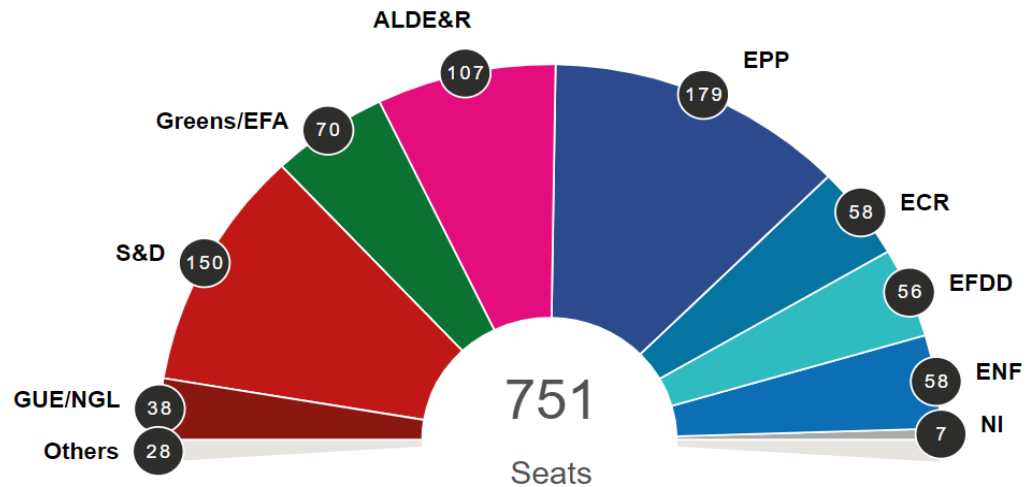


MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
By Brunello Rosa



Source: European Parliament

EU Elections Change the European Political Landscape

Last week we discussed the European election, which took place between Thursday 23 and Sunday 26 May. The voter turnout for the election, at above 50 percent, was the highest in the last 20 years, testifying to this election's importance. According to the preliminary results, most of the predictions made in advance of the election (by us and by others) are proving to be correct. The European People's Party (EPP), will remain the largest group in the European parliament, with around 180 seats, but will lose more than 40 MEPs compared to its results in the previous election in 2014. The Socialist and Democratic (S&D) Party will be the second largest group, with around 150 seats; it too will have close to 40 fewer MEPs than it had in 2014. Conversely, the Liberals of ALDE and the Greens will both gain seats, going from 68 to more than 100 and from 52 to around 70 respectively. This means that in order to form a 376-strong majority, the EPP and the S&D will have to coalesce with the Liberals. (The Greens seem not to be necessary at this stage).

What about the "national-populist" parties? The ENF group of Italy's Salvini and France's Le Pen will increase the number of its MEPs from 37 to around 60. The EFDD group of Farage's Brexit Party and Italy's Five Star will also rise, from 41 to around 60 seats. The ECR's group of UK Tories, Poland's PiS, Germany's AfD and Finland's True Finns will fall from 75 to around 60, mostly because of the UK Tories' debacle. These groups together will not yet be big enough to make an offer to the EPP, but they will increase their influence in future decision-making processes.

The press and most "mainstream" policymakers will probably take an unwarranted sight of relief following this election, as they will think that the "national-populist" parties have been kept at bay. We believe this view might prove to be incorrect, for two reasons.

First, these elections are forcing increasingly unnatural alliances to be made at the European level. The fact that the Liberals may now be in the same camp as the EPP and S&D means that they will all be jointly blamed for anything that can and probably will go wrong in coming years, thereby leaving the national-populist parties (and perhaps the Greens) as the only remaining alternative.

Second, some of the individual national-populist parties actually fared exceptionally well in these elections. In Germany, the CDU and SPD combined lost more than 18% of the vote, in favour of Greens (now Germany's second largest party) and AfD (now its fourth largest party). In France, Le Pen's National Rally Party has reportedly overtaken President Macron's *En Marche* party. In Italy's Salvini's Lega is the first party with 34% of votes having overtaken the Five Star (collapsed to 17%). In the UK, the Brexit Party has gathered around 32% of votes, is the largest party in this election and will certainly campaign for an eventual hard-Brexit solution. In Poland and Hungary, PiS and Fidesz respectively remain the parties that received the most votes. Elsewhere, in Greece, New Democracy has reportedly overtaken PM Tsipras' SYRIZA, and is getting ready to get back into power with the national elections of June 30th.

Thus, the parties forming what we have labelled the "Populist International" are still gaining ground. They know that the race to political power is a marathon, not a sprint. From their new, more powerful positions in EU politics, they will strongly influence the process of appointing the new heads of the EU Parliament, Commission, Council and, above all, the ECB. They will also be likely to have a greater say regarding the overall fiscal and monetary policy stance taken at the EU level. Overall, then, we continue to think that 2019 will be a crucial year for European politics. This EU election is likely to prove an inflection, if not a turning point, in the region's affairs.

Our Recent Publications



USA - Iran: Escalating Tensions, With High Risk Of Mis-Calculations,
by Nouriel Roubini, Brunello Rosa and Giorgio Cafiero, 23 May 2019



Fin-Tech: Towards A Tech-Driven Cold War, by Klecha & Co.
and Rosa & Roubini Associates, 21 May 2019

Looking Ahead

The Week Ahead: The EU Parliamentary Elections Key Event of The Week

In the US, the Fed's inflation gauge is expected below the 2% target (PCE Apr., c: 1.6% y-o-y; p: 1.3).

In the EZ, consumer confidence is likely to remain weak (c: -6.5 p: -6.5).

In the EU, EU parliamentary election results are likely to show gains of Euro-skeptic populist and far-right parties.

In Canada, the BoC is expected to keep interest rates unchanged (p: 1.75%).

The Quarter Ahead: US-China Stalemate To Continue

US-China trade war, after the US unilaterally increased tariffs on Chinese goods imports, China is likely to reiterate that "the US must alter wrong practices before negotiations can resume". In absence of progress over the coming weeks, further tariffs are likely - on both sides. A protracted trade-war could: *i)* divide the global economy into two incompatible economic blocs; and *ii)* foster the process of de-globalization.

In the US, the introduction of tariffs on Chinese goods is likely to bring about higher prices, slower growth, and lower business confidence—supporting the Fed's commitment to a "patient" stance. Expectations of a rate cut in 2019 rose to 78% (p: 73%). To deliver the 2-3 cuts the market is pricing in, the Fed would need: *i)* the US-China tensions to turn disinflationary, via a negative demand shock and a drag on real incomes; and *ii)* a deterioration in financial conditions—e.g.: triggered by a stock market selloff.

In the UK, PM May will resign on June 7; former foreign secretary and Brexit campaigner, Boris Johnson, is the early favorite.

In the EZ, higher risks, subdued growth and benign inflation are likely to keep the ECB dovish, despite the change in Governor in 4Q-2019. Given ongoing political and budget tensions, the EUR/USD could break below 1.10, especially if populist and far-right parties start undermining the unity of the single market. The US decision of postponing automobile tariffs could provide temporary relief for EU and Japanese exporters.

In Japan, exports are likely to remain sluggish, given the recent dip in China's economic indicators.

In Iran, the limits on uranium enrichment placed under the '2015 nuclear deal' could be surpassed within weeks, a move likely to exacerbate tensions with the US.

Last Week's Review

Real Economy: Globally, Manufacturing Is Decelerating

In the US, durable goods orders fell by 2.1% (Apr., c: -2.0; p: 1.7).

In the EZ, manufacturing remained in contraction in May, due to: *i)* stagnant demand; and *ii)* subdued business growth (EZ Markit manuf. PMI, *a*: 47.7 c: 48.2; p: 47.9; Germany Markit manuf. PMI, *a*: 44.3 c: 45.0; p: 44.4).

In Japan, while industrial activity kept contracting (IP Mar., *a*: -4.3% y-o-y; p: -4.6), the value of exports fell for a fifth straight month (*a*: -2.4% y-o-y; c: -1.8 p: -2.4%), hindered by US-China trade tensions and the global tech slowdown. As a result, economic growth remained stagnant (Q1 GDP, *a*: 0.2%; p: -0.3).

In India, PM Narendra Modi won a second five-year term in office, following a campaign focused on the country's slowing economy. Electoral promises include: *i)* tax cuts; *ii)* cash handouts to farmers; *iii)* a boost to manufacturing; and *iv)* USD 1.4tn to build new infrastructure.

Inflation remains subdued in Japan (Core CPI, *a*: 0.6% y-o-y; c: 0.4; p: 0.4) and the UK (Core CPI, *a*: 1.8% y-o-y; c: 1.9; p: 1.8).

Financial Markets: US Stocks Fell And Global Stocks Followed

Market drivers: geo-political tensions and disappointing economic data pushed investors into haven assets.

Stocks: w-o-w, global stocks fell (MSCI ACWI, -1.0%), led by the US (S&P 500, -1.0%). Volatility remained unchanged (VIX S&P 500, -0.1 to 15.9, 52w avg.: 16.2; 10y avg.: 17.4).

Bonds: globally, indices rose w-o-w (BAML Global bond index, +0.2%). In the US, the yield of 10yUSTs fell to its lowest level since 2017. In EMs, weekly issuances rose to USD 7.7bn (p: 5.3) and EUR 1.5 (p: 1.6).

FX: the USD depreciated against a basket of currencies (DXY, -0.4%) and the EUR (EUR/USD, 0.4% at 1.120). EM currencies rose (MSCI EMs, 0.3% at 1,616).

Commodities: Oil prices fell (Brent, 4.9% to 68.7 USD/b) as: *i)* demand-side risks, i.e., trade-related strains; outweighed: *ii)* supply-side risks, i.e., political tensions in the Middle East and Venezuela, and production disruptions in Russia and Nigeria.



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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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