

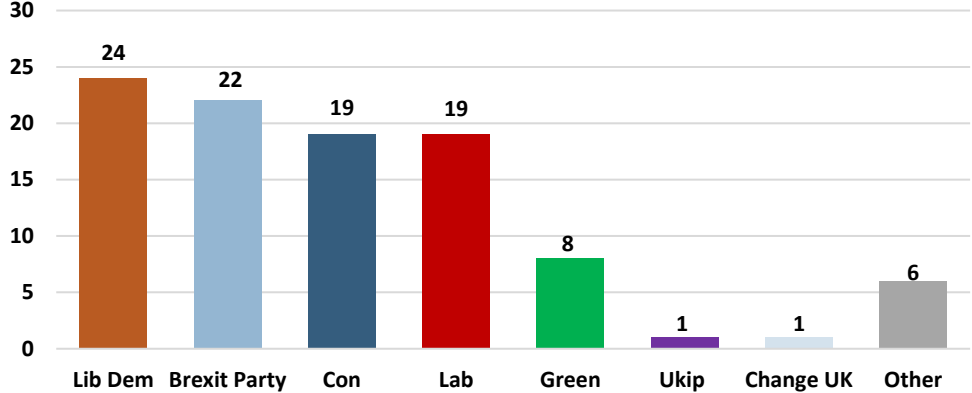
MAKING SENSE OF *THIS* WORLD

3 June 2019



R&R Weekly Column
By Brunello Rosa

Westminster Voting Intentions If A General Election Was Held Tomorrow (%)



Source: [YouGov poll, 28-29 May 2019](#)

How Brexit Wrecked the UK's Political System

From the beginning, the [ill-designed Brexit referendum](#) has intoxicated the UK's political system and introduced an element of uncertainty into the country's constitutional arrangements. In a parliament-centred political system such as the British possess, the source of legitimacy for political decisions rests squarely with Westminster (notwithstanding a strong role for the Prime Minister). From a purely procedural standpoint, then, simply labelling the [Brexit referendum as "advisory" and non-binding](#) might have saved the day. Unfortunately, since the day after the referendum its result has been considered politically binding on both sides of the political spectrum, which has committed to "deliver Brexit."

The inability or unwillingness by Parliament to ratify the Withdrawal Agreement negotiated by Theresa May with the EU has made manifest the constitutional short-circuit that has taken place, as the primary source of legal and political legitimacy is now countervailing the "will of people" as expressed in the referendum.

The birth of the Brexit party led by Nigel Farage, and its first-place finish in the European election held on May 23rd, is a response to this inability by Britain's parliament to deliver Brexit. The Tory party will try to respond to the rise of the Brexit party by choosing its new leader from the camp of Brexiteers, with different degrees of radicalism ranging from Boris Johnson to Dominic Raab and Michael Gove. At the same time, Farage might be tempted to "finish the job", forcing a split in the Conservative party between pro-Europeans and Brexiteers and becoming the leader of the right-wing of Britain's political spectrum.

The British results of the European election has other implications as well. First, both parties entangled in negotiations (Tory and Labour) lost a large portion of their votes. Second, those [parties in favour of Remain](#) (chiefly the Lib Dems and the Greens) did very well, and if we sum their votes, they represent a larger proportion of the electorate than does the Brexit party.


Moreover, [a recent poll by YouGov](#) shows that the Lib Dems would be the leading party in the UK if an election were to be held today, ahead of the Brexit party, the Conservatives, Labour and the Greens. If that poll is correct, Brexit would have made the unthinkable happen: a traditional two-party system governed by a first-past-the-post electoral law would become a messy four-party system with the major parties having only between 19% and 24% of the votes. Elections would become completely unpredictable, unless the four major parties coalesced ex ante into pairs (Labour-Lib Dem; Tories-Brexit). Alternatively, all parties might eventually break up and allow a new centrist formation to emerge and take control of parliament and the Brexit process. Such an outcome could lead, potentially, to the Brexit decision being reversed.

During his visit to the UK, US President Donald Trump could not resist the temptation to make things even more complicated, with his suggestions that [Boris Johnson should be the new Tory leader](#), [Nigel Farage should be involved in negotiations with the EU](#), and the UK should throw out the deal agreed to by Theresa May with the EU and aim instead for a hard Brexit, without paying the GBP 39bn owed to the EU in the coming years. Trump might not have considered that the UK is much smaller than the US is, and that the EU has so far had the upper hand in negotiation, in part because Article 50 is designed to punish the leavers.

Our Recent Publications

 [ECB Preview: Don't Expect Too Much Substance, But Still a Dovish Tone](#), by Brunello Rosa and Nouriel Roubini, 3 June 2019

 [European Elections Complicate The Policy Landscape](#), by Brunello Rosa and Nouriel Roubini, 28 May 2019

 [USA - Iran: Escalating Tensions, With High Risk Of Miscalculations](#), by Nouriel Roubini, Brunello Rosa and [Giorgio Cafiero](#), 23 May 2019

Looking Ahead

The Week Ahead: US Manufacturing Is Expected To Strengthen And EZ Inflation Weaken Further

In the US, manufacturing is expected to show strength (ISM manuf. PMI May, c: 53.3; p: 52.8); yet, Non-Farm Payrolls are expected to fall (Nonfarm Payrolls May, c: 190K; p: 263K) and average hourly earnings to remain unchanged; (Average hourly earnings May, c: 3.2%; p: 3.2%).

EZ inflation is anticipated to weaken further (CPI May, c: 1.4%; p: 1.7%), with monetary policy expected to remain accommodative.

The Quarter Ahead: US-Led Trade Tensions Will Hamper Global Growth

The Fed is monitoring risks and will react if needed. Expectations of a rate cut in 2019 rose to 94% (p: 78%). The ECB is likely to strengthen forward guidance, by showing willingness to cut rates if necessary.

In the US, the uncertainty around global trade and supply chains will hurt investment and exports. As global supply chains are at risk, many companies are likely to rethink their business models. US President Trump threatened across-the-board tariffs on Mexico starting June 10, likely to "rise to 25% by October, unless migrant flows are significantly deterred".

Meanwhile, **China** accused the Trump administration of "committing economic terrorism". On June 28-29, Presidents Xi and Trump will to meet at the G20 Summit to resume trade talks.

In the EZ, the risk of a fresh period of instability is rising, as the EU parliamentary elections brought about: *i*) stronger Eurosceptic parties (now at 25%); *ii*) strains in coalition governments in Italy and Germany; and *iii*) the risk of early elections in a few countries. Italy's tensions with Brussels over fiscal discipline are likely to resume, as indicated by rising Italian government bond yields.

In the UK, while the resignation of PM May increased the prospect of a "no-deal" exit, the opposition Labour Party leader, Mr. Corbyn said "any Brexit deal should be put to a referendum".

In the Middle East, the tensions between Saudi Arabia and Iran are likely to grow: at a recent emergency summit in Mecca Saudi Arabia called for "a decisive Arab stand against Iran".

Last Week's Review

Real Economy: Escalating Trade Tensions Hinder Economic Activity And Sentiment Slowdown

In the US, Q1-2019 GDP was revised downwards, to 3.1% (c: 3.1%; p: 3.2%), as consumption remained subdued at 1.5% (PCE May, c: 1.5% y-o-y; p: 1.4%).

In the EZ, the business environment remains weak due to: *i*) Brexit uncertainties; *ii*) weaker-than-expected growth; and *iii*) low confidence (Business climate May, a: 0.30; c: 0.40; p: 0.42; Consumer confidence May, a: -6.5; p: -7.3; Industrial confidence, a: -2.9; c: -4.3; p: -4.3).

In China, manufacturing was weaker than expected, below the 50 benchmark for fourth time in the past six months (PMI May, a: 49.4; c: 49.9; p: 50.1), due to strong declines in export orders - a direct effect of the ongoing trade dispute.

In Turkey, Q1-2019 GDP rose by 1.3% q-o-q (c: 1.3; p: -2.4) - lifted by: *i*) looser fiscal policy; and *ii*) state bank-led credit expansion - but fell by 2.6% y-o-y.

Financial Markets: Trade And Geopolitical Tensions Weigh On Performance Of Stocks And Bonds, Oil Prices Hit Three-Month Low

Market drivers: Trade war fears, geopolitical tensions and disappointing economic data keep pushing investors into haven assets. As President Trump threatened tariffs on Mexico, exacerbating growth concerns, stocks fell; the 10y/3m yield curve dipped to -12.3 bps, the most inverted since 2007.

Stocks: w-o-w, global stocks declined (MSCI ACWI, -1.9%), led by the US (S&P 500, -2.6%). Volatility rose (VIX S&P 500, +2.8 to 18.7, 52w avg.: 16.2; 10y avg.: 17.4).

Bonds: globally, indices rose w-o-w (BAML Global bond index, +0.4%). The 10y UST yield declined to 2.17%, hitting a fresh 20-month low. Yields on German 10-y bunds fell to -0.20%, matching the all-time low reached in July 2016.

FX: the USD appreciated against a basket of currencies (DXY, +0.1%) and the EUR fell (EUR/USD, -0.3% at 1.117). EM currencies rose (MSCI EMs, +0.1% at 1,618). FX volatility is rising, especially in Ems: the MXN lost more than 3% against the USD, reaching its lowest level of the year.

Commodities: Oil prices fell to a three-month low (Brent, -6.1% to 64.49 USD/b), driven by doubts over the outlook for global demand - due to: *i*) a worsening of the US-China trade war; and *ii*) the ongoing slowdown of the Chinese economy - putting oil on course for its worst month this year.



@RosaRoubini



Rosa & Roubini



Rosa&Roubini Associates

For more information, please call us on +44 (0)207 1010 718 or send us an email to info@rosa-roubini-associates.com

www.rosa-roubini-associates.com

118 Pall Mall, London SW1Y 5ED

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		



Rosa & Roubini Associates Ltd is a private limited company registered in England and Wales (Registration number: 10975116) with registered office at 118 Pall Mall, St. James's, London SW1Y 5ED, United Kingdom. VAT registration number GB 278 7297 39. **Analyst Certification:** We, Brunello Rosa and Nouriel Roubini, hereby certify that all the views expressed in this report reflect our personal opinion, which has not been influenced by considerations of Rosa & Roubini Associates' business, nor by personal or client relationships. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the views expressed in this report. **Disclaimer:** All material presented in this report is provided by Rosa & Roubini Associates-Limited for informational purposes only and is not to be used or considered as an offer or a solicitation to sell or to buy, or subscribe for securities, investment products or other financial instruments. Rosa & Roubini Associates Limited does not conduct "investment research" as defined in the FCA Conduct of Business Sourcebook (COBS) section 12 nor does it provide "advice about securities" as defined in the Regulation of Investment Advisors by the U.S. SEC. Rosa & Roubini Associates Limited is not regulated by the FCA, SEC or by any other regulatory body. Nothing in this report shall be deemed to constitute financial or other professional advice in any way, and under no circumstances shall we be liable for any direct or indirect losses, costs or expenses nor for any loss of profit that results from the content of this report or any material in it or website links or references embedded within it. The price and value of financial instruments, securities and investment products referred to in this research and the income from them may fluctuate. Past performance and forecasts should not be treated as a reliable guide of future performance or results; future returns are not guaranteed; and a loss of original capital may occur. This research is based on current public information that Rosa & Roubini Associates considers reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. Rosa & Roubini Associates, its contributors, partners and employees make no representation about the completeness or accuracy of the data, calculations, information or opinions contained in this report. Rosa & Roubini Associates has an internal policy designed to minimize the risk of receiving or misusing confidential or potentially material non-public information. We seek to update our research as appropriate, but the large majority of reports are published at irregular intervals as appropriate in the author's judgment. The information, opinions, estimates and forecasts contained herein are as of the date hereof and may be changed without prior notification. This research is for our clients only and is disseminated and available to all clients simultaneously through electronic publication. Rosa & Roubini Associates is not responsible for the redistribution of our research by third party aggregators. This report is not directed to you if Rosa & Roubini Associates is barred from doing so in your jurisdiction. This report and its content cannot be copied, redistributed or reproduced in part or whole without Rosa & Roubini Associates' written permission.

