Rosa & Roubini
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MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
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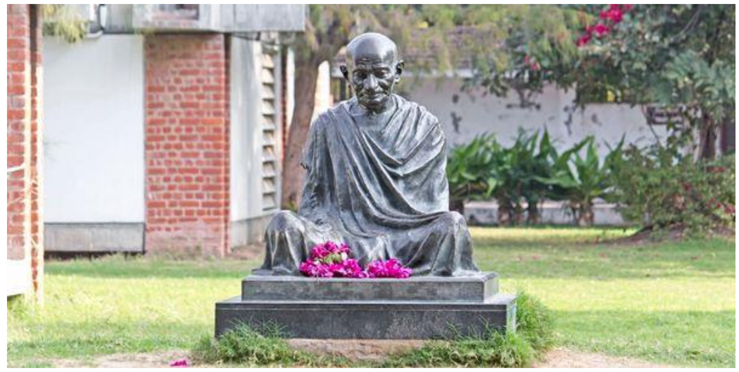

What Ever Happened To Prudence In Politics?

The level of recklessness existing in politics has increased remarkably during the past few years. This recklessness has produced unexpected outcomes and dangerous side effects that will impact certain countries for years to come. Examples of this phenomenon can be seen in most of the regions of the world:

Let's start with the UK. In 2016, PM David Cameron launched a referendum on the UK's participation in the EU. He made this decision as a way of solving the internal debate taking place within the Conservative party, which had been divided for years over this issue (and still is!). The referendum, only the fourth held in the country in 40 years, did not include any precautionary mechanism that could prevent a small majority from deciding the fate of the entire country and its four constituent nations. One could have included a minimum threshold in the referendum (e.g. requiring at least 55% of votes to validate the outcome), or a provision that would have required a majority vote to be achieved in the referendum within each of England, Scotland, Wales, and Northern Ireland. Instead, the Leave camp won by a narrow 52-48% majority, and the Brexit process was initiated in March of 2017.

In the two and a half years since then, the issue has still not been resolved. Partisanship in the country's political debate has reached levels not seen in decades. The new Prime Minister Boris Johnson is further radicalising this clash, shutting down parliament and threatening further constitutional stretches in coming days. All this just to increase the stakes in the UK's negotiations with the EU, to threaten the 27 with a no-deal scenario. This is yet another example of lack of a prudence being taken in contemporary politics.

Moving over to Italy now, we can see that other notable examples of political recklessness have emerged as well, in recent years. In 2016, Matteo Renzi launched a referendum on his plan for constitutional reform, which was very controversial. As if that was not enough, Renzi said that his political career depended on the outcome of that referendum, thus raising the stakes to the point of risking his entire government. The referendum did not pass. Years of discussions over how to change the country's constitution were wasted in a single day, and the government collapsed as well, paving the way to the Five Star and Lega victory in 2018.

Lega's Matteo Salvini made the same mistake in 2019: he pulled the plug on a government that was extremely popular at the national level (even if internally divided and quarrelsome). He bet everything on the fact that the PD and the Five Star would not make a deal with one another, and that the President would call early elections right in the middle of the budget season, thereby risking budget prorogation and market turmoil. All this did not occur, and so he lost power. In this case, this actually removed a risk factor from the political landscape; namely the possibility for Italy to leave the euro area. Nonetheless, the political calculus behind Salvini's gamble was not prudent, and could have cost the country dearly.

On the other side of the Atlantic, President Trump was after running a very divisive campaign, a campaign which radicalised the political landscape in the US and reduced the space available for cooperation between the two parties in Congress. After that, Trump started applying his "art of the deal" approach, consisting of assertive moves, veiled and not-so-veiled threats, and brinkmanship, to a number of situations: NAFTA, trade and tech disputes with China, the Iran nuclear deal, etc. This approach has made US leadership less predictable, leaving traditional allies confused. As a result of his trade wars and widespread uncertainty, the world economy has entered a slowdown, which affecting the US economy and risks jeopardising Trump's chances of being re-elected in 2020.

In Japan, meanwhile, PM Abe seems willing to spend all of his political capital on a referendum to change Article 9 of the country's pacifist constitution, even as public opinion remains opposed to such a change. Here too, we see a political leader making a bet that could backfire massively on himself. In this case, the bet is taking place in a country that has been fighting deflation for the last 30 years.

These are only a few examples, from four prominent G7 countries, of the recent increase in political recklessness. Other examples could be given as well, both in advanced economies and in developing countries. Brazilian President Bolsonaro's approach to the fires in the Amazon, for instance. Maduro and his mis-management of Venezuela. Argentina taking on the largest loan on IMF's history, only to default on it after one year. North Korea's development of a nuclear program. The list goes on. In our view, having political leaders who play with fire, as if there were no consequences to their mistakes, is very dangerous. When too many of them act in this same way, global risks increase and risk materialises in unexpected ways, with the result being that potentially catastrophic consequences can be realized following incidents that would otherwise have only minor negative effects.

Our Recent Publications

- ECB PREVIEW: ECB's Easing Package May Be Smaller Than Expected, By B. Rosa and N. Roubini, 6 September 2019
- **GEOPOLITICAL CORNER:** *Argentina Hurtles Toward The Abyss,* *by John C. Hulsman, 28 August 2019*

Looking Ahead

The Week Ahead: US Retail Sales Expected To Weaken And Chinese Trade Balance Narrows

In the US, retail sales are expected to weaken (c: 0.3%; p: 1.0).

In the EZ, the ECB is expected to announce an easing package.

In Japan, economic growth is expected to slow (GDP Q2, c: 0.3% q-o-q; p: 0.4).

In China, the trade balance is expected to narrow (c: USD 43.0bn; p: 45.1bn).

The Quarter Ahead: Geopolitical Tensions Remain High

In the coming weeks ***the US and China*** will hold face-to-face negotiations. Yet, a breakthrough is unlikely - as issues that stalled past negotiations remain unresolved, such as China's SOE sector and IP laws.

In the US, Fed's Chairman Powell stated that "economic growth will range between 2 to 2.5% this year", supported by: i) consumer spending; and ii) monetary easing, due to a weak global outlook, trade uncertainty, and muted inflation. Market expectations of 'one-rate cut' in September fell to 91.2% (p: 94.6).

In China, the CB will keep supporting bank lending, to counter the effect of the trade war with the US.

In the UK, on October 17-18 PM Johnson will attempt to secure a new Brexit deal at the EU summit in Brussels, as: i) the House of Lords voted to stop a no-deal exit; and ii) the opposition blocked a snap election on October 15. Conservative party members risk losing their seats if they fail to support the new Brexit deal.

In Iran, despite the European attempt at saving the nuclear deal, the government announced it will "no longer abide by the 2015 'uranium-enrichment accord'" and accelerate its nuclear research work.

Last Week's Review

Real Economy: Weak US And EZ Data Support Further CBs Easing

In the US, job gains were weaker-than-expected (Nonfarm payrolls Aug., a: 130K; c: 159K; p: 164K), but the labor market remains resilient, as: i) average hourly earnings beat forecasts (a: 3.2% y-o-y; c: 3.1; p: 3.3); and ii) the unemployment rate remains low (a: 3.7%; p: 3.7). For the first time in years, the manufacturing– hampered by trade tensions - showed signs of contraction (ISM Manuf. PMI Aug., a: 49.1; c: 51.1; p: 51.2).

In Germany, the industrial sector continues to weaken as factory orders fell by more than expected (Jul., a: -5.6%; c: -1.1; p: -3.6).

In Switzerland, economic growth slowed (GDP Q2, a: 0.2% y-o-y; c: 0.9; p: 1.0), with consumer spending weakening amid: i) trade tensions; and ii) a slowdown in neighboring Germany.

In Turkey, the contraction in economic growth was lower-than-expected (GDP Q2, a: -1.5% y-o-y; c: -2.0; p: -2.6). Disinflation readings (CPI Aug., a: 15.0% y-o-y; c: 15.5; p: 16.7) are supportive of further monetary easing.

In line with consensus, Interest rates were left unchanged ***in Canada*** (a: 1.75%), ***Australia*** (a: 1.0%) and ***Sweden*** (a: -025%).

In China, in an effort to support domestic demand, the CB reduced the RRR by 50 bps - to boost banks' ability to lend USD126bn. Manufacturing and sales data remain weak.

In Russia, the CB cut its benchmark lending rate by 25bps to 7% (c: 7%).

Financial Markets: Risky Assets (Equities, EM Bonds) Lifted By Upcoming Monetary Easing

Market drivers: risk-on sentiment was driven by: *i)* weak US and EZ economic data, as they support further easing; and *ii)* Fed Chair Powell's reassurance against a possible US recession.

Stocks: w-o-w, global stocks rose (MSCI ACWI, 1.9% to 521), driven by both DMs (S&P500, 1.8% to 2,979; Eurostoxx, +2.0% to 3,495) and EMs (MSCI EMs, +2.4% to 1,008). Volatility declined (VIX S&P 500, -4.0 points to 15.0, 52w avg.: 17.0; 10y avg.: 17.1).

Bonds: w-o-w, global indices fell (BAML Global bond index, -0.3% to 287.9), led by DMs (S&P Global, -0.4% to 112.0). Global corporate bond issuances rose to record levels, as companies sold more than USD140bn of debt. In the US, USD 72bn was raised w-ow, across 45 deals – equaling the total amount issued in August. The 10y UST yield rose by 4 bps, to 1.54. In Bahrain, the CBB sold debt worth BHD 166mn (USD 441mn); the issuance of three-month T-bills worth BHD 70mn was: i) oversubscribed by 194%; and ii) held weighted avg. interest rate 2.79%.

FX: the USD weakened (DXY, -0.5%) against a basket of currencies. The EUR and GBP rose (EUR/USD, +0.3% to 1.103; GBP/USD, +1.0% to 1.228). EM FX rose (MSCI EMs, +0.8% at 1,608).

Commodities: Oil prices were lifted (Brent, +1.8% to 61.5 USD/b) by: i) better prospects about the global growth outlook; and ii) declining US stockpiles. Gold fell (-0.9% to 1,506 USD/Oz.)

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The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*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*	*MPC*	*Monetary Policy Committee*
bpd	*Barrels per day*	*NAFTA*	*North-American Free Trade Agreement*
bps	*Basis points*	*NATO*	*North Atlantic Treaty Organization*
BS	*Balance sheet*	*OECD*	*Organization for Economic Cooperation and Development*
c	*Consensus*	*Opec*	*Organization of Petroleum Exporting Countries*
C/A	*Current account*	*p*	*Previous*
CB	*Central bank*	*P2P*	*Peer-to-peer*
CBB	*Central Bank of Bahrain*	*PBoC*	*People's Bank of China*
CBK	*Central Bank of Kuwait*	*PCE*	*Personal Consumption Expenditures*
CBT	*Central Bank of Turkey*	*PE*	*Price to earnings ratio*
CDU	*Christian Democratic Union, Germany*	*PM*	*Prime minister*
CNY	*Chinese Yuan*	*PMI*	*Purchasing managers' index*
CPI	*Consumer Price Index*	*pps*	*Percentage points*
DJIA	*Dow Jones Industrial Average Index*	*pw*	*Previous week*
DJEM	*Dow Jones Emerging Markets Index*	*QCB*	*Qatar Central Bank*
d-o-d	*Day-on-day*	*QAR*	*Qatari Riyal*
DXY	*US Dollar Index*	*QE*	*Quantitative easing*
EC	*European Commission*	*q-o-q*	*Quarter-on-quarter*
ECB	*European Central Bank*	*RE*	*Real estate*
ECJ	*European Court of Justice*	*RBA*	*Reserve Bank of Australia*
EIA	*US Energy Information Agency*	*RRR*	*Reserve Requirement Ratio*
EM	*Emerging Markets*	*RUB*	*Russian Rouble*
EP	*European Parliament*	*SWF*	*Sovereign Wealth Fund*
EPS	*Earnings per share*	*tn*	*Trillion*
EU	*European Union*	*TRY*	*Turkish Lira*
EUR	*Euro*	*UAE*	*United Arab Emirates*
EZ	*Eurozone*	*UK*	*United Kingdom*
Fed	*US Federal Reserve*	*US*	*United States*
FOMC	*US Federal Open Market Committee*	*USD*	*United States Dollar*
FRB	*US Federal Reserve Board*	*USD/b*	*USD per barrel*
FX	*Foreign exchange*	*UST*	*US Treasury bills/bonds*
FY	*Fiscal Year*	*VAT*	*Value added tax*
GCC	*Gulf Cooperation Council*	*VIX*	*Chicago Board Options Exchange Volatility Index*
GBP	*British pound*	*WTI*	*West Texas Intermediate*
GDP	*Gross domestic product*	*WTO*	*World Trade Organisation*
IMF	*International Monetary Fund*	*w*	*Week*
INR	*Indian Rupee*	*w-o-w*	*Week-on-week*
IPO	*Initial public offering*	*y*	*Year*
IRR	*Iranian Rial*	*y-o-y*	*Year-on-year*
JPY	*Japanese yen*	*y-t-d*	*Year-to-date*
k	thousand	*ZAR*	*South African Rand*
KSA	*Kingdom of Saudi Arabia*	*2y; 10y*	*2-year; 10-year*