# MAKING SENSE OF *THIS* WORLD — 2 December 2019

*R&R Weekly Column*
*By Brunello Rosa*


## An Eventful Weekend Shakes Germany's Political Landscape

Two important events shook Germany's political landscape this past weekend. On the left, the Social-Democratic Party (SPD) chose the radical couple Norbert Walter-Borjans and Saskia Esken as new co-leaders of the party, instead of finance minister Olaf Scholz and Klara Geywitz who they defeated in the party's leadership race. Scholz and Geywitz were perceived as champions of the status quo, which basically means the SPD remaining in the grand coalition with Angela Merkel's CDU. Walter-Borjans and Esken however have proposed a more radical platform, which requires the re-negotiation of the "coalition contract" and foresees the rupture of the grand coalition as a possibility.

At the opposite side of the political spectrum, Alternative für Deutschland (AfD) chose a relatively moderate (by AfD standards) ticket to lead the party, after the unifying figure of Alexander Gauland decided not to run again for the party's leadership in order to allow a generational changeover to occur (Gauland is 78 years old). The party, which already holds 94 seats in the German Bundestag (out of 709) and is the third largest party after the CDU and the SPD, chose as co-leaders Tino Chrupalla and Joerg Meuthen. Chrupalla is a legislator from Saxony, who will represent the former communist states of the East where AfD surged in three elections this year. Meuthen is a professor of economics in the industrial south-western state of Baden-Wuerttemberg. Contrary to the SPD's decision to choose a leadership ticket that may distance itself from Merkel's CDU, the unusually moderate choice by the AfD was specifically made to allow the AfD to become a potential ally of the CDU, at least at the local and state government levels.

The selection of these new leaders of the SPD and the AfD occured just over a week after the CDU confirmed Annegret Kramp-Karrenbauer (AKK) as leader of the CDU. Where do these events leave Germany, and what implications might they have for the broader European integration process?

From a domestic standpoint, Germany's political instability is now clearly on the rise. If the SPD does pull the plug on the government, Merkel might either lead a minority government, or try to strike another coalition deal, or call a snap election. In such an election, the Greens would likely emerge as the first party of the left, which would open up three options (assuming that no party has enough seats to govern alone): 1) *A CDU-Green grand coalition*, if the CDU emerges as the first party in the election. (But, such an outcome might not be the case if AKK remains as CDU party leader, as she might not be able to guarantee that the CDU will end up as the first party in the election); 2) *A new attempt of the Jamaica coalition* (CDU-Greens-Liberals); and 3) *an alt-left coalition between the Greens, the SPD and the Linke*. That is, assuming the three parties together have enough seats, and assuming the Linke compromises on key policies such as Germany's participation in NATO. In any case, it is clear that the myth of Germany's political stability is now a relic of the past.

For the broader European integration process (now that Ursula Von Der Leyen has been confirmed as president of the EU Commission) these political events could be either positive or negative. They might be positive if the ongoing political tsunami in Germany were to bring to power the Greens in a relatively stable coalition (a "grand" coalition with the CDU, a leftist coalition with the SPD and Linke, or the "Jamaican" coalition). The Greens are undoubtedly pro-Europeans even if in favour of fiscal discipline, and are advocates of the "green" new deal that in Europe is likely to become the proxy for much-needed fiscal stimulus. German politics might be negative for European integration, on the other hand, if the country's political instability were to lead to a stalemate within its own decision-making process: Germany remains the largest, richest and most influential country in Europe, without which no decisions are made. The events of the next few weeks will determine which of these outcomes will ultimately prevail.

### *Our Recent Publications*

- Flash Preview: RBA To Remain On Hold In December, While Remaining Dovish, *by Brunello Rosa, 29 November 2019*
- Flash Preview: BoC To Remain On Hold, With Some Risk of Easing, *by Brunello Rosa, 29 November 2019*
- Six 'Grey Swan' Events Could Hit The Global Economy And Markets In 2020, *By Alessandro Magnoli Bocchi, Fawaz Sulaiman Al Mughrabi and Farah Aladsani, 28 November 2019*
- **GEOPOLITICAL CORNER:** The Pivotal Brexit Election Could Change The Nature of the UK, *by J. Hulsman, 5 November 2019*

## ***Looking Ahead***

### ***The Week Ahead: Robust Labour Market In The US And Dovish Central Banks in Australia and Canada***

***In the US,*** in November the labour market is likely to remain robust (Nonfarm Payrolls Nov. c: 183K; p: 131K; Avg. Hourly Earnings, c: 0.3% m-o-m; p: 0.2; Unemployment rate; c: 3.6%, p: 3.6).

***In Australia and Canada,*** central banks are expected to leave their key interest rates unchanged at 0.75% and 1.75%, respectively.

***In Turkey,*** the Q3 GDP reading is expected to show an expansion (Q3, c: 1% y-o-y; p: -1.5).

### ***The Quarter Ahead: US And China Trade Deals Are Reaching The Final Stages***

President Trump stated that the ***US and China*** are in the "final stages" of a 'Phase I trade deal', despite China's warnings of retaliations against US legislation authorizing sanctions on Chinese officials responsible for human rights abuses in Hong Kong. The next round of US tariffs on Chinese goods is due on December 15.

***In the US,*** President Trump will present his defense in a public hearing by the 'Judiciary Committee' on December 4. Following weeks of hearings, the 'House Intelligence Committee' will release a report likely to state that "Trump sought foreign interference in US elections for his personal benefit". Market expectations of a Fed rate cut in 2020 fell to 63% (p: 67%).

***In the UK,*** early polls indicate a conservative-majority win in the December 12 general elections, which would empower PM Johnson to pass his 'Brexit-deal' by the January 31 deadline.

***In China,*** the PBoC's annual Financial Sustainability Report described 13% of the country's lenders as 'high risk' and warned against excessive corporate debt (165% of GDP in 2018); as a result, the CB is likely to enact measures to ensure that troubled banks*: i)* increase their capital*; ii)* reduce bad loans; and *iii)* limit dividends.

***In Saudi Arabia,*** Aramco's IPO attracted bids of USD 44.3bn; despite global investors' tepid interest, it remains on course to be the world's largest listing.

***In global oil markets***, the US is likely to consolidate its 'net exporter' status (for first time since the 1940s, in September the US became net exporter of oil), a reversal that could affect its foreign policy.

## ***Last Week's Review***

### ***Real Economy: Stronger-Than-Expected DM Data, with DM Headline Inflation Picking Up***

***In the US,*** the economy grew by 2.1% y-o-y, faster than the initial estimate of 1.9% (Q3 GDP, c: 1.9%; p: 2.0). The US domestic economy remains robust, as key economic indicators pick up: i) orders for durable goods rose faster-than-expected, by 0.6% m-o-m (Oct., c: -0.8; p: -1.4); non-defence capital goods orders – a proxy for business investment – rose above consensus, after two months of contraction (a: 0.1% m-o-m; c: -0.3; p: -1.8); and iii) personal spending rose (Oct., a: 0.3% m-o-m; c: 0.3; p: 0.2). In October headline inflation exceeded expectations, remaining at 1.3% y-o-y (PCE, c: 1.2; p: 1.3), while core inflation eased (Core PCE, a: 1.6% y-o-y; c: 1.7; p: 1.7). The NY Federal Reserve added USD 109 bn in temporary liquidity to the financial system. The intervention came in two parts: 1) via overnight repurchase agreements, or repos, that totalled USD 88bn; and 2) via a 15-day repo that totalled USD 21bn.

***In the EZ,*** economic sentiment picked up (a: 101.3; c: 101.0; p: 100.8), driven by improved consumer confidence (a: -7.2; c: -7.2; p: -7.6) and inflation accelerated (CPI Core Nov., 1.3% y-o-y; c: 1.2; p: 1.1; CPI, a: 1.0% y-o-y; c: 0.9; p: 0.7).

***In Germany,*** while the car industry announced cuts of 50,000 jobs, unemployment unexpectedly dropped (Unemployment change Nov., a: -16k; c: +5k; p: +5k).

***In Japan,*** key indicators weakened more-than-expected (IP, a: -7.4% y-o-y; c: 1.9; p: 1.3; Retail sales, a: -7.1% y-o-y; c: -4.4; p: 9.2), as a result of: *i)* weak external demand; *ii)* the recent sales tax hike; and *iii)* typhoon-related damages.

### ***Financial Markets: DM Equity Rise, But Uncertainty Justifies Caution On Risky Assets***

***Market drivers:*** Eased liquidity conditions and better-than-expected economic data lifted DM equities. Yet, investors remain cautious over: *i)* China's potential retaliatory actions; and *ii)* social unrest in EMs (HK, Chile, Lebanon).

***Stocks:*** w-o-w, global equity indices rose (MSCI ACWI, +0.6% to 547), led by DMs (MSCI World, +0.8% to 2,292; S&P 500, +1.0% to 3,141); EM stocks fell (MSCI EMs, -0.8% to 1,040).

***Bonds:*** Returns were flat w-o-w (BAML Global, +0.1% to 285.5).

***FX:*** w-o-w, the USD held flat against other currencies (DXY, +0.0% to 98.273), while the GBP strengthened (GBP/USD, +0.8% to 1.293). Pressure increased on Latin American currencies (USD/BRL, -0.9% to 4.236; USD/MXN, -1.0% to 19.562).

***Commodities:*** Oil prices fell (Brent, -1.5% to 62.4 USD/b) amid signs that supply will remain steady: at next week's meetings, Opec and allied producers are unlikely to increase production cuts; most likely, they will keep in place the current cuts.



***Farah Aladsani*** *contributed to this Viewsletter.*

*The picture in the front page comes from this website*

## Abbreviations, Acronyms and Definitions

| | | | |
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| *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* |