



R&R Weekly Column
By Brunello Rosa



Geopolitics And Politics Are In Motion At The Beginning Of 2020



The year has just begun, and geopolitical and political events are already accumulating. From a geopolitical perspective, the most relevant development has been the escalation of tensions in the Middle East, with the US and Iran likely to begin some form of direct and indirect military confrontation following [the killing of Iranian general Qassem Soleimani in Baghdad](#). US President Trump reportedly ordered the attack as a retaliation for an Iran-backed militia's attack of the US embassy in Iraq, and for [the killing of a US civilian contractor on an Iraqi military base in Kirkuk](#). These events followed months of provocations from Iran to which the US has not responded, including a drone attack on [Aramco's refinery facilities in Saudi Arabia](#). Tensions between the US and Iran have been on the rise since [President Trump decided to pull out of the JCPOA](#), the agreement between Iran and six international counterparts to limit the development of its nuclear program. That agreement was negotiated by Trump's predecessor Barack Obama in 2015. We have discussed the run-up to these events in [previous papers](#) and [scenario analyses](#), and shortly we will publish an updated scenario analysis, with its implications for oil prices.

From a political risk perspective, these developments have a clear bearing on the US political environment. As discussed in our recent 2020 global outlook, 2020 will be an election year in the US, and most of the macroeconomic and policy events will be driven by the developments in the US presidential race. To make things even more complicated, the [US President was impeached by the House of Representatives at the end of December](#), and his "trial" in the Senate will start soon. As we discussed in our [analysis of September 2018, regarding the risk of a global recession materialising in 2020](#), Trump might be tempted to "wag the dog" with military operations during his campaign for re-election, with Iran being the most likely designated target. The recent developments in the Middle East will surely help Trump obfuscate the news about his impeachment trial. He might also hope that the country will rally behind him in the event an overt conflict takes place, as it often does to presidents in similar circumstances. However, the political spectrum has thus far been divided by Trump's decision, which reportedly was not discussed and agreed to in advance with other political leaders.

In Europe, there are interesting political developments taking place in Spain and in Austria. In Spain, [Pedro Sanchez seems on the verge of being confirmed Prime Minister](#), with [a second vote](#) for his "investidura" on January 7th. He managed to strike a deal not just with Podemos, but also with the [independentist parties of Catalonia](#) and the [Basque Country](#). This solution is fraught with risks. The leader of the [Esquerra Republicana de Catalunya \(ERC\)](#), Oriol Junqueras, has spent the last couple of years in prison, and has been ordered to be released only recently, given his election to the European Parliament. Depending on the votes of ERC is clearly a gamble for Sanchez, considering that his government fell precisely because the Catalan parties did not support his budget. On the other hand, having both the Catalan and the Basque pro-independence parties in government could mean that a peaceful solution to Spain's domestic conflict is likely, [considering that the Catalans have always asked to be given at least the same powers and autonomy granted to the Basque Country](#) in return for dropping their quest for independence.

In Austria, following months of negotiations, the Chancellor [Sebastian Kurz managed to strike a deal to form a government with the leader of the Greens, Werner Kogler](#). This coalition between the conservative Austrian People's Party (ÖVP), which belongs to the European People's Party (EPP), and the Greens, could provide the model for the next German coalition government, if the next general election (scheduled for 2021) were to result in yet another hung parliament. Such a solution could stabilise Germany's political landscape, [and provide the platform to push further European integration and stop the ongoing process of European dis-integration](#). European political risk was another factor discussed in our September 2018 paper on the risk of a global recession in 2020. As the recent examples from Spain and Austria show, the news from this front is mixed, and worth following in coming months.

Our Recent Publications

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|  2020 GLOBAL OUTLOOK AND ASSET ALLOCATION - Despite The Improved Outlook, Beware of The Cracks , by Nouriel Roubini, Brunello Rosa, Alessandro Magnoli Bocchi, 16 December 2019 |  GEOPOLITICAL CORNER - Macron Rolls The Dice Over French Economic Reform And The Leadership Of Europe , by John C. Hulsman, 17 December 2019 |
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Looking Ahead

The Week Ahead: US Labor Market Expected To Remain Strong, EZ Consumer Spending Expected To Rise

In the US, labor market data are expected to indicate: *i*) a fall in nonfarm payrolls (c: 160K, p: 266K); *ii*) stable wage gains (Avg. hourly earnings, c: 3.1% y-o-y; p: 3.1); and *iii*) a low unemployment rate (c: 3.5%; p: 3.5).

In the EZ, consumer spending is likely to rise (Retail sales Nov., c: 2.1% y-o-y; p: 1.4). Core inflation will likely remain muted (Core CPI Dec., c: 1.3% y-o-y; p: 1.3), well-below the ECB's target of 'close to but below 2%', while higher energy prices are likely to have lifted the headline reading (CPI, c: 1.3% y-o-y; p: 1.0).

In Germany, manufacturing is expected to pick up (IP Nov., c: 0.7% m-o-m; p: -1.7; Factory orders, c: 0.1% m-o-m; p: -0.4).

In China, as of January 6th, the PBoC will cut commercial banks' RRRs by 50 bps. The move: *i*) will increase bank lending; by *ii*) releasing CNY 800 bn (USD 115 bn) of liquidity into the financial system.

The Quarter Ahead: Risk Of Escalation In Middle East Tension

In the US, President Trump ordered an airstrike that killed the high-profile Iranian general Qassem Soleimani. After the Baghdad attack President Trump stated: 1) the "Soleimani-airstrike was a pre-emptive measure" to "protect US personnel against attacks from Iran"; 2) the US does not want to 'start a war' with Iran; and 3) in a message delivered to Iran's supreme leader, Ayatollah Ali Khamenei: "the US are willing to talk"; however, negotiations are unlikely, as the Ayatollah vowed to "take tough revenge", and Iran's President Rouhani stated "the US will pay not only today but also in the years to come". While Iran's allies asked to expel the US military from Iraq, the US is expected to send 3,500 additional troops to the region, mostly via Kuwait.

In the US, the minutes of the Fed's December meeting showed confidence in their current monetary stance, given: *i*) overall robust labour market conditions, which could possibly improve further in 2020; *ii*) eased trade tensions; and *iii*) a more optimistic global economic growth prospects. The market-probability of a 'one rate hike' in 2020 rose to 41.2% (p: 2.1). The Fed expects to gradually transition away from the current active repo operations, as "ongoing purchases of short-term Treasury bills are expanding the banks' reserves". In September, as investors struggled to exchange high quality collateral (i.e. Treasury bills) for cash, reserves had dropped to an eight-year low. The liquidity squeeze faced in the repo market is widely believed to have been caused by the Fed's past attempts at balance sheet unwinding.

Last Week's Review

Real Economy: PMIs Weak In The US And Flat In China. Turkish Inflation Accelerated

In the US, manufacturing sector activity contracted at its quickest pace since the financial crisis, marking the lowest reading since June 2009 (ISM Manuf. PMI Dec., a: 47.2; c: 49.0; p: 48.1); in particular, the 'demand' and 'new orders' subcomponents kept contracting. However, sentiment for near-term growth prospects turned positive, given recent progress on the 'phase-one' trade deal with China.

In China, official PMI data were slightly above expectations (NBS Manuf. PMI Dec., a: 50.2; c: 50.1; p: 50.2) and the subcomponent 'new export orders' rose for the first time since May 2018. A private survey tracking manufacturing activity also pointed to expansion (Caixin Manuf. PMI, a: 51.5; c: 51.7; 51.8).

In Turkey, inflation accelerated faster-than-expected to 11.8% y-o-y (c: 11.5; p: 10.6), prompting Finance Minister Berat Albayrak to declare that in 2020 "stabilizing the inflation rate to single digits will be the top agenda item".

Financial Markets: Safe Haven Assets Uplifted By Rising Fears Of Conflict In The Middle East

Market drivers: Global equities fell and safe-haven assets - including gold and the Japanese Yen - rallied after a resurgence of Middle East tensions.

Stocks: w-o-w, global indices were flat (MSCI ACWI, +0.0% at 567), as DMs fell (S&P 500, -0.2% to 3,235; Eurostoxx 50, -0.2% to 3,773) and EMs rose (MSCI EMs, +0.5% to 1,124). The security and defense sectors gained. Volatility rose (VIX S&P 500, +0.6 points to 14.0, 52w avg.: 15.2; 10y avg.: 16.8).

Bonds: w-o-w, returns rose (BAML Global, +0.3% to 285.9) as yields fell across DMs (10y UST, -9 bps to 1.79%; 10y German bund, -3 bps to -0.28%).

FX: w-o-w, the USD and EUR weakened (DXY, -0.1% to 96.838, EUR/USD, -0.2% to 1.116). The JPY appreciated (USD/JPY, +1.2% to 108.080).

Commodities: w-o-w, oil prices rose (Brent, +0.6% to 68.6 USD/b). Immediately after the attack, Brent futures rose by 3.5% – the highest since the September attack on Saudi oil facilities. While US energy infrastructure in the Middle East is a likely target for Iranian retaliation, prices eased after reports of rising US inventories, as the markets remain concerned of a supply surplus. Gold approached a six-year high (+2.7% to 1,551 USD/Oz.).



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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	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



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