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MAKING SENSE OF *THIS* WORLD

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Italy: Governing Coalition's Fragility Persists, Despite Recent Victory In Regional Election

Two crucial regional elections took place in Italy a couple of weeks ago, one in Emilia-Romagna (in northern Italy) and the other in Calabria (in southern Italy). Lega's leader Matteo Salvini greatly increased the significance of the election in Emilia-Romagna, a region that has been a stronghold of the Democratic Party (PD), making the election appear, in effect, as a referendum on the government. As we discussed in our in-depth analysis following the election, if Lega's candidate Lucia Borgonzoni had won with a relatively ample margin, this could have led to the resignation of Nicola Zingaretti from the leadership of the PD. Since Di Maio had already resigned from his national leadership role in the Five Star Movement, a resignation by Zingaretti could have led to the collapse of the government altogether. Since Borgonzoni did *not* win, however, and since her opponent, the incumbent leader Stefano Bonaccini, won with a 7-point difference in the regional election, this scenario did not happen. So, Giuseppe Conte and his government could relax for the moment. Still, this respite might prove short-lived.

In fact, theoretically speaking, if the governing coalition manages to survive the additional round of elections in May/June 2020, the possibility for this parliament to last until 2022 (after the election of the new president), could be quite high, either with the current governing coalition or with a slightly different one. Elections in 2020 would become extremely unlikely and, if the coalition were to stick together for six more months from January to June 2021, then in September President Mattarella would lose his power to dissolve parliament. Thus the only theoretical window for an election would be between March and June 2021.

In reality, things might prove more complicated than this. Matteo Renzi is restless in his attempt to force a change of the Prime Minister, and is now using a parliamentary battle over the reform to the statute of limitations in criminal trials to re-launch his assault. An already fragile majority is vulnerable to defections in parliament, and the possible support from MPs from other parties (for example, from Forza Italia), would not be reassuring for PM Giuseppe Conte. He could become hostage to all sorts of vetoes. If MPs from a new party were to vote in favour of the government in a confidence vote, President Mattarella might call Conte for an update on parliamentary developments, and send him back to the Chambers for a new confidence vote, to re-assess the "perimeter" of the coalition supporting the government. The reality is that the Italian government remains fragile, and could collapse as a result of a parliamentary incident at any time.

What is the centre-right doing during all this? Salvini's Lega continues to poll above 30%, and Meloni's Fratelli D'Italia has now reached 10% in the polls, well ahead of Berlusconi's Forza Italia, which now struggles to get to 6%. Altogether, the centre-right coalition polls around 50%. Salvini's popularity remains very high, but not as high as it was previously. The belief in his infallibility has been now severely hit by two consecutive mistakes: his decision to make the Conte-1 government collapse in August 2019, and his decision to transform the regional election in Emilia-Romagna into a referendum on the government. He will soon face a vote in the Senate, which will decide whether or not he will have to stand a trial for "kidnapping" the migrants of the Gregoretti ship. And he will probably lose the constitutional referendum over making a cut to the number of MPs, which will take place in March. Investigations into "Moscow-gate" are continuing, meanwhile.

Can Salvini stage a comeback through all this, and so ascend to power in the coming months or years? Theoretically speaking, yes, he can, especially if the governing coalition proves incapable of sticking together. Polls suggest that Italians still seem inclined to give Salvini a chance to prove himself as PM. But the biggest obstacle to his final ascent to power is… himself. The recent re-organisation of Salvini's party shows that he might have understood the underlying problem that has led him to all the mistakes mentioned above. During his period in government, when he was gaining popularity, he managed to antagonise the US allies (his trip to Washington was reportedly a disaster), the Europeans (his preferred target), the Chinese (by not signing the MoU on the silk-road) and the Russians (with Moscow-gate). In addition, he antagonised the vast majority of the global economic and financial establishment, which fears a breakup of the Eurozone following a potential decision by Italy, led by Salvini, to leave the euro area. It will take time for Salvini to gain credibility within all these powerful circles.

So, somewhat ironically, the centre-right led by Salvini needs time to become a credible governing coalition. And the centre-left hopes to stay in power for as long as possible. These two converging tendencies might keep this parliament alive for longer than is currently believed, even if it remains true that an accident could occur that would bring down the government at any time.

Our Recent Publications

- Flash Preview: Riksbank on Hold, With An Eye On The Global Economy, While Considering the Introduction of an E-krona, *By Brunello Rosa and Nouriel Roubini, 7 February 2020*
- Flash Preview: RBNZ to Deliver A "Dovish Hold", *By Brunello Rosa and Farah Aladsani, 7 February 2020*
- Flash Review: A "Hawkish Hold" for RBA, But Rate Cuts Remain On The Table, *By Brunello Rosa and Fawaz Sulaiman Al Mughrabi, 4 February 2020*
- **GEOPOLITICAL CORNER:** The Olympian View: Mapping The Global Strategic Topography, *By John Hulsman, 28 January 2020*

Looking Ahead

The Week Ahead: Inflation Expected To Rise In China And US; Industrial Production Expected To Improve In The EZ

In the US, CPI inflation is expected to rise to 2.4% y-o-y (p: 2.3%), while core CPI is expected to fall to 2.2% y-o-y (p: 2.3%).

In the EZ, IP is likely to improve, while remaining in contractionary territory, at -0.9% y-o-y (p: -1.5%), and investor confidence is expected to improve to 12.7 (p: 7.6).

In China, CPI inflation is likely to rise to 4.9% (p: 4.5%), the highest rate since January 2012.

In Sweden and New Zealand, the central banks are likely to keep their key policy rates unchanged at 0.0% and 0.75%, respectively.

The Quarter Ahead: The Coronavirus Outbreak To Threaten Growth Prospects

Efforts to contain the ***coronavirus outbreak*** are hampering global growth prospects, as: *i)* global supply chains get disrupted; shipping companies that carry goods from China to the rest of the world are reducing the number of seaborne vessels. ***China*** is home to seven of the world's ten busiest container ports, and about 80% of 'world trade in goods, by volume' is carried by sea; *ii)* in DMs, key companies (e.g.: automakers) - struggling to find alternative suppliers to the world's largest manufacturer - are starting to halt factories; and *iii)* travel gets restricted and airlines cancel flights: according to the World Tourism Organization, when abroad Chinese tourists spend USD258 bn a year, nearly twice what US citizens spend. As a result, China's growth could decline to 5.5% in 2020, from 6.1% in 2019 – negatively impacting major economies across the world- as China accounts for roughly one-sixth of global economic output. To contain the slowdown, the government swiftly implement the recently signed trade agreement and slashed tariffs by 50% on USD 75bn of US imports. Officials stated that they will further cut tariffs on selected US goods to 5% from 10%, while levies on other items will be reduced to 2.5% from 5%.

In the EZ, ECB's Lagarde expressed worried about the coronavirus, but did not hint at any fresh policy moves to counter the new risks.

In the US, the markets expect the Fed to cut rates sooner than announced: the market probability of 'one or more' rate cut in 2020 stands at 82% (p: 88.5%).

Last Week's Review

Real Economy: The Coronavirus Outbreak Constraints The Recovery, Geopolitical Risks Ease

In the US, January's labour market data showed: *i)* above-consensus non-farm payrolls (a: 225k; c: 160k; p: 147k); *ii)* a higher-than-expected earnings growth (Avg. hourly earnings; a: 3.1% y-o-y; c: 3.0%; p: 3.0%); and *iii)* a still low unemployment rate, slight up from its previous 50-year low (a: 3.6%; c: 3.5%; p: 3.5%). In December, factory orders rose more-than-expected to 1.8% (c: 1.2%; p: -1.2%) – the largest gain since August 2018, mainly boosted by demand for transportation equipment. President Trump will remain in office, as the Republican majority Senate acquitted him on 2 impeachment counts.

In the EZ, December's retail sales rose less-than-expected, by 1.3% y-o-y (c: 2.4%; p: 2.3%).

In China, January's manufacturing fell below expectations, while remaining in expansionary territory (Caixin Manuf. PMI, a: 51.1; c: 51.3; p: 51.5).

In Turkey, inflation stayed in double-digits, and rose above-consensus to 12.2% y-o-y (c: 11.8%; p: 11.8).

In Australia, as expected the RBA kept its key policy rate on hold at 0.75% (p: 0.75).

Financial Markets: Stocks Rallied, Bonds Remained Flat, Volatility Fell, And Oil Prices Dropped

Market drivers: upbeat US labor data and China's tariff rollback lifted risk-on sentiment.

Stocks: w-o-w global indices rallied, erasing their earlier losses, driven by worries about the severity of the coronavirus' economic impact (MSCI ACWI, +2.7% to 574), driven by DMs (S&P 500, +3.2% to 3,328; Eurostoxx 50, +4.3% to 3,798). Volatility fell, but remains above the 52w avg. (VIX S&P 500, -3.3pts to 15.5; 52w avg,: 14.8; 10y avg.: 16.7).

Bonds: w-o-w, returns fell (BAML Global, -0.2% to 289.2), and DM yields recovered some losses, while remaining low – suggesting that: i) investors remain cautious; and ii) expectations of further Fed easing limit the upside (10y UST, +6 bps to 1.58%; 10y German bund, +6 bps to -0.38%). In MENA, fixed income supply in 2020 stands at USD 8.7bn – compared to USD 9.5bn over the same time period in 2019.

FX: w-o-w, the USD rose, boosted by strong manufacturing data (DXY, +1.3% to 98.684), while the EUR and GBP fell on 'Brexit trade negotiations' uncertainty (EUR/USD, -1.4% to 1.094; GBP/US, -2.3% to 1. 289).

Commodities: Oil prices fell sharply (Brent, -6.3% to 54.5 USD/b), led by concerns about China's upcoming slowdown, while OPEC and Russia have yet to agree on a unified position to contain the price slide. Gold fell (Gold, -1.3% to 1,570 USD/Oz), as increased risk appetite drove investors away.

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The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

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