



R&R Weekly Column
By Brunello Rosa



Political Risk Takes Centre Stage In US And Europe

In our [recent column](#), we noted how political risk was on the rise at the beginning of the year. This week will prove particularly challenging in this regard.

In the US, the inauguration of the 46th president in US history on January 20th, rather than merely featuring a speech by the new “leader of the free world”, as usually takes place, will instead be a highly risky event, with the state of emergency still in place [after the “insurrection” that occurred on January 6th](#), when Donald Trump supporters entered the US Congress to stop the parliamentary ratification of the electoral college vote. The FBI warned that there may be [armed protests in 50 states](#) planned on the day of the inauguration, organised by far-right movements. To make things worse, the incumbent [president said he will not attend the inauguration ceremony](#), thus opening a wound in the transition of power in the world’s leading democracy.

In Europe, [Italy is staging yet another government crisis](#). As is typical when centre-left governments are in power, a component of the majority detached itself in a sign of disapproval over the management of the pandemic and the process followed by the government in drafting the recovery and resilience national plan. Similar episodes occurred in 1998 when Rifondazione Comunista left Prodi’s first government, and in 2008, when UDEUR left the second Prodi government. The centre-right found itself in a similar situation in 2010 [when Fini’s component of the Popolo della Libertà left Berlusconi’s fourth government](#). On that occasion, the government managed to survive a confidence vote by parliament thanks to a group of MPs (the so-called “Responsabili”) coming from opposition parties which joined the majority.

As we discuss in [our in-depth scenario analysis](#), we believe that Giuseppe Conte is tempted to follow this example of the centre-right, by trying to find support in a group of MPs coming from the current opposition (or, from Italia Viva, Matteo Renzi’s party that has been part of Conte’s governing coalition until now). But this is proving harder than anticipated. At this stage, a new government with “Responsabili” coming from opposition parties, or a new pact with Italia Viva, seem the likeliest scenarios. Elections seem the least likely outcome, yet cannot be completely ruled out.

In Germany, Armin Laschet, currently the president of North-Rhine Westphalia, Germany’s most populous state, was [elected to succeed Annegret Kramp-Karrenbauer](#) as Chair of the CDU and, therefore, become the frontrunner to be the next Chancellor when general elections are held in September 2021. [We anticipated the potential election of Laschet in May 2018](#), when he was totally out of the political radar screen. Laschet [is a continuity candidate](#), so very reassuring in this respect, and he could easily lead a new centre-right coalition, or a new grand coalition with the SPD or the Greens after the elections. He may yet be challenged in his race to the become CDU/CSU candidate for the Chancellorship by Jens Spahn, the health minister whose effective management during Covid has boosted his profile at the national level, or by Markus Söder, the popular leader of the CDU’s Bavarian sister-party. In our view, [as we discussed in an in-depth analysis](#) of German politics, the main political weakness of Laschet is that he might leave the right flank of the party uncovered, as compared to Fredrik Merz. That political space on the right that may then be occupied by the AfD, thus posing risks to the Germany’s leadership in the European integration process.

Last but not least, *in the Netherlands*, [PM Mark Rutte and his cabinet resigned last week](#) in response to a child welfare fraud scandal. Rutte will, however, remain in office until the March 2021 general election, in which he hopes to be confirmed as party leader and Prime Minister. The election in the Netherlands has been one of the main reasons behind the slow ratification process by national parliaments of the Next Generation EU recovery plan. [This delay poses a serious threat to the actual implementation of the plan.](#)

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Looking Ahead

The Week Ahead: US And EZ Manufacturing PMI To Slow While Central Banks To Remain Accommodative

In the US: i) manufacturing PMI is expected to slow to 56.5 (p: 57.1); while ii) services PMI is likely to remain unchanged at 54.0.

In the EZ: i) manufacturing PMI is expected to decline to 54.6 (p: 55.2); while ii) services are likely to remain subdued, at 45.0 (p: 46.4).

Central banks to remain accommodative this week, i) ECB at 0.0%; ii) BoJ at -0.1%; and iii) Norges Bank at 0.0%.

The Quarter Ahead: US Stimulus Remains Uncertain; Vaccine Rollouts Face Difficulties; Central Banks To Remain Dovish

Over 2021-22, the global economy will continue to recover as vaccine roll-outs will help containing the coronavirus.

Monetary policy will remain accommodative, preventing DM sovereign bond yields from rising significantly, across the curve.

US Fed Chairman Powell noted that “the US economy could return to pre-coronavirus pandemic level fairly soon” thanks to “a torrent of monetary and fiscal aid over the past year”, referring to the nearly USD 4tn (USD 2.2tn in the ‘March CARES Act’, and USD 900bn in the ‘relief bill’) in direct fiscal stimulus approved by the Trump administration and Congress.

In the US, the ‘Center for Disease Control and Prevention’ (CDC) warned about an infectious COVID-19 variant, known as B117; at the moment, 76 cases were detected in 12 states, but “it could dominate the US by March”. US President-elect Joe Biden’s USD 1.9tn ‘economic stimulus plan’ is likely to face Republican resistance in Congress, highlighting challenges in securing bipartisan-backing for a sizeable relief package, despite Mr. Biden’s appeal for: 1) “unity, before and after the January 20 inauguration”; and 2) “a speedy approval of the stimulus plan, our top legislative priority”.

In the EZ, most governments will struggle with slow vaccine roll-outs, as Pfizer announced it: i) will delay deliveries to European countries; and ii) was required “extra regulatory approvals”, hence “estimated volumes of vaccine distribution may need to be adjusted”, as part of “efforts to deliver more doses than originally planned in total in 2021”.

In Hong Kong, the government is likely to delay the distribution of mainland ‘Sinovac’s COVID-19 vaccine’ because of “a lack of trial data” – raising concerns over a vaccine Beijing intends to distribute across most emerging markets.

Last Week’s Review

Real Economy: Vaccine Distribution Pace Remains Subdued; US Stimulus Faces Disputes

In the US, in the week ending on January 9 the ‘filings for unemployment benefits’ increased to 965k (c: 795k; p: 784k), the highest number since mid-August - amid record increases in COVID-19 cases, deaths, hospitalizations, and new restrictive measures across the country. In December: i) retail sales fell to 2.9% y-o-y (p: 3.7%); while ii) IP eased to -3.6% y-o-y (c: -4.6%; p: -5.5%) – the smallest decline since February 2020. December’s CPI inflation increased to 1.4% y-o-y (c: 1.3%; p: 1.2%), while core inflation remained mute at 1.6% y-o-y.

In the EZ, November’s IP eased by -0.6% y-o-y (c: -3.3%; p: -3.8%) – recording the seventh month of improvement.

In Kuwait, S&P affirmed the State’ ratings at ‘AA-’, with negative outlook.

Financial Markets: Global Equities Fall; Bonds Flat; A Stronger USD Weighs On Commodities

Market drivers: equity markets suffered a tense political situation in the US, due to ongoing efforts to remove President Trump from the White House, such as: i) the Democrats’ call to invoke the ‘25th Amendment’; and ii) the House of Representatives’ unprecedented ‘second impeachment’ of the president.

Global equities closed lower w-o-w (MSCI ACWI, -1.2%, to 656). In the US, the S&P 500 Index fell (-1.5%, to 3,768), dragged by: 1) poor retail sales data; 2) the communication services sector; and 3) the IT sector after social media companies Twitter and Facebook announced bans of President Trump and others from their platforms. In the EZ, Europe’s shares fell (Eurostoxx 50, -1.2%, to 3,600) as the resurgence in COVID-19 infections dented optimism about: i) a steady economic recovery; and ii) plans for further fiscal stimulus in the US.

Fixed income: w-o-w global bonds remained flat (BAML Global, +0.1% to 298.2), as well as USTs (-1 bp, to 1.10%).

FX: w-o-w, the USD traded higher against other currencies (DXY, +0.7%, to 90.772), while the EUR/USD fell (1.1%, to 1.208). Going forward, an improving risk appetite and lower real yields in the US are likely to weigh on the USD.

Commodities: Oil prices fell (Brent, -1.6% to 55.1 USD/b), as expanding lockdowns in China weighed on market sentiment, making an immediate global oil-demand pick up more unlikely, while a stronger USD dragged crude futures down. Gold prices fell (-1.2% to 1,827 USD/Oz.) as rising US bond yields increased the opportunity cost of the ‘safe heaven’ asset.



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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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