



R&R Weekly Column
By Brunello Rosa



Germany Is Facing Lengthy Negotiations Following An Inconclusive General Election

We have been discussing Germany's elections for months now. [In our initial piece of analysis](#), we discussed Germany's international position, noting how the CDU leader Armin Laschet was aiming for a more neutral position for the EU between the US and China. We discussed, for example, how Laschet took the German state of North-Rhine Westphalia, which he has run as Minister-President since 2017, and made it the hub for Chinese activities in the country. In [a second piece](#) on domestic politics, we noted how Germany, even with a new Chancellor, was ready to continue running the same course that Merkel has been leading the country on, as long as that new Chancellor is centrist and moderate. [In a final preview](#), we noted how the CDU/CSU were losing ground in the polls to the advantage of the SPD, and how this meant that Germany would need a three-party coalition to form a government.


This scenario has now materialised, with the polls closed and the [provisional results](#) showing the SPD ahead with around 26% of the votes, followed closely by the CDU with 24% and the Greens with 14.8%, the FDP with 11.5%, AfD with 10.3% and Die Linke (The Left) with 5%. What we already know is that we will need a three-party coalition to form a government, and such a coalition could be either the SPD, Greens and Liberals (the "traffic light" coalition), the CDU, Greens and Liberals (the "Jamaica" coalition), or the SPD, CDU and Greens (the "new Grand Coalition"). But other possible, albeit less combinations could also emerge, involving Die Linke or AfD.


Some of the lessons we can learn from these polls include the following:


- 1) The era of stability in Germany is effectively ended, with the fragmentation of the political system requiring a three-party coalition being formed following lengthy negotiations, which could last for months before a "coalition contract" is finally signed.
- 2) The impact on the European integration process could be significant, as Germany remains the cornerstone of every key EU decision. France with President Macron and Italy with PM Draghi seem ready to take the baton from Germany in leading the next phase of the integration process, in which important decisions need to be taken regarding foreign policy and defence matters, among other things.
- 3) A positive aspect of these elections is that the anti-EU, anti-system parties seem to be out of the picture for now, marginalised by the system. Clearly, though, these parties may be called in to help form a government if all other coalition options prove to be undoable.
- 4) As we [discussed in our recent column](#), this means that Germany remains committed to the European project, and that one of the three key elections of 2021-22 has not gone wrong just yet. However, the success of this election cannot yet be taken for granted either, and we still need to wait for the result of the Italian and French presidential elections in order to be sure that the EU integration process is not D.O.A.


Once the composition of parliament is completed it will become clearer what coalitions are actually feasible in parliament and not just on paper. It will be hard for anyone to form a government, but the ability of a party to form a coalition will be more relevant than finishing first in the polls. That is why Armin Laschet could still become PM even if the SPD end up the party with the most votes. It is likely that long negotiations will now begin, under the auspices of the President of the Republic Frank-Walter Steinmeier. Whichever coalition eventually emerges, Germany will express one of the weakest governments it has had in the last 40-50 years. This cannot be considered good for the rest of Europe.


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Looking Ahead

The Week Ahead: US GDP Growth Is Expected To Accelerate And Inflation To Rise In The US and EZ

In the US, Q2 GDP growth is expected to accelerate to 6.6% (p: 6.3%).

In the US, August's PCE price index is expected to remain at 4.2%, while core-PCE price index is projected at 3.5% (p: 3.6%).

In EZ, September's inflation rate is seen rising to 3.3% y-o-y (p: 3.0%), and core-inflation to 2.9% (p: 2.8%).

The Quarter Ahead: Delta variant of COVID-19 Continues Pressuring Global Economic Recovery; Biden Supports Tax Increase

The fast-spreading Delta variant of COVID-19 will slow the pace of the global economic recovery. In its latest quarterly report on the economic outlook, the OECD lowered its growth forecasts for the global and US economies in 2021. The OECD now expects global output to expand by 5.7% this year, down 0.1% from the previous forecast in May, with the outlook for 2022 improving to 4.5% growth, up by 0.1%.

DM economic activity weakens. The US and EZ economies slowed in September, as supply-chain bottlenecks and worries over the Delta variant weighed on businesses – adding to signs the global economy is experiencing a soft patch amid an uneven recovery, as PMI surveys will likely show. Manufacturing and services businesses in both the US and EZ are likely to report slower growth in activity, although the pullback is likely to be more pronounced in Europe.

Biden Expresses Support for Annual Tax on Billionaires' Unrealized Gains. The tax increase, being pursued by Senate Finance Chairman, would be among a number of tax provisions that Mr. Biden is seeking - to pay for a proposed USD 3.5tn spending plan that captures much of his first-term agenda.

Biden assembles the 'Quad'. After the recent moves that upset US close allies, US President Biden met with Australian, Indian, and Japan's PMs to share concerns over China's increasing clout in Asia. However, at the UN General Assembly President Xi Jinping warned against 'the practice of forming small circles or zero-sum games'.

CBs begin to turn hawkish. US Fed prepares for future rate hikes, though they appear to be at least "a year in the future". Fed officials indicated that they are ready to begin "tapering the stimulus provided during the pandemic". Over the course of the COVID-19 crisis, bond purchases have added more than USD 4tn to the Fed's balance sheet, which now stands at USD 8.5tn.

Last Week's Review

Real Economy: Economic Growth Beginning To Slow, As Inflationary Pressures Are Transitory.

In the US, preliminary data for September's PMIs showed: *i*) manufacturing softening to 60.5 (c: 61.5; p: 61.1), the slowest growth in factory activity in 5 months; and *ii*) services declining to 54.4 (c: 55.0; p: 55.1), as 'new business' eased for the fourth month running - amid weakening demand and ongoing COVID-19 worries.

In the EZ, preliminary data for September's PMIs showed: *i*) manufacturing softening to 58.7 (c: 60.3; p: 61.4), marking a third successive month in which growth has slowed; and *ii*) services declining to 56.3 (c: 58.5; p: 59.0), as supply chain constraints affect service providers.

In Norway, Norges bank become the first G10 CB in to hike its interest rate by 25bps to 0.25%. **In other DMs**, CBs in US, Japan, UK, Sweden and Switzerland all kept their interest rates unchanged (Fed: 0.25%; BoJ: -0.1%; BoE: 0.1%; Riksbank: 0.0% and SNB -0.75%).

In Turkey, the CBT lowered its one-week repo rate by 100bps to 18%, claiming that the tightness of their policy stance had "created a larger-than-expected contractionary effect on commercial loans".

Financial Markets: Global Stocks Gain Momentum; Bonds Flat; USD Weakens; Gold Rises

Market drivers: investors remain optimistic, despite: *i*) a move from the PBoC to ban cryptocurrencies; and *ii*) mounting concerns over a potential default from Evergrande.

Global equities rose slightly w-o-w (MSCI ACWI, +0.1%, to 730). In the US, the S&P 500 Index advanced (+0.5% w-o-w to 4,455), as: *i*) energy stocks outperformed; while *ii*) utilities shares lagged. In the EZ, shares gained (Eurostoxx 50, +0.7 to 4,159), as: *i*) optimism about a continuing economic expansion offset concerns of a gradual CB support withdrawal; while *ii*) lingering worries about Chinese property developer Evergrande curbed gains. In EMs, equities fell (MSCI EMs, -1.1%, to 1,265), as Chinese stocks were mute (Shanghai Comp., 0.0%, to 3,613). **Volatility** fell (VIX S&P 500, -3.0 points to 17.8, 52w avg.: 21.2; 10y avg.: 17.3).

Fixed Income: w-o-w global bonds fell (BAML Global, -0.4% to 295.4), while UST yields rose (+9 bps, to 1.45%), highest since July 5.

FX: w-o-w, the US Dollar Index rose slightly (DXY, +0.1%, to 93.327; EUR/USD -0.1%, to 1.171). In EMs, currencies fell against the USD (MSCI EM Currency Index, -0.2% to 1,729).

Commodities: Oil prices rose (Brent, +3.7% to 78.1 USD/b), amid global supply concerns following storms in the US. Gold prices fell (-0.2% to 1,750 USD/Oz), hit by a series of hawkish signals from major CBs.



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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