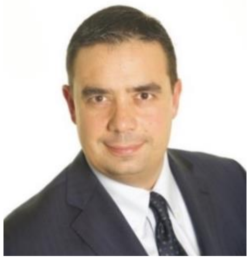
Rosa & Roubini
ASSOCIATES

MAKING SENSE OF *THIS* WORLD

31 January 2022



R&R Weekly Column
By Brunello Rosa

Mattarella's Re-election Eases Short-Term Concerns in the EU

Sergio Mattarella was re-elected Italy's President of the Republic on Saturday, after seven inconclusive ballots. Nervousness had been mounting in political circles, as well as in the country at large, for the inability of the electoral college (made up of MPs and regional representatives) to converge on a figure who would be able to win at least 505 out of the 1009 "grand electors". The political leaders of the parliamentary majority that supports Draghi's government decided in the end to converge on Mattarella, the only name that would find unanimous support (with the exception, perhaps, of Fratelli d'Italia).

This is the most reassuring outcome that one could hope for in the short run, as it guarantees total institutional and governmental continuity. Mattarella is well-respected internationally and is able to guarantee Italy's position within the geopolitical landscape. Draghi, moreover, will remain PM, guaranteeing the implementation of the country's recovery plan, which gives access to the funds of the NextGenEU. For these reasons, this political solution is by far the most favoured by market participants (as we discussed in this interview).

On the other hand, Mattarella's re-election only postpones the resolution of the uncertainty about Italy's medium-term institutional setting by a couple of years, pushing it back to after the election of the country's next parliament in 2023. In fact, Mattarella will likely resign as soon as he perceives that a majority can be found in the new parliament to elect his successor, possibly in early 2024.

Draghi will also start encountering difficulties as PM, as political parties will likely be less willing to accept his decisions in the year ahead of the general election. Furthermore, the fact that the political parties that support his government could not agree on his name to become the next president, even after four or five inconclusive ballots, reveals that they do not want to give him *carte blanche* on every issue.

Additionally, if one needed further proof of the inability of Italy's political system to achieve even the most basic goals, this election showed that parties cannot even discharge their duty of electing Italy's top institutional figure. The complaints that political leaders often make about being subject to the rule of technocrats are therefore totally mis-placed. They had the chance of showing effectiveness in their actions, and failed miserably. But this is hardly a surprise.

If we look at the broader European political landscape, we said that 2021-22 was the crucial period to test the resilience of the European construct. If any of the German general election, Italian Presidential election and French Presidential and parliamentary elections were to "go wrong", the survival of the European project itself would be at risk. German elections have delivered a very fragmented parliament, but a "traffic light" majority, however heterogeneous and weak, ultimately emerged. Italy kicked the can down the road. Now it is France's turn.

In France, Macron is still ahead in the polls and may be re-elected, but the emergence of Valérie Pécresse as leader of the Republicans will make the June parliamentary elections more uncertain, with Macron possibly forced to his first *co-habitation*. In any case, both Macron and Pécresse are mainstream politicians and would keep France on track with the European integration process. A different story would be if Eric Zammour or Marine Le Pen were to prevail, though this outcome remains only a risk scenario at this stage.

Two out of three electoral risks have not materialised so far, and the third – France's – is unlikely to. This bodes well for the continuation of the EU integration process. But EU leaders need to remain alert, as populist parties are still strong in many countries of the Union, including in France and Italy.

Our Recent Publications

- Flash Preview: ECB To Further Clarify Its Policy Stance After March, *by Brunello Rosa and Nouriel Roubini, 28 January 2022*
- *Flash Preview: BoE To Increase Rates Again To Keep Up With Inflation Surge, by B. Rosa and Nato Balavadze, 28 January 2022*
- Flash Review: Fed Confirms First Hike in March and Mulls Balance Sheet Run-off, *by B. Rosa and Nato Balavadze, 27 January 2022*
- *Flash Review: Hawkish BOC Flags Upcoming Rate Normalisation, by Brunello Rosa and Nato Balavadze, 27 January 2022*

Looking Ahead

The Week Ahead: US Weak NFP Expected, While EZ Shows Slower GDP Growth and Lower Inflation, With BOE Likely To Raise Rate

In the US, in January NFP are expected to show a 155k increase (*p.*199K), with unemployment rate remaining unchanged at 3.9%.

In the EZ, *i)* Q4 GDP is expected to slow down to 0.3% q-o-q (*p:* 2.2%) and 3.9% y-o-y (*p:* 4.7%); *ii)* in December unemployment rate is likely to decrease to 7.1% (*p:* 7.2%); *iii)* in January headline inflation and core inflation are seen falling to 4.3% y-o-y (*p:* 5.0%) and 1.9% y-o-y (*p:* 2.6%) respectively; *iv)* in December retail sales are likely to contract by -0.5% m-o-m (p: 1.0%) and decrease to 5.4% y-o-y (*p:* 7.8%); and *v)* ECB is expected to keep its policy stance unchanged.

In the UK, BoE is expected to raise its base rate to 0.5% (*p:* 0.25%).

The Quarter Ahead: Tensions over Ukraine Rise; IMF Cuts 2022 Global Growth; Qatar to Discuss Gas Supply to Europe

Ukraine tensions simmer, as Biden warns Putin may invade Ukraine next month. Officials in Moscow said that their principal concerns were not addressed by US and NATO. In case of invasion, Nord Stream 2 pipeline, running from Russia to Germany and doubling Russia's gas exports to Germany, could face serious sanctions. In addition, the US calls for a public UN Security Council meeting to discuss "threatening behaviour by Russia" on January 31, a day before Moscow takes over the rotating presidency of the council. NATO allies discuss deploying more troops to Eastern Europe.

IMF downgraded the global growth forecasts in its World Economic Outlook Update o*f *January 2022, as slower expansions are expected in the two largest economies – the US and China. IMF projects that global GDP growth will weaken from 5.9% in 2021 to 4.4% in 2022. Increasing COVID cases in addition to surging inflation and higher energy prices are seen weighing on economic activity. IMF warned about market's sell-off, as central banks turn hawkish.

US regulator bans Chinese state-owned telecom company Unicom over national security and espionage concerns. In addition to that, in November, the US government already added a number of companies to its restricted trade list.

Qatar's ruling emir and Biden are expected to discuss Europe energy concerns during the meeting at the White House on January 31. Qatar explores providing short-term emergency liquid gas to Europe, facing serious shortages if Russia ceases supplies.

Last Week's Review

Real Economy: EZ GDP Slows Down; US GDP Advances, While Inflation Is on the Rise

Among the largest Euro Zone economies, according to the preliminary estimates, Q4 GDP growth *i)* contracted by 0.7% (p: 1.7%) in Germany; and *ii)* slow downed to 0.7% (p: 3.7%) in France.

In the US, *i)* Q4 GDP advanced by 6.9% q-o-q (c: 5.5%; p: 2.3%) stronger than expected; *ii)* PCE and core-PCE price index rose to 6.5% q-o-q (*p:* 5.3%) and 4.9% (*p:* 4.6%) respectively; *iii)* in January, the IHS Markit US Composite PMI decreased to 50.8 (*p:* 57.0), as manufacturing PMI and services PMI both fell to 55.0 (*p:* 57.7) and 50.9 (*p:* 57.6) respectively well below the market expectations; and *iv)* the Fed left its funds target range unchanged at 0-0.25%.

Financial Markets: Stock Markets Are Down; Bond Yields Rise; Dollar Strengthens

Market drivers: Most major benchmarks pulled back in response to rising interest rate fears and growth worries. Investors pay close attention to geopolitical risks, involving tensions in the Middle East and Eastern Europe, amid rising oil prices. Escalating the Ukraine crisis and deterioration of relations between Russia and the West also weighed on investor sentiment. On the other hand, Apple reports a record revenue providing encouragement for tech and US markets.

Global Equities fell w-o-w (MSCI ACWI, -2.5%, to 695). The US S&P 500 Index fell (-0.6% w-o-w, to 4,370). In the EZ, shares also decreased compared to last week (Eurostoxx 50, -2.2% w-o-w, to 4,137) dragged by losses in auto and technology stocks. In EMs, equities fell (MSCI EMs, -4.2%, to 1,192). Volatility rose to 28.4 (VIX S&P 500, 52w avg.: 20.7; 10y avg.: 17.8).

Fixed Income: w-o-w, UST yields (+1.4 bps, to 1.78%) and German 10-year bonds (+1.3 bps, to -0.54%) rose as investor sentiment grow that the Federal Reserve will raise interest rates in the months ahead.

FX: w-o-w, the US Dollar Index rose (DXY, +1.5%, to 97.12; EUR/USD -1.6%, to 1.116), lifted by hawkish messages, possible withdrawal of pandemic-era stimulus and rising geopolitical risks over Ukraine. In EMs, currencies decreased against the USD (MSCI EM Currency Index, -0.5% w-o-w, to 1,734).

Commodities: w-o-w, oil prices extended gains, hitting 7-year high due to supply shortage concerns as well political risks in Ukraine and the Middle East that could disrupt energy markets (Brent, 1.6% to 89.3 USD/b). w-o-w, Gold prices fell following hawkish comments from Fed (-2.7% to 1,783 USD/Oz).

***Nato** Balavadze contributed to this Viewsletter.*

The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

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*