Global markets: Five events to watch this week

Weekly Market Compass: Tracking elections in Europe and India, and several reports in the US

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It seems that so much happens in a given week these days. However, this week could be particularly momentous as we start to get answers on some key questions that have implications for global markets. Here are five events to watch:

European parliamentary elections

Elections will occur this week in countries that are part of the European Union, with results to be released next Sunday, May 26. There is concern that the rise of economic nationalism and populism could result in populist/nationalist parties garnering more votes in these elections than already expected. However, I believe they are unlikely to cause any kind of market de-stabilization for two reasons. First of all, centrist parties, which are more adept at compromise, are likely to form a "grand coalition" that enables them to retain power. In addition, even when we have seen nationalist/populist parties come to power, there has been little impact on the bond market immediately after the election. In both the Portugal 2015 legislative election and the 2018 Italian general election, it was only when concerns about unsustainable debt and even the possibility of a debt downgrade arose that spreads widened.[1] There are some other potential ramifications with regard to these elections which I believe are worth discussing:

- The outcome of these elections could undermine certain governments. For example, it appears that Nigel Farage's Brexit party may garner more votes in the UK than Theresa May's Conservative party. This could undermine May's continued leadership, perhaps prompting Tory leaders to work behind the scenes in an attempt to force her to resign.
- As a result of the Spitzenkandidaten process, the European Union (EU) Parliament has gained more power. In particular, it now has some control over the "short list" for the President of the European Commission, from which heads of state will choose the successor to Jean-Claude Juncker.
- Most important is the appointment of the next head of the European Central Bank (ECB), which will be indirectly related to the outcome of these elections. According to EU rules, the ministers of Economy and Finance of the EU must consult with the European Parliament and the ECB Governing Council, and then choose an ECB President "from among persons of recognized standing and professional experience in monetary or banking matters" after the recommendation of the EU Council. There is a view that the next ECB president may need to hail from a northern European country given that the last two ECB presidents came from southern European countries. As I have written before, this selection has the potential to drive up systemic stress and lower business confidence if he or she is more hawkish.

FOMC minutes and Fed officials' speeches

When the Federal Reserve (Fed) last met, US-Sino trade negotiations had been moving smoothly and an agreement was expected imminently. And so, from that perspective, the Federal Open Market Committee (FOMC) minutes might seem to be irrelevant. However, we will want to review the minutes carefully for a greater understanding of what could trigger the Fed to cut rates this year and, conversely, what could trigger the Fed to raise rates this year.

Fed Chair Jerome Powell has recently alluded to "transitory" sources of lower core inflation, which suggests the Fed might not lower rates to stimulate inflation. Conversely, some Fed officials have advocated raising the Fed's inflation target to more than 2% – or changing the inflation target to an average of 2%. For example, just last week Minneapolis Fed president Neel Kashkari argued that, for the Fed's inflation framework to be effective and credible, it must allow inflation to climb modestly above 2%. This suggests that perhaps the Fed could lower rates in order to meet that higher target.

We may learn more from Fed officials' speeches this week, as we will be hearing from Powell, Vice Chair Richard Clarida, Chicago Fed President Charles Evans, Boston Fed President Eric Rosengren and St. Louis Fed President Jim Bullard. I hope that the current tariff war situation may be addressed, given its potential to increasingly negatively impact the US economy the longer it drags on.

Indian election results

After weeks of voting, election results will be announced this week. There are concerns about the outcome, given exit polling. However, I believe Prime Minister Narendra Modi will secure a second term. The Bharatiya Janata Party (BJP) is likely to remain the largest party in Parliament – though it may well lose the outright majority it won in the 2014 general elections (which had been the first in many years). And I expect a more fragmented Indian parliament with more power for the opposition alliance. That likely means that critical reforms – including labor market liberalization of hire and fire rules, and land acquisition reform to boost investment and efficiency in the industrial and agricultural sectors – could face an even more difficult time. Against that, Modi is likely to continue his reform agenda with the streamlining of India's bureaucracy, especially if his larger reform agenda is stymied in parliament by stronger opposition parties (given that the bureaucracy is an area where Modi can maneuver without parliamentary backing for legislative reform). In addition, he is also less likely to engage in radical experimental reforms or overrule expert advice as he evidently did with demonetization itself. In my view, the net effect of these changes is that the markets are likely to remain relatively well-supported and the growth rate is likely to remain solid – in the high single digits where it is now.

US durable goods report

While some parts of the US economy are showing impressive strength, last week saw the release of a disappointing industrial production report. This follows a disappointing ISM Manufacturing Index reading – especially the new orders sub-index. I worry that manufacturing firms are being hurt by existing tariffs – and it could worsen given the deterioration in the US-China trade relationship. This could, of course, negatively affect durable goods orders, so we will want to follow this closely.

US retail earnings reports

A number of retailers will be reporting earnings this week. I will be paying close attention to what they share on their calls about the health of the US consumer. Recall that consumer sentiment is at a strong high right now. But we want to see if US retailers expect that to translate into strong spending in coming months.

Looking ahead to longer-term events

In addition to these five immediate events, there are several longer-term issues that I'm paying attention to:

Developments in the trade war. Markets reacted positively to two recent developments in the US: 1) that the Trump administration will postpone applying auto tariffs on imports from the European Union and Japan for as much as six months; and 2) the Trump administration is eliminating steel tariffs for Canada and Mexico. Stocks moved up on the news, as it seemed to indicate that the Trump administration is willing to negotiate and be flexible when it comes to trade negotiations. However, I believe that is a misreading of these developments. I think the US is desperate to take attention away from the deterioration in trade relations between the US and China by providing some positive news flow vis a vis trade. In addition, I believe that the US may now realize that traditional allies could help it place pressure on China, and is now trying to win them over after alienating them with trade conflicts of their own.

US-Iran tensions. The rise in tensions between the US and Iran has largely been overlooked because of the US-China trade situation. I worry that tensions will continue to rise between the two nations. There is even the potential for an accidental war to start. We will want to follow the situation closely as this has the potential to draw many nations into a major military conflict.

Bitcoin. Some strategists are suggesting that the recent rise in bitcoin is tied to growing expectations of a recession to come soon. There is no historical data to follow given that bitcoin is a fairly new creation, and I am very skeptical about this conclusion. However, the ups and downs of bitcoin are well worth following for the messages they could be sending about a variety of market conditions, including how "risk on" or "risk off" capital markets may be.

Gold. Similarly, some strategists are suggesting the rise in gold is tied to greater concerns about the breakdown in trade negotiations between the US and China. This makes sense, in my view, especially given the power of tariffs to be inflationary.

Source

[1]A spread represents the difference between two values or asset returns – in this case, spreads widened between Portuguese bonds and German bunds, and between Italian bonds and German bunds.