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## MACRO NEWS

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### **POLITICAL UPDATE: JAPAN, SPAIN, ITALY, GERMANY, BREXIT**

#### Berenberg Macro Flash

##### **JAPAN'S SNAP ELECTION STRENGTHENS ABE**

Japanese prime minister Shinzo Abe's decision one month ago to call snap elections has paid off handsomely. With a few seats still to be declared, the latest projections indicate that Abe's Liberal Democratic Party-led coalition probably won 312 of the 465 seats in the lower house to secure the critical two-thirds supermajority. This increases the chances that Abe will succeed to reform Japan's pacifist constitution, enabling Japan to take a more assertive approach to foreign policy. To alter the Japanese constitution, two-thirds of lawmakers must back any proposed revisions, which must then be supported by a majority in a national referendum. In the economic sphere, Abe will likely step-up his fiscal and supply-side reform efforts which have raised Japan's potential growth, for instance by dramatically increasing its level of female labour market participation. We also expect Abe to reappoint BoJ governor Haruhiko Kuroda next March. Further reforms and an aggressive monetary policy will likely set the stage for the Japanese economy and its financial markets to sustain their recent positive momentum. For a more detailed update on the Japanese economy, please see the recent note from Mickey Levy, "[Japan: Ride the positive economic profit wave](#)".

##### **CATALONIA: CLOSER TO THE ENDGAME**

Unfortunately but unsurprisingly, it may get worse before it gets better. With no support from Europe and not even a sufficiently convincing mandate from their own voters, the leaders of the Catalan independence movement cannot win the current standoff with Madrid, in our view. Even without any intervention from Madrid, the erosion of Catalonia's tax base as more than 1100 companies have already announced a shift of their headquarters from Catalonia to other parts of Spain is undermining whatever economic rationale the region may have had for its bid to go it alone. The risk is now that, trapped in a cul-de-sac largely of their own making, the Catalan regional leaders may prefer to go down with a bang rather than yield with a whimper, hoping to enter history books as heroes of resistance rather than as mavericks who got it wrong.

Following the refusal of the Catalan regional leader Carles Puigdemont to answer the question whether or not he has already declared independence, Madrid has started the proceedings according to Article 155 of the Spanish constitution to take control of the Catalan regional government as well as the region's police, its finances and its public media. New elections in Catalonia will follow within six months, possibly as early as January. The Spanish Senate will likely approve the approach on Friday. Meanwhile, Catalonia's regional parliament may discuss whether to formally declare independence on Monday. If so, it could fuel tensions further. In case Madrid then attempts to arrest Puigdemont, protests may escalate for a while with a risk of some civil disobedience against Madrid from parts of a deeply divided Catalan society. After a period of significant noise and modest economic damage, the situation would probably ease somewhat thereafter. Whether or not the standoff will do lasting damage, driving more Catalans into the camp of the more radical pro-independence groups, will largely depend on how massively Madrid intervenes and what Madrid offers Catalonia in later talks about a constitutional reform. For now, we maintain our assessment that the Catalan conflict will weigh modestly on Spanish GDP growth in late 2017 and early 2018, cutting Spain's growth rate for the full year 2018 to 2.7% instead of the 2.9% which the country could have achieved otherwise. Please see recent note "[Catalonia: First signs of a return to reason?](#)".



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### ITALY: FAR AWAY FROM THE CATALAN PROBLEM

In separate referenda, two of Italy's richest regions voted overwhelmingly for more regional autonomy. Is Italy heading towards Catalan-style conflicts? No, not at all. Beyond a general yearning for change and a hope in richer regions that they may have to transfer less money to poorer regions in the future, we see few parallels between the current Italian and the Spanish regional issues. Instead, the situation in Lombardy and Veneto differs from Catalonia in three key respects: (i) the non-binding regional votes were for more autonomy, not for outright independence; (ii) the referenda were held on the basis of the Italian constitution, not against the national constitution as in Catalonia; (iii) Italy's mainstream political parties were either in favour of more autonomy for the regions or roughly neutral on the issue. The popular votes in Italy – and possibly similar initiatives in other Italian regions – will be followed by lengthy negotiations between the regions and Rome over constitutional reforms. Whatever these talks may or may not yield after a process that could take years, a Catalan-style escalation looks extremely unlikely.

### GERMANY: JAMAICA IN WINTER?

Farewell to finance minister Schäuble. When Germany's new parliament convenes for the first time on Tuesday, Wolfgang Schäuble looks set to take on his new role as president of the Bundestag in charge of teaching manners to potentially unruly MPs of the right-wing AfD. From Tuesday onwards, chancellor Angela Merkel and her government, including interim finance minister Peter Altmaier, will formally be in a caretaker position until parliament re-elects Merkel for a fourth term. Talks about forming a "Jamaica" coalition between Merkel's "black" CDU/CSU, the "yellow" FDP and the Greens reportedly started fairly well last week. The very fact that Schäuble leaves his office as finance minister with a fiscal surplus of close to 1% of German GDP makes it possible to grant all parties at least some of their wishes without busting the budget. We look for a modest fiscal stimulus of at least 0.3% of German GDP next year. Nonetheless, it won't be easy to find compromises on key contentious issues such as migration. As a result, it seems a little more likely that the new government will finally be formed in January rather than just before Christmas. Will it make a big difference? Not really. If key decisions, for instance about foreign policy and European issues, really had to be taken beforehand, the parties locked in intense coalition talks would probably be able to do so whenever needed.

### BREXIT: EU27 EXTENDS AN OLIVE BRANCH TO THERESA MAY

Recent reporting in some of the British press that Brexit negotiations are on the brink of collapse seems to be at odds with reality. Last week's EU summit did not yield any hard progress on the key elements of Brexit. The bill, citizens' rights and the Irish border question. However, key players in the EU camp signalled with a more positive rhetoric that they acknowledge the recent softening of the UK position as laid out by prime minister Theresa May in her Florence speech. For example, EU president Donald Tusk noted that while progress remains insufficient to advance to post-Brexit trade talks, the "reports of the deadlock ... have been exaggerated". Furthermore, Reuters report that EU27 leaders have been given a 'green light' by Tusk to begin internal deliberations on the terms of a transitional deal. In a way, this is not much of a story. Of course, all sides are looking into the issues which they expect to discuss in the future. But by stating the obvious, the EU27 are extending an olive branch to a weakened UK prime minister Theresa May. The gesture may help her sell the contentious Brexit bill – likely to be around £50 billion – to the Brexiteers within her party and to the public. So far, progress on Brexit seems to be well within our base case; we see a 70% chance that the UK and EU will settle the terms of divorce by early next year, before agreeing to a two year transitional deal next year, ready for March 2019 when the UK leaves the EU. We see a 30% risk of a hard Brexit. For more detailed analysis, please see, ["Analysing Brexit: the options and outlook"](#).



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As an aside: Yesterday Germany's FAZ newspaper published an unflattering article about last weeks EU summit dinner and the prior phone calls from May to Merkel and Macron as May "crying for help". This story seems to be hitting the UK press today. Remember, FAZ is the newspaper which had leaked the details of the previous Brexit dinner. Result: EU leaders give progress made so far a more positive spin without yielding anything on substance.

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