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PARTNERSHIP SINCE 1590

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26 / 11 / 2018

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MACRO UPDATE: BREXIT, EUROZONE GROWTH, GERMAN POLITICS

Berenberg Macro Flash

UK: THE HARD SELL TO AVOID A HARD BREXIT

Can UK Prime Minister Theresa May sell the Brexit deal at home? As expected, the early signs are not encouraging as May and her whips now try to gather the votes to get it through parliament after she and her EU27 counterparts signed off the withdrawal agreement and the declaration on the future partnership in just 38 minutes at yesterday's special EU summit. May's Conservatives rely on 10 Northern Irish Democratic Unionist Party (DUP) MPs for a slim working majority of 13 seats in the House of Commons. But the DUP have said they will vote against May's deal due to the regulatory commitments by the UK in the so-called "backstop". These commitments would de facto keep Northern Ireland – but not Britain – in the single market for goods once the transitional period has ended if the UK and EU have not agreed to other terms of trade that keep the Irish border open. Meanwhile, far-left Labour leader Jeremy Corbyn has said he will instruct Labour MPs to vote against the deal too.

But it is still early days. Parliament will spend the next two to three weeks debating the deal before voting on it before Christmas. Only during these debates can we genuinely begin to gauge whether May can get the numbers or not. Two-thirds of MPs are pro-EU or at least in favour of a soft Brexit - much of the Conservative Party and most Labour MPs. While May will struggle to bring the DUP around, she will aim to bring on board most of her party plus a few Labour moderates. In the end, we expect the moderate majority in parliament to do what it takes to avoid a damaging no-deal hard Brexit - see [UK: The safeguards against a hard Brexit](#). The clear statements from EU leaders that the UK could not expect a deal more to the liking of Brexiteers it wanted to renegotiate the agreement may help to concentrate minds. Our base case (80% chance) remains that parliament will either pass the current deal in a first or second vote or – after significant political turmoil – will endorse some other solution that avoids a "no deal" hard Brexit in the end. Such an outcome would present upside potential for the UK economy over the medium-term - see [UK: growth spurt ahead if Brexit deal is struck](#). However, the tail risk of a hard Brexit remains significant at 20%.

EUROZONE OUTLOOK: GREY WINTER

Since March, a series of external shocks has hit the Eurozone. The resulting weakness is gradually spreading from the external to the domestic sector. As an end to this trend is not yet in sight, we have to brace ourselves for more subdued news in the next few months. This is the clear message from recent survey data including last Friday's flash PMI – see [Weaker Eurozone momentum to persist as PMI s slide further](#). This week, two data points will likely highlight the current downturn:

- the forward-looking **German Ifo expectations** due today (we project a decline from 99.8 in October to 98.9 in November, below the Bloomberg consensus of 99.2), and
- the **EU Commission survey of economic sentiment** due on Thursday (we expect 108.8 after 109.8 in October, below the consensus of 109.1), the broadest gauge of the current situation.



As usual, external shocks show up most strongly in manufacturing and in those countries that are either heavily export-oriented (Germany) or structurally weak (Italy). Short of a major monetary or fiscal boost, which we can rule out for the time being, the external shocks need to fade first before growth can snap back from the current pace of around 1% annualised to just above the 1.5% trend rate. We expect that to happen from spring 2019 onwards as vulnerable emerging markets (think Turkey) hit bottom, oil prices become less of a drag, the Brexit outlook becomes clearer, China stabilises in response to some further stimulus and the US and China finally start to contain their disputes (see [Eurozone progress report: coping with the risks](#)).

An early trade war truce struck between Donald Trump and Xi Jinping on 29/30 November in Buenos Aires would be a bonus. Even an agreement to delay the move from 10% to 25% tariffs on \$200bn of US imports from China to allow more time for talks, while possible, would already count as a positive surprise. Near-term, the newsflow may remain as grey as the November weather in major parts of Europe, though.

GERMAN POLITICS: ADVANTAGE AKK?

A bout of Merkel nostalgia seems to be limiting the political risks in Germany. Less than two weeks before the centre-right CDU will elect the successor to Angela Merkel as party boss on 7 December, Annegret Kramp-Karrenbauer has moved into the pole position. After four of eight regional party conventions ahead of the vote, a poll among CDU members shows a rise in support for „AKK“ to 38% from 35% two weeks ago and losses for her close rival Friedrich Merz (to 29% from 33%) and for Jens Spahn (6% instead of 7%, all data from ZDF Politbarometer).

AKK is widely seen as being close to Merkel. She seems to benefit from a little „Merkel nostalgia“. Since Merkel announced that she is stepping down as party leader in December 2018 and will not seek re-election as chancellor in 2021, her poll ratings have gone up. A clear majority of Germans now wants her to serve out her full term.

The centrist AKK would find it easier than the more conservative candidates Merz or Spahn to work with the centre-left SPD and prevent the SPD from bringing down Merkel as chancellor by leaving the coalition with the CDU/CSU next year.

The race to replace Merkel remains open, though. The regional CDU conventions in the two biggest German states, North Rhine-Westphalia and Baden-Württemberg, are still ahead this week. On 7 December, the 1001 CDU party delegates may not heed what current opinion polls of party members suggest. Still, with more support for AKK as CDU leader and for Merkel as chancellor, the probability has risen further that the transition from Merkel to her successor will be smooth and that Merkel can remain chancellor until the next regular election in 2021 if she wanted to do so. With AKK at the helm of the CDU, Merkel may have a 60% chance to still be chancellor in December 2019, with Merz, the chance may be a mere 40%.



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In any case, the economic and political impact of the change at the top of the CDU now - and even of a potential change in the composition of government next year - would remain limited. German politics largely moves by a de facto consensus between the major mainstream parties who usually have to team up to pass initiatives through the upper house of parliament, the Bundesrat. For example, the net result of the most significant change that may happen, a new chancellor Merz heading a new coalition (CDU/CSU-Green-FDP), would be a number of new faces, a slightly different style, an earlier closure of some coal power stations and an early abolition of the solidarity surcharge to the income tax. All in all, it would probably amount more to tweaking at the edges than to a major policy shifts.

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