MACRO NEWS

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DEFUSING TRADE TENSIONS? MACRON AND MERKEL TO MEET TRUMP

Berenberg Macro Flash

The trade tensions stoked by US President Donald Trump pose the key risk to our positive outlook for the global economy. We expect the trade uncertainty to cause a dent in demand growth near term. While the temporary loss of momentum will be visible in the Eurozone, it may be largely obscured in the US by the fiscal stimulus. This week, we will learn more about the potential impact of the trade tensions and the risk that they may escalate further.

The US has exempted the EU from its new steel and aluminium tariffs until 30 April. Ahead of that deadline, French President Emmanuel Macron will pay a three-day state visit to the US starting this evening. Germany's Angela Merkel will be in Washington on Friday. Whether or not Trump is open for reasonable compromises on trade may become clearer during these meetings. Eyes will be especially on his talks with Macron, who has built up the strongest relationship of all European leaders with Trump. Ideally, the leaders will agree that: (i) the EU remains exempt from the new US tariffs, (ii) the EU and the US negotiate a new deal to open their respective markets further (a mini-version of the TTIP which Trump had shelved upon taking office), and (iii) let the WTO adjudicate disputes. If the US and EU can indeed defuse their current trade spats, probably with some EU concessions, this would strengthen our call that China and the US can also avoid a tit-for-tat escalation and come to an agreement within the next four to six weeks. Such a deal would probably involve some further significant Chinese steps to open its markets and restrain its penchant for forced transfers of technology. Separately, geopolitics will play a major role in Trump's talks with Merkel and Macron as Trump has threatened to revoke the nuclear deal with Iran on 12 May.

How much are the recent trade tensions weighing on current business sentiment? After noticeable drops in February and March, the key sentiment readings for April are due in the Eurozone this week, ranging from the PMIs (today) to the German Ifo (Tuesday) and the broadest measure, the European Commission's economic sentiment index (ESI) for the Eurozone and EU members on Friday. Roughly in line with consensus, we look for further modest drops in April in the German Ifo and the ESI. If we are right that the worst of trade tensions will be over within the next four to six weeks, confidence should recover from June onwards. The key components to watch in the confidence surveys this week will be the expectations component of the German Ifo (fickle but forward-looking and hence relevant for the investment outlook) and the reading for exports orders in the EU Commission survey. With a normal correction in volatile data exacerbated by trade concerns, Ifo expectations have receded from a post-2011 high of 103.9 in November 2017 to 100.1 in March, just a tad above the long-term average of 100 (these Ifo data refer to the re-calculated index including services to be published from this month onwards).

According to the Markit flash PMIs, sentiment among Eurozone purchasing managers stabilised in April at 55.2. This could be a first sign that the recent decline in Eurozone confidence indicators will bottom out in the next few months. While activity in the services sector improved slightly from 54.9 in March to 55.0 in April, the reading for the manufacturing output index weakened marginally from 55.9 to 55.8. We should not read much into small changes in volatile high-frequency data. Still, it is somewhat re-assuring that the factors such as trade tensions that weigh on the more export-oriented manufacturing sector did not spread further to services in April. Encouragingly, employment increased at a faster pace in April than in March in the overall flash PMI, although still falling short of the gains seen in early 2018. Solid gains in employment are likely to underpin consumer demand, helping to mitigate the hit from trade tensions. Once again, Markit quotes a shortage of qualified labour as one reason why employment is not rising even faster than it is. As companies are trying hard to find suitable workers, they will probably not slow down their actual pace of hiring people in response to the temporary dent in business confidence seen over the last few months. At 55.2 in March and April, the overall level of the flash PMI remains compatible with growth slightly above trend in the Eurozone.

MACRON REMAINS ON TRACK

Beyond the near-term concerns about trade and the precise shape of the cyclical upswing, the key issue for the longer-term health of the Eurozone is whether Macron will manage to reform France as thoroughly as we expect. So far, he remains well on track. After a heated debate, France's National Assembly just passed a significant tightening of asylum laws with a clear 228 to 139 majority and 24 abstentions. Although asylum and migration issues are quite controversial within Macron's presidential party (LREM), only one LREM parliamentarian voted against (and announced that he would leave the party thereafter). This suggests that Macron can rely on his parliamentary party to back him even on highly divisive issues. It adds to our confidence that Macron and his government will be able to get through the current wave of protests (mostly against his railway and education reform proposals) with only minor concessions and continue to implement his impressive agenda of pro-growth economic reforms. A France that turns itself from a struggling country into a new powerhouse of Europe, as we expect, would benefit not just itself but also its major partners and strengthen the cohesion of the Eurozone and the EU in the process.

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