Holger Schmieding, Chief Economist | Holger.schmieding@berenberg.com | +44 20 3207 7889

EU POLITICAL UPDATE: TRADE DEADLINE, FRENCH STRIKES, ITALIAN POLITICS

Berenberg Macro Flash

TRADE TENSIONS: US TO HIT EU ON 1 MAY?

The European Union is bracing itself for the likely imposition of punitive US steel and aluminium tariffs tomorrow as the temporary exemption which the US had granted the EU is due to expire on 1 May. Despite the spectacular gestures of friendship between US president Donald Trump and his French counterpart Emmanuel Macron last week and a friendly discussion between Trump and German chancellor Angela Merkel last Friday in Washington, the US has not sent any clear signal that it will extend the exemption for the EU.

While the EU is still hoping that the US may back down, it has prepared a response with EU tariffs on a panoply of US exports to the EU worth roughly €2.8 bn (including iron, steel, orange juice, whisky, motorcycles) and an appeal to the World Trade Organization (WTO). In addition, Germany is airing the idea to meet US concerns about EU car tariffs, which are higher than US tariffs on most kinds of vehicles, by concluding an overall EU-US agreement on abolishing mutual tariffs on industrial imports. This would be a slimmed down version of the draft TTIP deal which Trump had shelved upon coming into office.

The trade tensions stoked by Trump pose the key risk to our positive outlook for the global economy. We see the uncertainty about future trade relations as the key reason for the significant drop in sentiment indicators in the Eurozone in the last few months. That the dispute made fewer headlines in the last few weeks amid a flurry of negotiations may have contributed to the tentative signs in April data that the slide in confidence may be bottoming out. If the US now goes ahead and the EU responds in kind, sentiment and investment intentions would probably be hurt again in May, especially if the US then threatens a further round of tit-for-tat tariffs targeted for instance on EU car exports to the US.

Ultimately, we expect the EU and the US as well as the US and China to strike new deals within the next few months, averting full-blown trade wars. All sides have too much to lose from a full-blown conflict. China and the EU have shown a clear willingness to negotiate and address specific US concerns. For Trump, the current noise may be part of his usual negotiating tactic, as his initial approach to North Korea may suggest. If the trade tensions indeed lessen within the next four to six weeks, the temporary dent to growth in Europe should be over by mid-year. In the US, the impact will likely be obscured by the concurrent fiscal stimulus anyway.

FRANCE: WHO WILL BLINK FIRST?

After one month of strikes in some key sectors, and possibly two more months to go, Macron and his government continue to hold firm, insisting that France needs to change. We expect them to keep the edge in the various disputes with the labour unions thanks to sufficient public support for their reforms.

Earlier this year, Macron's Prime Minister, Edouard Philippe, introduced a proposal to cut cost at the national railway SNCF, make the company more efficient and open the current railway monopoly up to competition, as required by EU law. While most privileges granted to SNCF workers are anachronistic relics of a different time (e.g. life-long job security and early retirement from the age of 52 onwards), the SNCF is a sacred cow to French unions as perhaps the last surviving epitome of the old French social welfare model. In response to the government's plan to overhaul the SNCF and a number of other reforms, labour unions announced to strike for 36 days between April and June, of which 26 fall on workdays – that is 2 out of 5 workdays. A number of workers from other industries, both union and non-union members, including employees of Air France, are also striking to press their own demands. Some students have joined in to protest against more selective university entry requirements.

Behind closed doors, Macron and Philippe may be willing to offer cosmetic concessions here and there. Philippe has accepted to meet union representatives on May 7 over the SNCF reform. Still, as in the case of last year's labour market reform, we expect Macron and Philippe to push through the key elements of their current proposals. That would bode well for their ambitious further reform agenda such as changes to unemployment insurance, education, training, pension etc.. One year after we made our call that France is heading for a golden decade on the eve of the second round of the French presidential election on 7 May 2017 we remain convinced that France is indeed turning the corner.

ITALY: NO POLITICAL PROGRESS YET

Nearly two months after Italy's inconclusive general election, the political stalemate continues without a clear solution at hand. The two winners of the election, Luigi Di Maio from the anti-establishment 5Stars and Matteo Salvini from the right-wing Lega party, are both struggling to gain enough support to form a coalition and become prime minister. While Sunday's regional election in Friuli-Venezia Giulia (1.2m people) seems to have strengthened the centre-right and especially the Lega in line with the result of the regional vote in small Molise (300k people) on 22 April, the additional momentum for Salvini will probably not suffice for him to break the deadlock.

Last week, President Sergio Mattarella asked Roberto Fico (5Stars), speaker of the lower house, to seek a compromise between the 5Stars and the centre-left Democratic Party (PD). Whereas the talks with the PD's acting leader Maurizio Martina went well initially, ex-PD leader Matteo Renzi once again ruled out such a coalition over the weekend. The PD leadership will meet on 3 May and debate the government talks with 5Stars. But as Renzi still has significant support within the PD, the risk that a coalition with the 5Stars may tear the PD apart will probably prevent a formal tie-up between the 5Stars and the PD. We attach only a 15% probability to such a scenario.

As the Lega's Salvini is keen on re-opening the talks with 5Stars, we still see such a coalition as the least unlikely scenario in the end. But other options such as new elections, a (temporary) unity government or a minority government are becoming more likely. Please see our report on Italian coalition negotiations for more details. Both Lega and 5Stars may not mind new elections as they continue to gain momentum in the latest opinion polls with c. 34% of the votes for the 5Stars (vs. 32.7% in the election) and c22% for the Lega (vs. 17.4% in the election) while Berlusconi's Forza Italia would drop to c. 11.5% (vs. 14%) and the PD would decline to c.18% (vs. 18.7%) according to the average of the last five opinion polls.

Financial markets are largely taking the Italian uncertainty in their stride so far. This makes some sense as the radical parties have backed away from the ultimate tail risk, namely a demand for a referendum on euro membership. Still, any significant reform reversal or increase in the budget deficit could weaken an Italy that still needs further reforms well beyond the steps it has taken in the last few years. While the damage of bad policies would probably not show up very much during a cyclical recovery, Italy might be paying a significant price for any reform slippage once the cyclical upswing is over. Within the Eurozone, Italy remains the key risk to watch.

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7878
www.berenberg.com
holger.schmieding@berenberg.com