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POLITICAL UPDATE: GERMANY, TRADE, EU SUMMIT

Berenberg Macro Flash

GERMAN POLITICS

The disruptive dispute between Chancellor Angela Merkel's CDU and CSU leader Horst Seehofer will come to a head this afternoon. CDU and the Bavarian CSU want to make a final attempt to resolve their differences about migration policy. Whereas Merkel rejects unilateral German action, Seehofer insists on unilateral steps that would go beyond the measures agreed by Merkel on the European level.

Although the outcome of the current German political crisis remains uncertain, Merkel seems to have a slight edge over her Bavarian adversaries. Last night, Seehofer offered to the CSU to resign from his positions as CSU boss and Germany's interior minister after eight hours of contentious discussions within the CSU. This suggests that many in the CSU shy away from walking out of the government in Berlin and breaking the 70-year bond between CDU and CSU. If Seehofer resigns, other CSU ministers may potentially stay in the government. If Seehofer had forced Merkel to sack him by imposing unilateral border controls against Merkel's wish, the CSU would have almost certainly left the government.

The CDU seems to have largely rallied around Merkel. While she is now probably under major pressure to offer the CSU some face-saving compromise this afternoon, it seems unlikely that she will endorse unilateral German action to close the border to asylum seekers already registered elsewhere in the EU, as Seehofer demands. Whether any new CSU leader after Seehofer would be ready to give up this demand and keep the party in government in Berlin even if Merkel maintains a hard line is an open question. The risk that the CSU may walk out of the government in Berlin, turning Merkel into the leader of a minority government, remains serious.

For a discussion of possible German scenarios see [here](#). The direct economic impact of a German political crisis should be small. Still, Merkel's position at home and abroad is weakened by the dispute. It also complicates the efforts to reform the EU and the Eurozone.

EU SUMMIT: KEY RESULTS, NO SURPRISE

Trade: The EU is not inclined to give in to bullying by US President Donald Trump. At their 28-29 June summit, EU leaders endorsed the retaliatory tariffs imposed by the EU Commission in response to the US steel and aluminium tariffs. EU leaders emphasised their readiness to defend and strengthen the multilateral trade order under rules governed by the World Trade Organisation (WTO) and their willingness to strike further trade deals with interested countries. While ready to negotiate a reduction in mutual trade barriers with the US, EU leaders also seem to be bracing for further conflict, arguing that the "EU must respond to all actions of a clear protectionist nature".

Our main scenario remains that trade tensions, after the current escalation, will fade somewhat later this year as Trump either strikes deals with key trading partners or slows down the pace of imposing new tariffs as retaliatory actions by other countries hurt part of his political base.

Migration: The EU is tightening controls of its external border and stepping up efforts to further restrain and deter the inflow of migrants from Africa and the Middle East. At their summit, EU leaders also abandoned the futile approach to re-distribute asylum seekers within the EU according to any fixed quota and/or against the will of the country supposed to accept them.



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MACRO NEWS

Eurozone reforms: As expected, the EU also took a further small step towards a Eurozone banking union by designating the European Stability Mechanism (ESM) as the final backstop in case banks need to be wound down in an orderly fashion. Beyond that, EU leaders agreed to discuss further reforms at a later stage, also in line with expectations.

Brexit: Exasperated by a lack of progress, EU27 leaders urged the UK to finally come up with “realistic and workable proposals” for the future UK-EU relationship. As expected, they expressed their concern that “no substantial progress has yet been achieved on agreeing a backstop solution” to keep the border between Ireland and Northern Ireland open after Brexit.

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