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MACRO UPDATE: TRADE, G7, ECB, ITALY

Berenberg Macro Flash

Trade war: still getting worse

Tit for tat. US President Donald Trump announced late on Friday that he wants US companies to leave China and that he will raise the punitive tariff on $250bn of imports from China from 25% to 30% on 1 October. The move came after Beijing had presented details of its reaction to Trump's previous tariff threats.

Trump's immediate response sows further uncertainty and adds to downside risks for global manufacturing. Following the previous escalation of US-Chinese trade tensions, we changed our economic outlook in mid-August. As our base case, we no longer expect a partial resolution before spring 2020. The global industrial downturn thus looks likely to deepen in the second half of this year, spreading gradually to other sectors in the most-affected economies. If trade tensions do not escalate much further, producers may get used to current level of noise. If so, global industry could bottom out at the turn of the year and recover slowly thereafter. The new round of tit-for tat highlights the downside risks to our calls. Of course, as both China and the US remain ready to talk, a positive surprise in the form of a partial resolution of at least some tariff issues remains possible.

As much as the US Fed may dislike it, any economic weakness resulting from trade tensions will strengthen the case for lower rates in the foreseeable future.

G7: no negative surprise

Is that progress? Unlike last time in Canada when the G7 meeting ended with a bust-up, the Biarritz summit has not yet made big negative headlines. Instead, Trump and French President Emmanuel Macron are reportedly planning a joint press conference at 14:30h London time. That could be a mildly encouraging sign. In their deliberations so far, G7 leaders even agreed some useful initiatives to combat deforestation in the Amazon and to support a French-German initiative to stabilise Africa's Sahel region. If we get through the last day of the G7 without any major accident, the summit may even have served the original purpose of such G7 meetings, namely for leaders of some key countries to exchange views as a potential basis for co-operating better - or less badly – in the future. Unsurprisingly, the G7 also brought no breakthrough on trade and Brexit, the key economic issues of the day. On Brexit, the EU remains ready to look at UK proposals for alternatives to the Irish backstop that can permanently prevent a hard border in Ireland. The EU has not received any such proposal yet and doubts that such alternatives can be devised ahead of the 31 October Brexit day.

ECB: Even Weidmann gives green light for some action

In a wide-ranging interview with German FAS published on Sunday, Bundesbank President Jens Weidmann explained in cautious terms the case for even easier ECB policies. Of course, he did not announce that he would indeed vote for a rate cut and new asset purchases. However, his somewhat sympathetic discussion of such potential moves sends a clear message: even the ECB hawks will not try to prevent a policy package to come. They will only try to shape its details. In the interview, Weidmann noted that rate policy has not yet reached the point at which a new rate cut to further below zero would no longer be effective. He also pointed to “some room for manoeuvre” for asset purchases within the limits the ECB has imposed on itself. Unsurprisingly, Weidmann argued that the ECB should not change the criteria for asset purchases fundamentally. His colleagues on the ECB Council may not agree with him on this particular point. We continue to expect a significant ECB policy package on 12 September, including a cut in the deposit rate of at least 10bp with some tiering system to ease the pain on banks as well as renewed asset purchases of up to €40bn per months.

Weidmann also warned against any “panic“ and “activism” in response to the economic slowdown. If the outlook were to worsen significantly, fiscal policy - especially in Germany - would have some room for a stimulus beyond letting the automatic stabilisers do their job. For Weidmann, the onus should be more on fiscal than on monetary policy.

Italy: tiptoeing towards a deal?
Under pressure from President Sergio Mattarella, negotiations to form a left-of-centre government between the 5Stars and the Democrats have apparently made enough progress on substance to now get stuck on the last big issue: who shall lead the new government? The 5Stars want current prime minister Giuseppe Conte to stay in office. After taking on the Lega’s Matteo Salvini directly when the 5Star-Lega coalition fell apart last Tuesday, Conte has become quite popular in Italy. The Democrats want to signal a new beginning with a new face at the top. Late last week, Mattarella had given the parties time until tomorrow, Tuesday, to show that they can build a new government and thus prevent the snap elections which Lega leader Salvini wants. With all major players of the centre-left apparently eager to avoid snap elections, chances still are that the distribution of top jobs can eventually be resolved. Expect Mattarella to put heavy pressure on both sides. A government formed by the 5Stars and the Democrats with the explicit mandate to pass a 2020 budget that prevents a major confrontation with Brussels and allows Rome to take back the VAT hike currently scheduled for 2020 would be positive news for Italy and Europe. Of course, as Italian politics are volatile and riven by the usual personal rivalries, some serious risks remain.

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