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

MACRO UPDATE: BREXIT, CENTRAL BANKS, HONG KONG, GERMAN POLITICS

Berenberg Macro Flash

BREXIT: DELAY AND REFERENDUM 2.0 LIKELY

The United Kingdom is not ready to leave the European Union on 31 October. Instead, the UK seems to be heading for a Brexit referendum 2.0 first before clarifying its future relationship with the EU. Most likely, the current political turmoil will end in a pre-Brexit snap election that will be fought as a de facto Brexit referendum in late 2019. Alternatively, the opposition may first topple Prime Minister Boris Johnson so that a new interim prime minister could call a formal Brexit referendum for early 2020 to settle the Brexit issue before going for new elections afterwards.

Of course, it remains theoretically possible that the UK may leave the EU with an amended Withdrawal Agreement on 31 October. Johnson may finally try to find common ground with Irish Prime Minister Leo Varadkar, whom he is due to meet in Dublin today, However, the hurdles for a new deal are very high: (i) Passing any Brexit deal would be a huge challenge in the highly charged atmosphere of the current UK parliament. (ii) The UK has not started any serious negotiations with the EU yet. Instead, Johnson's emissaries to Brussels have reportedly tabled a list of almost impossible demands that go well beyond dropping the "Irish backstop". In Brussels, that has nourished the impression that Johnson is putting up a show for his domestic hardline audience instead of trying to forge a deal with Ireland and the EU.

CENTRAL BANKS: THE BUFFER IN ACTION

In the absence of serious inflation pressures, central banks can and will act as the major anti-cyclical buffer. As much as the US Fed may dislike it, it has little choice but to cushion the blow which Donald Trump's disruptive trade policies are dealing to global and US growth by cutting rates. Beyond reducing its federal funds rate by 25bps on 18 September, we look for a further such rate cut in Q4. Although Fed rate cuts will not stimulate US demand by much, the political risks which the Fed might incur if it does not react to an economic slowdown by easing policy could be serious. Trump as well as left-wing Democrats question the independence of the Fed. Recent US data such as the mixed purchasing manager surveys and the slightly softer employment report project a modest slowdown in growth that is largely confined to trade-dependent manufacturing. Still, as the Fed is pointing out, the downside risks have increased.

This Thursday, the European Central Bank will likely set the stage for other central banks. We expect a 20bp cut in the deposit rate and stronger guidance that ECB policy will remain highly expansionary for even longer. Although the issue is highly contested at the ECB, we see a probability of more than 50% that the ECB will also announce new net asset purchases on Thursday (see our ECB preview). On both sides of the Atlantic, highly accommodative monetary policies limit the risk of financial turbulence.

HONG KONG/CHINA: A KEY RISK TO WATCH

Even after Hong Kong's Carrie Lam has formally withdrawn the controversial extradition bill that sparked the protests, the situation remains tense. A violent crackdown of pro-democracy protests could be a serious shock for global politics and global markets. An excessive use of force by Beijing would make it much more difficult for the US (and the EU) to strike any new trade deal with China. Presumably, the leadership in Beijing is aware of that. In her own measured way, German Chancellor Angela Merkel reminded Beijing of that by urging China during her visit last week to resolve the situation through peaceful negotiations. But whether Beijing will really restrain itself, especially once the celebrations of the 70 year anniversary of the Communist takeover in Beijing on 1 October are over, remains one of the key risks to watch.

GERMAN POLITICS: GREENS MAY HAVE PEAKED

Germany's Greens have a reputation: they are better at winning opinion polls than elections. Following an early summer hype when the Greens were briefly ahead even of Merkel's CDU/CSU in the polls, the return to more normal levels seems to have started. In two East German state elections eight days ago, the Greens raised their share of the vote by significantly less than polls had predicted. Even opinion polls are no longer moving their way. The last four national opinion polls put the CDU/CSU on average by 5 points ahead of the Greens again, with one poll (Emnid from 7 September) projecting even an eight-point lead for the CDU/CSU (29% versus 21%). At the same time, the traditional centre-left SPD has recovered marginally to roughly 15%. However, the SPD continues to trail behind the Greens (23% on average in recent polls).

The modest rebound in support for the traditional parties of the centre-right and centre-left may partly reflect the growing recession risk. In tough times, attention turns away from Green issues such as a rapid exit from coal to bread-and-butter issues of growth, employment and social policy. For answers to these questions, many voters still look to the traditional parties rather than the Greens. For a concise discussion of the German political outlook, see also German state elections: bad, but it could have been worse.

Joh. Berenberg, Gossler & Co. KG
60 Threadneedle Street
London EC2R 8HP
Phone +44 20 3207 7889
www.berenberg.com
holger.schmieding@berenberg.com