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MACRO UPDATE: OIL, GERMAN STIMULUS, BREXIT

Berenberg Macro Flash

SAUDI ARABIA: SUSTAINED OIL PRICE SHOCK STILL UNLIKELY

After drone attacks knocked out Saudi oil installations that produce 5% of the world's supply, the US has blamed Iran. US President Donald Trump has threatened retaliation. This highlights a standard risk to the global economic outlook: sudden major spikes in oil prices caused by shortfalls in supply act as a tax on oil consumers. They can potentially hit global growth, especially at a time when confidence is fragile already. As a rule of thumb: an increase in the oil price by €10 per barrel adds 0.3 percentage points to Eurozone consumer price inflation within two months, reducing the growth of real disposable incomes by the same magnitude. For countries that are hovering on the brink of recession already, this could make the difference between stagnation or a mild contraction of GDP (think Germany and Italy).

Our base case remains that the proxy war which Saudi Arabia and Iran are fighting in Yemen will not escalate into a direct confrontation between the two regional powers or a major and prolonged armed conflict between Iran and the US. Iran and Saudi Arabia would have too much to lose from such a full-blown confrontation, in our view. More likely, individual acts of sabotage and retaliation will make headlines without disrupting Saudi oil exports dramatically for long. Short-term losses can probably be offset by releasing oil from strategic reserves. Trump has already ordered that for the US. The International Energy Agency (IEA) does not expect a serious supply shortage. Thanks to US fracking, oil supply is more elastic than it used to be. While oil prices could be more volatile for a while, we do not project a sustained surge in oil prices similar to or even worse than the one of autumn 2018. However, we need to watch this geopolitical risk.

GERMANY: A GREENER SORT OF SLOW-MOTION STIMULUS

Blessed with a fiscal surplus and negative interest rates, Germany is trying to spend as much money as it can on projects it considers useful. As a summer with record temperatures draws to a close, Germany's „climate cabinet" wants to finalise a green policy package on Friday, 20 September. While many details still need to be settled, some outlines are becoming visible.

Global attention will focus on a likely pledge to spend €40bn extra over four years to improve public transport and subsidise cleaner cars and cleaner heating systems. This comes on top of an earlier decision to spend up to €40bn extra to support regions hit most by the phasing out of coal until 2038. The sums may sound large. However, due to lengthy planning procedures and a severe lack of skilled workers, it will take time until the money can be disbursed. For the year 2020, the additional spending may not even reach €8bn (0.2% of GDP). Unwilling to cut taxes significantly and unable to raise public investment beyond the impressive 10.6% yoy nominal growth rate reached in H1 2019, Germany continues to deliver no more than a slow-motion stimulus. After a fiscal expansion of 0.3%-0.4% of GDP in 2019, we look for an additional fiscal easing of 0.4%-0.5% per year in both 2020 and 2021. It will add up over time and support domestic demand. However, the German stimulus will not be a European let alone a global game changer.

As a key element, Germany's green policy package will put a price on more CO_2 emissions than before. Germany will likely complement the EU scheme for CO_2 emission permits with a national scheme that broadens the coverage to heating systems and transport fuels. The national scheme will include minimum and maximum prices for such permits to avoid disruptive spikes in permit prices.

BORIS "THE HULK" IN THE FOOTSTEPS OF THERESA

After two months in office, UK Prime Minister Boris Johnson finds himself in almost the same situation as his predecessor Theresa May in March: unable to deliver on his impossible promises, short of a majority in parliament and at risk of losing office shortly, he is flying to the EU to ask for help. Johnson will meet outgoing European Commission President Jean-Claude Juncker for lunch in Luxembourg today. His vow to not even negotiate with the EU before the EU has ditched the backstop is history. Johnson's best bet remains to accept EU terms for Brexit, dress them up and sell them to his parliament as a much improved deal.

As discussed in our close look at backstop options, Dublin and the EU might go along with two potential changes to the backstop: it could be restricted to Northern Ireland only (which was the EU's initial offer anyway); or the EU could give even stronger guarantees that it cannot mis-use the backstop to trap the UK in the EU customs and regulatory union once feasible alternatives to the backstop exist.

UK intentions remain difficult to read for the EU, though. On the one hand, Johnson emphasised again over the weekend that he wants a deal with the EU. On the other hand, he suggested in a „Mail on Sunday" interview that he would use any trick to circumvent the „no hard Brexit" law so that the UK would leave the EU on 31 October come what may. According to Boris, he will act like the fictional movie character "The Incredible Hulk" who gets stronger the madder he is in order to break out of the "manacles" of EU membership on 31 October. Such words may impress his hardline base. But they do not make it easy for the EU to believe that Johnson is serious about a deal and that he could be trusted to deliver his side of any bargain.

On balance, we see a 10-15% probability Boris and the EU will agree on a slightly modified deal that will clear the UK parliament by 19 October. More likely, the UK will hold a de facto Brexit referendum 2.0 in the form of a late 2019 snap election dominated by the Brexit issue or a genuine referendum in the first half of 2020 – see "hard Brexit risk down as moderates gain momentum".

On Tuesday, the UK Supreme Court will hear an appeal against the suspension of parliament. The verdict will make headlines. If the court were to agree with the High Court of Scotland (suspension unlawful) instead of the High Court for England and Wales (suspension lawful), Johnson would probably face calls to resign. If the unlikely case that he were to comply, the UK may get a new government and a new prime minister (Jeremy Corbyn?) early. This is not our base case, though. Parliament will have to take its key decisions about Brexit once the UK has either managed or failed to strike a deal with the EU at the 17-18 October EU summit. Until then, parliament's role will be limited, with or without the suspicious suspension.

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