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POLITICAL UPDATE: US, UK, AUSTRIA, CHINA

Berenberg Macro Flash

US and UK: divide and misrule

Last week's start of an impeachment inquiry against US President Donald Trump and the UK Supreme Court verdict against UK prime minister Boris Johnson illustrate the resilience of mature democracies in the face of unusual challenges. Checks and balances are working. However, these proceedings and, even much more so, the actions that triggered them also deepen the political divides in both countries. Three years after the great populist upsets of 2016, the UK Brexit referendum and the election of Trump in the US, the polarised politics in the US and the UK are still moving in potentially damaging directions.

In the US, the probability that a Republican-controlled Senate will rule with the required two-thirds majority [to oust Trump](#) remains very low. Instead, the impeachment proceedings will likely fire up the radical parts of both political camps at the expense of more moderate voices. This matters for the policy outlook. Taking the odds implied in some electronic betting markets at face value, left-wing Elizabeth Warren is now more than twice as likely as centrist Joe Biden to challenge Trump in the November 2020 presidential election. If Warren wins the Democratic nomination, this could turn into an economic risk on its own. It could also raise the probability that Trump might be re-elected despite the damage which his trade wars are causing at home and abroad.

In the UK, where both parliament and the population are bitterly divided over Brexit, a negotiated soft Brexit could possibly help the country to heal the rift over time. However, Johnson's tactical mistakes and rowdy rhetoric make it ever more difficult for him to achieve this. Even in the still unlikely case that he accepts the slightly re-packaged deal which the EU may offer him on 17 October, he might be unable to persuade the UK parliament to pass it. He has set expectations among Brexit hardliners that he cannot meet. At the same time, his treatment of what he has labelled a "zombie" parliament will make it even more difficult to garner the required votes from the opposition to pass a hypothetical deal. If he cannot extricate himself Houdini-style from his self-designed straitjacket, he will either have to resign, break the law or ask the EU for another Brexit extension on 19 October despite his vow to not do so under any circumstances. It will be the opposition in parliament, not Johnson, that decides whether or not the UK will first go for new elections in late 2019, as Johnson wants, or hold a new Brexit referendum first. Either way, the risk of extreme outcomes, be it a hard Brexit after a new election or a move of left-wing Jeremy Corbyn into 10 Downing Street, still looms large. See this [report](#) for our detailed probabilities.

Austria: life after populism

The same social and political forces that are causing the deepening political divides in the US and the UK are at work almost all over the European continent as well. But helped by the constraints which euro membership imposes on them, countries sharing the euro seem to be better at containing the risks. For now, the populist tide is receding in many parts of the continent. The left-wing radicals of Syriza (Greece) and Podemos (Spain) have lost a lot of ground in the last two years. In Italy, the 5Stars have morphed from a motley collection of radicals (think Beppe Grillo) into an almost standard pro-EU centre-left party (think Giuseppe Conte) within the last 16 months.

In Austria, support for the right-wing FPÖ plunged to 16.1% in the snap election on Sunday, down from 26% in October 2017. Conservative ex-chancellor Sebastian Kurz raised the vote for his ÖVP further from 31.5% in 2017 to an estimated 37.1% now. While the centre-left SPÖ fell further from 26.9% to 21.7%, the



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climate change debate propelled the Greens to 14.0% from a mere 3.8% two years ago. The liberal Neos also advanced from 5.3% to 7.8% (all numbers based on projections available at 20:20h local time).

Until a scandal around his then-coalition partner FPÖ had brought down Kurz in May, he had successfully pursued an ambitious agenda of pro-growth economic reforms. In our [European Progress Monitor](#) of May 2019, we had identified Austria as one of the most-improved countries in the EU over the last two years. The election result gives Kurz a mandate to continue with his reform agenda. He will probably try to form a coalition with the Greens. A tie-up with either the SPÖ or the decimated FPÖ would also be numerically possible.

As in many other countries, the traditional centre-left and centre-right mainstream parties have lost much of their traditional appeal in Austria. The charismatic Kurz owes his victory largely to his own political skills rather than his ÖVP party. As in France where Emmanuel Macron triumphed in May 2017, Austria shows that the shift away from traditionally mainstream party machines need not pave the way for left- or right-wing populists. Instead, a well-marketed centrist reform agenda can carry the day. Unfortunately, this does not seem to be the case in the US and the UK, for the time being.

China: watching Hong Kong after 1 October

The rulers of China want to turn the celebrations to mark the 70th anniversary of Communist rule on 1 October into their highlight of the year. For that reason, it always seemed unlikely that they would crack down very harshly on the demonstrations in Hong Kong beforehand. That could have spoiled the image of harmony between people and party which they want to project on their big day. Once the festivities are over, however, we may need to watch developments in Hong Kong very carefully. In 2014, Russia started its invasion of Ukraine's Crimea peninsula right after the end of the Sochi Winter Olympics.

In Hong Kong, Beijing's local administrator, Carrie Lam, has belatedly tried to start a dialogue with the population. But beyond rescinding the extradition law which had sparked the protests, she has not met the demands for more democracy and an independent inquiry into alleged police brutality. Demonstrations continued over the weekend. If the situation can be resolved peacefully, China and the world would duck a significant risk. But if Beijing were to use excessive force, the resulting justified backlash across the advanced world and beyond would make it much more difficult for any major Western country, not least the US, to conclude and ratify any trade deal with Beijing for quite a while. Unfortunately, geopolitical risks may continue to shape the economic outlook more than standard economic dynamics.

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