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

POLITICAL RISK UPDATE: HONG KONG, US, GERMANY

Berenberg Macro Flash

Economic news back on track but political risks still loom large

The uptick in the [Eurozone manufacturing PMI](#) from 45.9 in October to a still-soft 46.6 in November and the small rise in German Ifo expectations from 91.6 to 92.1 in November add to the signs that the [downturn in global manufacturing and trade will likely bottom out](#) at the start of 2020. Three months after the last major political shock, the sharp escalation in the US-Chinese trade war in early August, economic forces are slowly re-asserting themselves. In the absence of a new political shock, the gap between stagnating global trade and resilient growth in domestic demand across the advanced world looks set to narrow due to a gradual upturn in global trade and manufacturing over the course of 2020 rather than by a faltering of consumer spending. This is our base case. However, we need to monitor the political tail risks. A new political shock could still prolong the downturn in trade and manufacturing. If so, a gradual softening of domestic demand over time could drag down equity markets and bond yields.

Hong Kong: yearning for democracy

Beyond the direct back-and forth on US-Chinese trade negotiations, the way in which China responds to events in Hong Kong can affect the outlook for the global economy more than almost any other political risk. After months of unrest, pro-democracy forces in Hong Kong scored a major victory in local council elections on Sunday, winning a majority of 17 of the 18 district councils. This shows that, in order to resolve the situation, Beijing and its local representatives need to address the concerns of Hong Kong's citizens.

If China were to use excessive force instead, the result would not only be a human tragedy. The resulting backlash in public opinion across the advanced world would make it much more difficult to strike and ratify any US (or EU) trade deal with Beijing for quite a while. The Western world may respond with some sanctions instead. The "Hong Kong Human Rights and Democracy Act", which the US Congress passed last week and which President Donald Trump may (or may not) sign into law this week, illustrates this point. For now, our base case remains that Beijing is sufficiently aware of the risks and will not escalate the situation so badly that events in Hong Kong could deal a heavy blow to China's – and the global – economic outlook.

US politics: No game changer yet

For now, neither the impeachment hearings nor Michael Bloomberg's entry into the presidential race look set to change the political game very much. Judging from afar, the impeachment hearings seem to cement the status quo. Democrats are finding further evidence that Trump is clearly flouting the rules that should govern presidential behaviour. But the new evidence does not seem to be surprising enough to make those Republicans in the Senate, whose votes would be needed to actually remove Trump from office, change their mind. The same seems to hold for the vast majority of Trump voters as well.



In a similar vein, Bloomberg's candidacy will add spice to the presidential campaign. But it may not affect the outcome very much. A moderate with sensible policy ideas, Bloomberg can expect to do well in New York and quite a few other major urban areas. However, in the polarised political climate of the US, he may drain support more from other moderate Democrats such as ex vice-president Joe Biden and Pete Buttigieg rather than from more left-wing candidates such as Elizabeth Warren. Whereas a moderate Democrat could hope to sway enough centrist voters and beat Trump on 3 November 2020, Trump would probably have a better chance to prevail against a more radical opponent.

Of course, the race for the Democratic nomination as well as the actual presidential election are wide open at this very early stage. After a surge in support for Warren during October, she has fallen back again in the last few weeks. Electionbettingodds.com currently puts the probabilities of clinching the Democratic nomination at 22.5% for Biden, 19.4% for Warren, 19.0% for Buttigieg, 11.4% for left-wing Bernie Sanders and 7.5% for Bloomberg.

German politics: AKK strengthens her position – but probably not for long

Who will succeed Angela Merkel? By directly asking her critics to either challenge her “here and now” or shut up, CDU party leader Annegret Kramp-Karrenbauer (aka AKK) carried the day at the CDU's party convention last Friday. If new elections had to be called shortly, AKK would still have a better-than-even chance to be the CDU's candidate to replace Angela Merkel as German chancellor, in our view. The question may arise if new SPD leaders were to take their party out of the coalition with the CDU/CSU in the next two months and if Merkel – instead of staying on as lame duck leader of a minority government for more than a month – would then to pave the way for snap elections shortly. However, if the CDU has more time to prepare for potential elections, the probability that the more pro-business and more charismatic Friedrich Merz or the more centrist Armin Laschet would be the party's candidate for chancellor would rise significantly. In a contest for CDU leadership, AKK had only narrowly prevailed over Merz a year ago.

For now, we see a 70% probability that the coalition of the centre-right CDU/CSU with the centre-left SPD sticks together throughout 2020, allowing Merkel to remain chancellor. The result of the SPD leadership contest to be announced on 30 November could change this probability significantly. To gauge the political outlook for Germany, we ultimately need to watch the SPD and the Greens, who are likely to end up as kingmakers for any new German government, even more than the CDU. See [German politics – closer to the danger zone](#).

For an update on **UK politics**, see Kallum Pickering's [UK: Johnson gains as Labour goes for broke](#).



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