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

MACRO UPDATE: IRAN CONFLICT, AUSTRIA, FRANCE, SPAIN

Berenberg Macro Flash

Iran conflict: a political more than an economic risk

Relative to the potential political and humanitarian consequences of an escalating conflict between Iran and a US/Saudi alliance, markets have reacted fairly calmly so far. This makes sense. To some extent, markets are used to turbulence in the Middle East. It usually hurts global confidence, growth and markets only if it drives up oil prices significantly on a sustained basis. While we have to watch the risk, we do not expect this to happen.

After the 14 September 2019 attacks on two key Saudi oil installations, oil prices briefly surged from $60.6 on 13 September to a peak of $68.4 per barrel Brent crude on 16 September, only to fall back to their starting level within two weeks. Even in a more intense conflict, we would expect the US and Saudi Arabia to be able to maintain – or restore – the flow of Saudi oil to global markets. In addition, global oil supply has become more elastic thanks to US fracking. We thus continue to base our economic outlook on the assumption that any hypothetical big spike in oil prices would only be temporary. Advanced economies are also far less dependent on oil than they were in the past.

To illustrate the hypothetical risks: a surge in oil prices by 30% or more above their December average of $65 per barrel that lasts for three months or longer would make a major difference to our forecasts for growth and inflation. A significantly shallower or shorter spike in prices would merely cause us to fine-tune forecast details without changing the underlying story of a modest rebound in global trade at still-low rates of inflation.

Austria: Setting an example for Germany and Europe

Austria could be setting an example for policy makers across core Europe. In our annual "European Progress Monitor" of 10 May 2019, we had already praised the Alpine republic for adjusting better to economic and financial challenges over the last five years than almost any other country in Europe. That progress looks set to continue in coming years. The coalition agreement which the Conservatives and Greens unveiled last week is noteworthy in two respects: First, it combines a pro-growth tilt with a green agenda, promising to achieve carbon neutrality by 2040 without stifling economic growth. Second, the two very different coalition partners have not gone for the lowest common denominator across all major policy areas. Instead, they have both focussed on their core points such as an income tax cut and migration control for the Conservatives and the green transition and political transparency for the Greens.

In both parties, strong leaders have managed to sell to their respective base that, as a price for progress on key issues dear to them, they have to grant the other side significant leeway on other issues. The result is change instead of stalemate. That sets the new Austrian coalition of a centre-right chancellor (Sebastian Kurz) with a centre-left junior partner apart from the current coalition of a centre-right chancellor (Angela Merkel) with a centre-left junior partner in next-door **Germany**. As the German SPD and – to a lesser degree – the CDU/CSU lack leaders who could sell difficult decisions to their base, the two German coalition partners have to continuously search for the lowest common denominator. While we see a 75% probability that the German government will stay together and Merkel remain in office throughout 2020, the pace of change in Germany policies (fiscal, energy, migration etc.) remains slow. As the results do not impress voters, CDU/CSU and SPD continue to languish in opinion polls at c. 28% and 14%, respectively.

France: expect Macron to prevail

Protests against President Emmanuel Macron's pension reform continue to paralyse parts of the French public transport system. However, first signs are emerging that the momentum of the protests is waning. Metro, railway and high-speed train services are slowly improving. According to an Ifop survey published on Sunday, public support for the protests has fallen from 51% before Christmas to 44% now. Prime Minister Edouard Philippe will meet union representatives today to find a route to a compromise. Lawmakers and the big moderate CFDT union seem ready to search for a way out. Still, the far-left CGT union has called for stepped-up protests on 9 and 11 January.

The strikes have already lasted longer than the ones in 1995, which had forced then-President Jacques Chirac to shelve his pension reform plans at the time. We expect Macron to achieve what Chirac did not. By offering some fiscal sweeteners without abandoning the core pro-growth elements of his reforms, he already prevailed against the „gilets jaunes" a year ago and the SNCF railway workers in mid-2018. We look for Macron to implement his pension reform with a few concessions such as keeping exceptions for a few groups (police, military etc.) and phasing in key changes such as the rise in the age required for full retirement benefits from 62 to 64 more slowly. If so, France would remain on track for a golden decade in the 2020s.

Spain – on track for the wrong kind of government

Centre-left PSOE leader Pedro Sanchez will likely be voted in as Prime Minister at the head of a minority coalition with far-left Podemos today. Having failed to muster an absolute majority in the 350-seat parliament on Sunday with just 166 ayes, 165 noes, 18 abstentions and one no-show, a simple majority (more ayes than noes) will suffice to re-install Sanchez this afternoon. The PSOE-Podemos alliance wants to raise taxes for high earners and large companies, increase welfare spending and index pensions to inflation. More importantly, they intend to reverse some of the labour market reforms which the centre-right PP under Mariano Rajoy introduced in the aftermath of the 2008/2009 financial crisis and the 2011/2012 Eurozone crisis.

Lacking a stable parliamentary majority, the left-left coalition can pass major policy measures only on a case-by-case basis with support from other parties. As Sanchez relies on – among many other regional parties – the relatively big separatist ERC, the question of Catalonia will decide the fate of his minority coalition. In exchange for the ERC to abstain today, Sanchez has agreed to discuss a roadmap for the future of Catalonia. Disputes about Catalonia could deprive him of a majority at any time.

The Spanish economy could probably cope with a weak left-left coalition that fails to get much done. But if the coalition can enlist the support of left-wing Catalan and Basque regional parties to reverse key labour market reforms and push through further measures similar to the 22% minimum wage hike of 2019, the damage could be serious. Spain may gradually cease to outperform the remainder of the Eurozone.

Global outlook 2020: modest rebound ahead

The newsflow so far this year does not change our core views:

- The political shocks that derailed the upturn in global trade last year will likely retard global GDP growth by less in 2020. From a lower starting level, global trade and manufacturing can return to moderate growth in 2020 after bottoming out at the start of the new year.
- As always, life is full of risks. A surge in core inflation could force central banks to put an end to the post-Lehman upturn in global growth and global markets. The looming US election on 3 November 2020 will dominate the political headlines. Iranian turmoil could cause a brief spike in oil prices. But none of these risks looks dire enough to make a major difference to our cautiously positive outlook for 2020.

For more, see our Global outlook 2020 published yesterday.

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