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ECONOMIC AND POLITICAL CONSEQUENCES OF ATTACKS IN EUROPE

Berenberg Macro Flash

The sad news of the attacks in France and Germany in recent days adds to potential economic and political impacts of terror.

Single attacks do not usually have significant political implications or shift underlying economic trends. But the cluster of recent attacks on top of a series of attacks since last year may contribute to the already heightened political risks in Europe and may weigh further on prospects for economic growth.

Our core theme for Europe in 2016 is that we need to watch politics first, then economics. Brexit has been a realisation of such political risk. As European nations debate how to move forward, including how to negotiate with the UK on the details of its exit from the EU, the spate of attacks may contribute to the changed political environment. While the attacks could strengthen the ties between European nations, increasing cooperation on security and foreign policy issues to present a united front to the challenges, the opposite may occur. Right-wing populists could heighten their arguments to limit migration and encourage retreat from European co-operation. At a minimum, there will be more pressure on European leaders who are striving to maintain cohesion in the face of rising concerns among citizens. The attacks also carry economic risks.

Political risks: In Germany, while the attacks could damage support for Chancellor Merkel, linked to concerns about the government's immigration policy, the populist threat in Germany is low. Germany's pro-EU and pro-euro mainstream parties should get more than 75% of the seats in the national parliament at next year's election. The populist risk from the attacks is somewhat higher in France but nevertheless remains limited. Parties with an anti-EU or anti-euro agenda, or those at least advocating a referendum on the euro, could obtain more than 30% of the vote in national elections, led by the ultra-right Front National. However, opinion polls indicate that staunchly pro-European reformers are among the most popular politicians in the country and could score well in the second round of elections next spring. In Italy, the traditionally very pro-EU country has become more Eurosceptic following years of economic stagnation and fiscal repair. Italy is the main focus of our concerns. The heightened threat of attacks may add to existing tensions. The term of the current parliament runs until June 2018. However, Mr Renzi's government could be at risk if he loses the referendum on constitutional reform this October, potentially leading to early elections.

Please see After the Brexit vote: assessing the domino risks for analysis on the 2017-19 European elections.

Economic risks: Recent economic conditions in Europe have been improving nicely, with many economic data and survey results exceeding market expectations. In the near-term, the confidence shock and heightened uncertainty following the Brexit vote will weigh on economic prospects. Uncertainties are expected to be felt in business investment, which has been weak. The series of attacks may accentuate the on-going confidence shock and contribute to additional downside risks to the growth outlook. Longer-run business planning and investment may be adversely affected, along with the tourism industry, which would be reflected in net exports. Consumer spending is expected to hold up. We continue to forecast sustained economic growth in the Eurozone, but expect the economy to grow at a sub-trend rate of 0.2% quarter-on-quarter in the second half of the year before returning to trend (0.4% qoq) in 2017.

European Central Bank: Although the attacks could create additional risks to growth, they are unlikely to influence monetary policy. There is sufficient liquidity and financial markets have continued to behave in an orderly fashion. The ECB is unlikely to ratchet up its current programme of quantitative easing and negative interest rates in response to the near-term risks. Eventually, the ECB could decide however, that its current EUR80bn per month purchases need extending beyond March 2017 in order to meet its inflation target.

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