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AFTER THE SUMMER BREAK: NO NEWS IS GOOD NEWS

Berenberg Macro Flash

Back in the office after a few weeks spent near the Arctic circle, a first glance suggests that not much has changed. Except for unexpectedly weak US GDP in Q2, most data and developments seem to be roughly in line with our expectations. By and large, markets are behaving accordingly. Valuations still reflect a fundamental caution signalled for instance by the huge yield gap between "safe haven" bonds and equity dividends. In such an environment, markets are inclined to stabilise or move up in the absence of major news, that is if no major risk materialises. That seems to have been the case in the last few weeks.

US data: Driven by weak non-residential investment and a further inventory correction, US GDP for Q2 disappointed. A soft durable goods report for June projects that capital spending could remain subdued in Q3. While policy-related uncertainties may continue to constrain business expansion plans, solid gains in consumption and residential investment as well as in employment suggest that – short of a political accident – the outlook for the US economy remains favourable. As Mickey Levy has argued, the US economy is on course for 2.1% growth in 2H 2016 and 2017.

European data have come in mostly in line. After a stellar Q1, the economy took a slight breather in Q2. German GDP data for Q2 due Friday at 07:00h BST will likely show that very clearly. A 1% quarterly decline in Germany industrial production led by a 4.3% drop in construction indicate a downside risk to the consensus call for a 0.2% qoq gain in German Q2 GDP. **However, leading indicators have held up well across the Eurozone after the Brexit vote**. Domestic demand continues to keep the Eurozone close to its 1.6% rate of trend growth. Below-trend growth in Q2, with a risk that the first Eurozone estimate of 0.3% qoq for Q2 GDP could be revised down slightly tomorrow, seems to be little more than a payback for an unexpectedly strong Q1, which had received an artificial boost to construction from an unusually mild winter.

Looking ahead, we look for a brief period of below-trend growth in the second half of 2016 as one of the Eurozone's major trading partners, the UK, falls into its post-Brexit stagnation. Thereafter, the Eurozone should be heading back to trend growth in 2017. Most leading indicators point to an upside risk to our Eurozone calls for late 2016.

Brexit impact: with a little help from the BoE, UK prime minister Theresa May seems to be steadying the ship. That marks a welcome change from the serial gambler David Cameron, who twice put the fate of his country at stake by calling the Scottish and the EU referendum – and lost the second gamble and his job in the end. More importantly, May seems to seek realistic co-operation rather than ideological confrontation with the EU, as might have happened if any of the leading Brexiteers had moved into 10 Downing Street. While nothing has been settled and while Britain is starting to pay the price for its Brexit decision in terms of reduced economic growth and a reduced purchasing power for its tourists on the beaches of Benidorm, May's calm approach does limit the risk of a short-term crisis. The data available so far suit our call that the UK will have growth just a tad above stagnation for the remainder of this year but will not fall into recession.

KEY RISKS AHEAD

As discussed at length over the last ten months, the key risks are political rather than economic. None of the major risks seems to have taken a turn for the worse in recent weeks. Turkey's lurch towards more authoritarianism after a rather clumsy coup attempt is a worry. However, it does not fall into the category of globally relevant risks, at least not yet.

US politics: learning to love the stalemate

The key global event in coming months will be the US elections on 8 November. The stakes are unusually high. A Trump victory could be bad news for global markets. Nobody knows what a president Trump would really do. But the risk of foreign policy upsets and a trade war with China would loom large. Trade-dependent Europe could be more vulnerable to that than the US itself. To a lesser extent, a sweeping victory for the Democrats in which they would take control of both houses of Congress could also be a concern. That would allow a president Clinton to implement a domestic agenda shaped too much by the regulatory inclinations of the more left-wing parts of the Democratic Party. From a market-perspective, a president Clinton forced to compromise with a Republican majority in the House of Representatives (and/or the Senate) would probably be the most palatable outcome.

This is just what opinion polls currently project. Clinton has a lead over Trump, although that lead is too volatile for comfort. Polls suggest that the Republicans, many of whom are not exactly fans of Trump, will maintain a majority in the House while the outcome for the Senate is too close to call.

The Italian risk

Politics in Germany and France are looking fairly stable by their own standards and Spain's Rajoy is apparently on course to form a minority government within the next four weeks with the help of the liberals. Italy thus remains the key political risk to watch. The pro-reform prime minister Renzi needs to win a referendum later this year to ratify his sweeping constitutional reform. While no date has been set, it will likely be held between the end of October and early December. As Renzi has tied his fate to the referendum result, a "no" vote could imply a tail risk of early elections in which some opposition parties would campaign with a demand to hold a referendum on euro membership. After opinion polls had shown a steady erosion of support for Renzi's reform up to the point that most polls were projecting a "no" to the constitutional reform four weeks ago, the polls have now improved a little. The average of recent polls even gives a slight lead to Renzi. That Renzi has now called it a "mistake" to "personalise" the referendum might be a hint that he may not resign even if he lost the referendum? The Italian political risk remains serious. Nonetheless, that opinion polls have stabilised fits into the overall diagnosis: the key risks out there did not get worse over the last few weeks.

Other risks

Life is always full of risks. Ever since the Lehman crisis, markets have focussed on risk scenarios even more than before. Beyond those risks mentioned above, we also have to keep an eye on many other issues such as China's grab for the South China sea, the conflicts in Syria and Libya and the behaviour of Russia. Some recent news could point to a more aggressive Russian stance against Ukraine again. Any major conflict could easily spook markets again. But by and large, the summer so far has been reasonably calm. Let's hope it stays that way.

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