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MONDAY MACRO UPDATE: EU POLITICS, ECONOMIC OUTLOOK, JACKSON HOLE

Berenberg Macro Flash

A SUMMIT FOR RENZI

Merkel, Hollande and Renzi meet today to discuss post-Brexit EU reforms. The informal get-together starts a series of intra-EU discussions ahead of the 16 September summit where EU27 leaders want to outline some reform ideas to be elaborated in more detail in the six months thereafter. Today's meeting serves two major purposes:

- First, it is supposed to strengthen the position of Renzi ahead of Italy's constitutional reform referendum which may determine Renzi's political fate. That Merkel and Hollande meet Renzi in a location of high symbolic value for Italy off the southern coast of the country should drive home the point that Renzi is one of the key leaders of the EU27 helping to shape the future of the continent. The Italian referendum, likely be held in November, poses a key risk to the political and economic outlook for later this year, almost on par with the US political risk. Opinion polls suggest that the result of the Italian referendum is too close to call.
- Second, the leaders will compare notes on EU reform ideas. Renzi may push more ambitious ideas than Merkel, who prefers modest changes ("a better Europe rather than more Europe"). As discussed before, we do not expect major changes to EU treaties that would need to be ratified by all 27 countries. Instead of a new rulebook, the EU27 will continue to head down the direction which has been visible for years, namely towards a more flexible interpretation of the existing rules and more cooperation between groups of member countries on individual issues rather than more integration for all.

We do not look for any formal loosening of the fiscal rules at the end of the EU reform discussions. Nonetheless, last month's decision to not impose fines on Spain and Portugal for their 2015 fiscal overshoots exemplifies the flexibility of the rules. Within limits, countries will be allowed a little more fiscal leeway. We expect that to hold especially for Italy, which has implemented serious structural reforms under Renzi. Of course, the meeting today will likely discuss these matters only in general terms without coming to any final conclusion.

Brexit itself will not be a big issue today. It is up to the UK to consider which options are realistic and to file for divorce before the slow-moving EU27 can respond. On Brexit, the bottom line for the EU27 will remain that, outside the EU, the UK cannot get a better deal than inside.

EUROPEAN ECONOMIC OUTLOOK: MOSTLY STABLE

This week, we will get the second monthly crop of key confidence surveys for Europe after the Brexit vote of 23 June. We look for more of the same; roughly stable readings for the purchasing managers' indices on Tuesday and the German Ifo business climate due Wednesday. On the negative side, some manufacturers across Europe may notice that demand for investment goods is falling in the UK in response to post-Brexit uncertainty. However, the calm approach of UK prime minister May has prevented a more general confidence crisis in the UK, which could have had more serious ripple effects on the UK's trading partners on the continent. In addition, the economic situation in many emerging markets seems to be stabilising, helping to bolster the export outlook for European companies. Politics in Russia and Turkey have become bigger concerns, but these problems are not yet of a scale to have a major impact on European business confidence.

JACKSON HOLE: DON'T EXPECT TOO MUCH

Short of any unexpected drama in global politics, market attention this week will likely focus on the US Fed's annual Jackson Hole symposium Thursday through Saturday. Observers hoping for clear pointers to the next monetary policy move will likely be disappointed. First, the meeting is more about a general discussion of key longer-term issues than about the next policy move. The symposium's title "Designing resilient monetary policy frameworks for the future" suggest that rather clearly. Second, whether or not the Fed will raise rates in December, as we expect, will depend mostly on the economic data due in the meantime. Even Janet Yellen does not know much more than the market as to how Q3 is shaping up in the US at this stage.

Many commentators will focus on the question as to whether monetary policy has become powerless and whether it is thus up to fiscal policy to play a bigger role. In my view, much of the discussion is misguided:

- As to **monetary policy**, the extremely low level of short-term and long-term interest rates means that any further cut in policy rates to reduce short-term money market rates or any further asset purchases to lower financing cost at the longer end of the maturity spectrum would indeed be largely pointless for economies that are close to trend growth anyway. Nonetheless, in case of an actual or potential confidence crisis, monetary policy can still help to stabilise the situation, as the BoE has shown with its reaction to the Brexit vote.
- **Fiscal policy** is overrated. If implemented in a timely fashion, a fiscal boost can occasionally help to smooth the economic cycle. But a fiscal stimulus cannot lift trend growth. As most major economies in the Western world are expanding at a reasonable if somewhat mediocre rate, any major fiscal stimulus would carry at least as many risks as rewards. In the Eurozone, we are likely to get more of the same, namely a small fiscal stimulus as Germany expands spending on infrastructure and refugees while countries such as France, Italy and Spain take their time to meet fiscal targets. After a stimulus of 0.3% of Eurozone GDP in 2016, we expect a stimulus of at least 0.2% for 2017. While the UK will probably announce a fiscal stimulus of around 0.5% of GDP for the next two years in November, the only result of the US elections in November that seems to be almost absolutely clear already is that the US will expand infrastructure spending in coming years. By and large, the Western world looks set to spend part of the windfall which the public purse garners from rock bottom interest rates. Going beyond that would be neither necessary nor prudent, in my view.

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