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MONDAY MACRO UPDATE: ITALIAN POLITICS, GERMAN ECONOMY

Berenberg Macro Flash

ITALY: A RENZI GOVERNMENT WITHOUT RENZI?

Italy is trying to defuse its political crisis fast. After Renzi's failed referendum eight days ago, the likely solution for the time being seems to be to carry on largely as before, just with Renzi exerting control from a back rather than the front seat. President Mattarella yesterday picked foreign minister Paolo Gentiloni (62) to form and lead a government based on the same centre-left and centrist political forces that had backed Renzi in parliament before. As there have not been serious defections from these groups after the referendum, there is a reasonable chance that the government should be confirmed by separate votes of confidence in both houses of parliament. The key tasks of the government will be to deal with the banking crisis and to design a new election law, probably jointly with Berlusconi's centre-right which seems open to such talks while refusing to take responsibility by actually joining the government. As to the banking issues, even German Bundesbank president Weidmann said over the weekend that he would not rule out state help for Italian banks if required. Such words from a Bundesbanker who is usually seen as a hardliner suggest that, one way or the other, Italy will be in a position to tackle its thorny banking problems in the near future.

Of course, the political risks in Italy remain serious. The new government, which will probably look largely like the old government, needs to be confirmed. Whether it can avoid the risk of snap elections in 2017 also remains an open question. As expected, president Mattarella would apparently like the new government to serve out the term until regular elections in May 2018. The radical opposition clamours for early elections. Even Renzi may at some point see early elections as his chance to return to the front seat of Italian politics, exonerated from losing the referendum by a fresh popular mandate for the centre-left party he still leads. But so far, Italy is dealing with the aftermath of the failed constitutional referendum in an orderly manner.

GERMANY: MOMENTUM AT HOME

The German economy entered the final quarter of the year in reasonable shape. Although industrial output in October surpassed its Q3 level only by a modest 0.2%, the surge in volatile manufacturing orders by 4.9% in October versus the Q3 average points to some stronger gains ahead. That would be in line with leading indicators which have by and large strengthened over the last few months. More importantly, the 1.3% rise in October retail sales above the Q3 average highlights the solid momentum at home. That imports (up 1.4%) advanced faster than exports (+0.9%) in October relative to the Q3 average fits the picture of a satisfactory economic expansion driven by domestic demand. After a temporary dip in GDP growth to 0.2% qoq in Q3, we look for a 0.4% qoq gains in German GDP in Q4. For next year, we expect more of the same, with some upside risk to our 2017 call for 1.5% German growth. Further gains in employment and real wages, a modest fiscal stimulus of 0.2% of GDP, a little spillover from any "Trumpenomics" boost in the US and an exchange rate that will likely remain competitively valued should keep demand growth on track, at least as long as political risks do not materialise with a vengeance. So far, the economy seems to be coping rather well with the occasional political surprises. For the **Eurozone** as a whole, we look for growth roughly in line with that of Germany next year, with **Spain** well above and **France** and **Italy** below the German pace of expansion.

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