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MONDAY MACRO UPDATE: TRUMP, BREXIT, FRENCH AND ITALIAN POLITICS

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TRUMP: A DIVISIVE START

"America first, America first". Across much of Europe, President Donald Trump's inauguration speech did not go down well, with German mainstream FAS newspaper even calling it a "provocation". At least to European ears, the protectionist and anti-establishment rhetoric sounded closer to Marine Le Pen than Angela Merkel, looking backwards rather than showing a way forward for the US and its allies. For a discussion of the new opportunities (think Congress) and heightened risks (think Trump) of the political changes in the US from a non-US perspective, see [President Trump: a view from abroad](#). With his "us against them" themes, Trump put the spotlight more on the risks than the opportunities. Of course, it's early days. The tone from some of the people surrounding Trump sounds much more conventional and encouraging.

Because Trump's rhetoric comes across as problematic in major parts of Europe, Trump may well drive some European voters away rather than towards right-wing populists. If so, that would be the same effect seen after the Brexit vote. Right afterwards, the confusion that befell Britain and the impression that even Brexit campaign leader Boris Johnson had no clear idea as to what Brexit actually means strengthened rather than weakened support for the European Union in many countries on the continent.

UK: SUPREME COURT RULING, MAY MEETS TRUMP

UK Prime Minister Theresa May will be the first international leader to visit Trump in the White House. Trump says the UK is at the front of the queue for a trade deal. The US is the biggest single buyer of UK goods and services after the EU. A free trade deal with the US would be of major benefit to the UK. But has Trump seen the US's bilateral trade balance with the UK? In 2015, the UK ran a trade surplus in goods and services with the US of 2.1% of UK GDP – compared to 1.4% a decade ago. By Trump's own logic, that the UK sells more than it buys from the US should put the UK in the basket of countries currently "stealing a living" from the US like China, Mexico and Germany. Concluding a substantial trade deal that could significantly improve UK market access to a much bigger and increasingly protectionist US might not be that easy for the UK.

Who controls the Brexit process in London? The UK Supreme Court will announce on Tuesday whether Prime Minister Theresa May can trigger Article 50 to kick-off the two-year British-EU divorce negotiations or if parliament must take a vote first. The Supreme Court case came about after May's government appealed a High Court judgement in favour of a parliamentary vote. Since parliament already agreed in the meantime to accept May's self-imposed March deadline, the court ruling matters less than before. As Labour leader Corbyn has come out in favour of implementing the referendum result, May will likely win the vote. However, if parliament is required to take a vote, May will have to produce a strategy – probably a white paper or something like that for parliament to discuss and vote on. Such extra information could be a plus for markets. We also see a modest chance that the mostly pro-EU parliament nudges the government towards a somewhat softer stance on Brexit, one that places more weight on access to the EU Single Market than controlling borders and the like.

FRANCE: ADVANTAGE MACRON?

The real winner of the French Socialist primaries could be the candidate who wasn't on the ticket: pro-reform ex-economics minister Emmanuel Macron. He looks set to benefit from the lurch of the Socialist Party to the left as the left-wing former education minister Benoit Hamon won the first round of the Socialist primaries on Sunday with 36% versus 31% for the mildly reformist ex-prime minister Manuel Valls and 18% for another left-winger, Arnaud Montebourg. Montebourg has now endorsed Hamon. That puts Hamon, who was trailing the two favourites (Valls and Montebourg) until recently, in the pole position to



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win the run-off of the Socialist primaries on 29 January. A Hamon victory would be the second upset after Francois Fillon emerged as the unexpected winner of the centre-right primaries two months ago. Coming from the hard left, Hamon intends to reduce the working week in France from 35 to 32 hours and levy a tax on robots.

For the first round of presidential elections on 23 April, opinion polls currently show a three-way race between centre-right reformer Fillon (around 25%), ultra-right Le Pen (around 25%) and centre-left liberal Emmanuel Macron (around 20%) with both potential Socialist candidates, Hamon or Valls, trailing well behind. Macron's campaign gained considerable momentum early this year. As a Socialist candidate from the hard left, Hamon would probably drive a further chunk of centre-left voters towards Macron on 23 April. Such a swing in votes towards Macron could possibly deny Le Pen a place in the run-off of the presidential elections on 7 May. If pro-reform Valls wins the Socialist primaries instead of Hamon, he would make life more difficult for Macron as he would appeal to roughly the same voters as Macron.

If Macron makes it into the second round of the presidential vote on 7 May, polls suggest that he would win against both Le Pen and Fillon. If Fillon faces Le Pen in the second round, he would also likely prevail against Le Pen, although his once stellar lead of 67% to 33% has eroded slightly to 62% versus 38% now. Whether it is Fillon or Macron who eventually wins the presidency, each one would likely introduce serious pro-growth reforms in France. That would be a major reform opportunity for France and Europe.

ITALY: MIND THE COURT

Heading for early elections? On Tuesday, Italy's Constitutional Court is scheduled to hold a public hearing on the election law for the lower house of parliament. The "Italicum" law introduced by Renzi when he was still prime minister awards a majority of seats to the strongest single party. While that looked like a good idea for Renzi when his centre-left Democratic Party was well ahead in the polls, it is now seen as a risk as it could theoretically propel the "Five Star" radicals to power instead. After voters rejected the other part of Renzi's big political overhaul, namely to downgrade the second house of parliament to a secondary role in a referendum last December, the political and – probably – legal case for changing the Italicum election law looks strong.

Many observers expect the court to at least ask for some amendments. Once the court has issued its verdict, political discussions about a new election law will start. Such a new or amended law is a prerequisite for new elections. That Italy could go for early elections from June 2017 onwards instead of waiting until the scheduled end of the parliamentary term in May 2018 is arguably the biggest political risk in Europe this year. Taking all significant radical parties together, Five Stars, Lega Nord and "Brothers of Italy", those political forces garner around 45% in opinion polls. In early elections, these parties would campaign for a referendum on the euro.

As we argued in our Year Ahead outlook ([Global outlook 2017: more growth, more links](#)), we put the tail risk that Italy may vote itself out of the euro at around 5%. The risk does not look huge: a majority of Italians seems to be in favour of the euro, the constitution does not allow for a referendum on an international treaty such as the one establishing the euro, changing the constitution would be extremely difficult as Renzi found out last December. In addition, quite a few of the deeply divided Five Stars would likely not vote to leave the euro anyway. Nonetheless, the risk is not zero either. Political uncertainty seems to be hanging like a sword over Italy, discouraging investment and making it difficult to attract capital to recapitalise the banks.



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