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POLITICAL UPDATE: US, GERMANY, FRANCE

Berenberg Macro Flash

Europe will master the populist challenge. We base all our economic and financial forecasts on this assessment. The ongoing taming of Trump, the victory for German chancellor Merkel's CDU in the regional election at the Saar and the further rise in support for the most pro-European presidential candidate in France suit this view. The newsflow over the last three days follows the defeat for anti-EU populists at the Dutch election eleven days ago. Although risks abound, recent trends are mostly pointing the right way.

US: TRUMP MEETS POLITICAL REALITY

The self-styled master of the deal has failed at the first hurdle. Instead of clinching a fast deal to repeal and replace “Obamacare”, US president Donald Trump and other Republican leaders had to withdraw their draft act on Friday even before the first vote in Congress. Seen from afar, this has three major implications:

First, it shows US checks and balances at work. The US political system can hem in even the most unusual president. Trump's immigration control decrees are on their way to the Supreme Court, his camp's contacts with Russia have turned into a major embarrassment for him and his vow to replace Obamacare by some unspecified “great” plan has been exposed as hollow. Last year, Trump's campaign rhetoric had raised grave concerns abroad. On the key issues that count for Europe and beyond, namely a potential US conflict with China, outright protectionism and a hypothetical deal with Russia's Putin that may have undermined NATO, Trump's first nine weeks in office have not borne out these concerns.

Second, Trump and Paul Ryan, the Republican leader in the House of Representatives, have suffered a major setback. This rekindles concerns that the Republicans may be so ideologically divided that they may not get much done despite a Republican majority in both houses of Congress and a Republican president in the White House. We do not expect that setback to derail eventual enactment of tax and fiscal reform, though.

Third, it shifts the focus onto the major fiscal overhaul that Republican leaders in Congress are planning. We expect a pro-growth corporate tax reform and a likely fiscal stimulus to raise US GDP growth to an annualised rate of close to 3% from mid-2017 onwards. Is this above-consensus forecast now at severe risk? On the one hand, Friday's events may weaken Trump and Ryan and their ability to get a major reform package through Congress. On the other hand, following their defeat on health care, Republicans will feel the pressure to enact some kind of tax reform, and may be more willing to negotiate. For two reasons, the fiscal reform discussions may fare better than the first Ryan/Trump attempt to reform healthcare: First, the Republican leaders in Congress are better prepared on these issues. Their blueprint for tax reform is much more reasoned and detailed. Some of the key provisions have been in the works and debated for a long time. Second, it is easier to defuse fiscal controversies – compared to ones about health care - with money. Disputes within the Republican camp about tax reform details may be settled by allowing fiscal deficits to widen more in the near-term than the fiscal hawks around Ryan would have considered prudent a while ago. On balance, we still look for a substantial US fiscal package likely to be passed, probably this August.

GERMANY: ADVANTAGE ANGELA

Election season has started well for chancellor Angela Merkel. Her CDU won the regional election in the small state of Saarland, raising its share of the vote by 5.4 points to 40.6% according to projections at 20:30h local time. With 29.8%, the centre-left SPD remained well below what opinion polls had suggested. The CDU will continue to govern at the Saar with the SPD as the junior partner. Four features of the result deserve special attention:

First, more people cast their vote than last time. The rise in voter participation from 61.6% to 70.4% benefitted the traditional mainstream parties, notably the CDU. In uncertain times dominated by news about Trump, Putin, Erdogan and Brexit, many Germans are rallying around the pro-European mainstream, just like the Dutch did eleven days ago. **The result at the Saar weakens the right-wing and left-wing fringes.**



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Second, the regional CDU leader at the Saar, state prime minister Annegret Kramp-Karrenbauer (AKK), is a close ally of chancellor Merkel. Like AKK at the Saar, Merkel is a fairly popular incumbent. The result thus bodes well for Merkel who is running for a fourth term at the German election on 24 September..

Third, the “Saint Martin” effect helped the SPD much less than opinion polls had projected. The surge in support for the SPD by ten percentage points in national opinion polls since the party had chosen Martin Schulz as its new leader did not translate into votes at the Saar. Although the SPD did less badly than regional polls had projected three months ago, the party fell short of the elevated recent expectations. The risk that a victorious SPD might have chosen to form a government with the ultra-left at the Saar apparently made some voters shy away from casting their vote for the SPD.

Fourth, although the anti-EU right-wing AfD managed to clear the 5% threshold to get seats in the regional parliament, its 6.2% result falls far short of what the AfD had achieved in other recent German state elections. While it is early days, this adds to some other signs that the AfD may finally have peaked.

We continue to see a 75% probability that Merkel will be re-elected on 24 September, with a 25% chance that her SPD challenger Schulz will lead the next German government. The next German regional elections are on 7 May in Schleswig-Holstein and on 14 May in North Rhine-Westphalia, the largest of the 16 federal states.

FRANCE: ADVANTAGE MACRON

With four weeks to go until the first round of the French presidential election on 23 April, the staunchly pro-European centrist reformer Emmanuel Macron is turning ever more into the favourite to win. On Sunday, nine centre-right members of the French Senate endorsed him. For what opinion polls are worth, they indicate three recent trends: First, with 26% to 25%, Macron is now slightly ahead of the ultra-right Marine Le Pen in most recent opinion polls for the first round on 23 April. Second, the scandal-stricken centre-right candidate Francois Fillon remains stuck at around 18%. Third, the communist-backed hardliner Jean-Luc Melenchon (around 13%) has pulled ahead of the official Socialist candidate Benoit Hamon (around 11%) after the first TV debate six days ago. This further reduces the tiny tail risk that Melenchon may bow out at the last minute, endorse Hamon and hence give the Socialist candidate a chance to make it into the final round of the presidential election. For the second round, polls predict a decisive win for Macron over Le Pen

Of course, the French campaign is far from over and opinion polls are no reliable guide to actual election outcomes. But shift in polls can carry a message. Shortly ahead of the Dutch vote, polls had picked up rising support for prime minister Rutte versus ultra-right Wilders. At the Saar, the last polls had also been more positive for the CDU than the ones before. So far, the trends in French opinion polls are mostly encouraging in that they suggest no more than a small tail risk that Le Pen could win.

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