The Global Economy – 11/17

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on Brexit and other relevant events in the global economy
by J.S. Research KG
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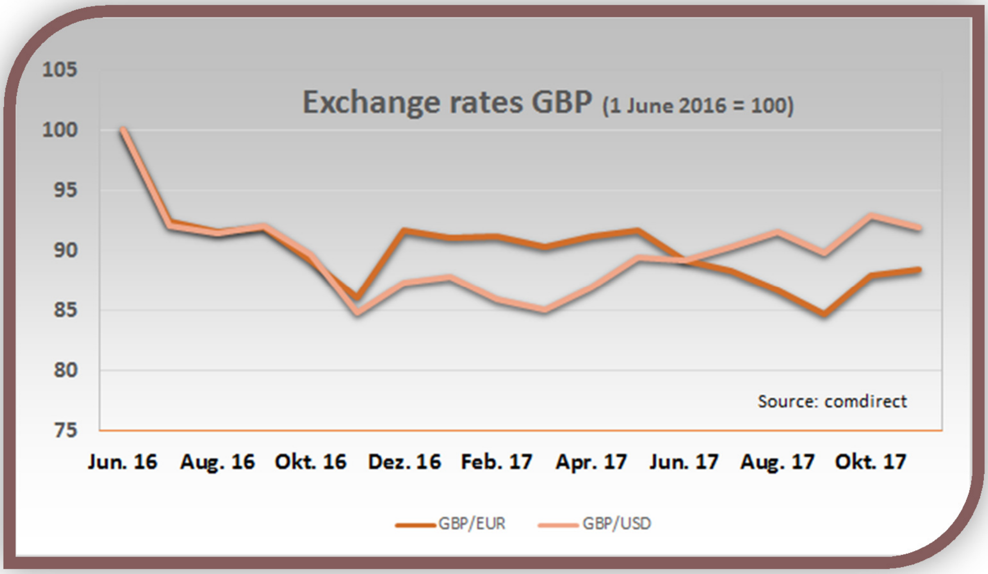
No progress in Brussels and disorder in Westminster – Brexit at a crossroads

So the decisive summit came – and the EU27 told Britain that to enlarge the Brexit talks to the areas of transition and trade, progress has not been sufficient thus far. Theresa May had hoped that her Florence speech might have provided enough concessions to take the talks to the next level. Particularly France and Germany, however, told Britain bluntly that her offer was no more but a starting point. Though at the end of the Brussels summit, Angela Merkel threw a lifeline to the British Prime Minister by all but promising to advance the talks to the next phase in December, the priorities of the German chancellor in general have been perhaps the single gravest misjudgment by the British government. Angela Merkel has never left any doubt about her, indeed, emotional attachment to European unity; by believing to the last minute that, eventually, the German chancellor would come round and side with the UK in order to protect German business interests, Theresa May and her team have fallen into a trap of their own making. True, Mrs Merkel has absolutely no interest in a no-deal Brexit – that at least ought to protect the talks from collapsing all too soon. Yet it is the British side of the negotiating table now seemingly set on a course for that worst of all Brexit scenarios if considerable effort is not made to evade it. It attests to the mental loggerheads on both sides that the EU27 believes the UK to secretly condone a no-deal Brexit while the UK feels positively pushed into exactly that outcome – a sure recipe for failure. Tellingly, even the most vocal proponent of a soft Brexit, Chancellor of the Exchequer Philip Hammond, lapsed into calling the EU “the enemy” – a slip of the tongue for which he rushed to apologise later. Because of the dynamics at play in domestic British politics, ever since the accidental general election in June we have been projecting that a no-deal Brexit has become the base scenario to be actively avoided rather than the other way round. After the Prime Minister’s coming round to the inevitability of a transition period of at least two years, Brexiteers now fear for their project: The EU has made it clear that whatever transition might come into effect, it cannot be anything other but the simple prolongation of the status quo – without Britain having a vote, of course. By potentially prolonging this transition phase over years on end, Brexit then might sneakily disappear. Hence, the Tory Brexiteers have taken to the parapets, as we had anticipated, and called for the Prime Minister to walk out on the negotiations. Meanwhile, Labour cunningly ploys to cabal with Tory Remainers over several amendments to the Great Repeal Bill designed to soften its hard edges (see issue 09/17 of this report); if any sizeable number of these amendments will be passed against the government (the Conservatives’ ally, the DUP is not bound by the support agreement with the Tories on most of these amendments), the days of Theresa May in No. 10 will be numbered – and Jeremy Corbyn will be entering Downing Street heading another minority government before likely calling yet another snap election sometime during 2018.



The new four-party government in the Netherlands - will it last? – Big companies gobbling up bonds skew the market – US states' interests and Donald Trump collide over NAFTA

Eventually, a deal in the prolongued negotiations for a **new Dutch government** has been struck – but on terms just as doubtful as an outright minority government would have entailed. Though our projection of the latter was thus negated, it was by the closest of margins: The new coalition of Prime Minister Mark Rutte's VVD, D66, CDA, and Christen Unie controls exactly 76 of the 150 seats in the Tweede Kamer, the lower house of the Dutch parliament. Its intentions are quite business-friendly: The new government will bring lower business taxes at the expense of severe cuts in public health-care spending, for example. Yet it is the bootstrapping ground of migration politics in particular which stands to threaten survival of this precarious alliance. Historically, the Christen Unie has favoured the very liberal approach of GreenLeft, a mixed bag of environmentalists, socialists, and communists, but was cajoled by its new coalition partners into a rather diffuse compromise on the subject-matter. The response from the opposition came swiftly: Jesse Klaver, the young shooting-star leader of GreenLeft who had refused to join the government, called the coalition agreement "not right, but ultra-right". If, by a very awkward combination indeed, his party now will be taking turns with Geert Wilders islamophobic Freedom Party in firing from two opposite sides in parliament on the government, this will leave cracks in the alliance's armour in time, endangering its flimsy one-seat majority. Yet the most indicative verdict on the government's prospects came from the party leaders themselves: With the exception of Rutte, Messrs Buma, Pechtold, and Segers of the CDA, D66, and Christen Unie, respectively, have announced not to join the cabinet but to stay in their posts as leaders of their parliamentary parties. This is but governing with one foot in the next election campaign. Taken together, it is all just another expression of an underlying, disconcerting trend in Dutch politics: A country already known for its fragmented party landscape, that landscape has become even more splintered in recent years, as large, moderate parties capable of leading pragmatic governments have all but disappeared. Undoubtedly, the Netherlands have entered a new era of political instability; a process initiated by the break-down of the compromise-heeding – and sometimes stifling, as it turned out – so-called Polder model around the turn of the millenium. This is why, in the face of our falsified projection of a minority government, we stick to our projection of fresh elections sometime during the second half of next year or over the course of 2019; Dutch politics need yet to find their new locus of relative stability.

The world's financial markets become ever more obscure by the year: The Financial Times has revealed that the **top 30 US companies have amassed some $400bn of corporate bonds** in the United States, equalling roughly 5 per cent of the market. And that, mind you, is only on top of their sovereign debt holdings. Consequently, their financial departments increasingly tend to behave like asset management behemoths, attempting to enhance their returns in a low-volatility, low-yield environment – and that exactly is where the new risk created by this unusual development looms. Because, by contrast to the traditionally dispersed and comparatively small non-financial bond holders, those new, gargantuan ones will need to rush for the exit once interest rates inevitably will start to rise (further) and, conversely, bond prices to fall. Yet the bond market, apart from the well-greased one in US Treasuries, never has been as liquid as equity, let alone forex markets. Into the addition, particularly corporate debt markets have dried up even more by regulations post-2008 limiting banks' market maker activities. In other words: A market singularly unable to process large chunks of paper thrown onto it will be pressed to do just that once the stampede of the corporate financial departments begins – you don't have to have a degree in economics to anticipate the effects on prices. A crash in bond markets, of course, would entail exploding rates, finishing off all those zombie companies on life support from ultra-loose monetary policy, thus spilling into equity markets, too. At the same time, all those passive investors believing they may cash in their bond ETFs at market prices whenever they choose to will awake rudely to the harsh reality that the issuers of their ETFs are just as unable to sell on a clogged bond market as anybody else. It is this completely new threat from the combination of corporates-turned-asset-managers and ETF-mania run amok that is the most relevant reason why the next financial crisis is set to emanate from the bond markets, once the world's central banks overshoot markets' expectations about the rate of retrenching QE.

It has been one of the pillars of Donald Trump's election campaign: his vow to end free trade allegedly so harmful to the US economy and American jobs. In particular, the then Presidential candidate vowed to vet, renegotiate, and – should it come to that – **take the US out of NAFTA** unilaterally. Incidentally, this has seemed to be one of promises on which the 45th President might produce results very fast because, while only Congress may decide on new trade deals, the executive can repeal existing ones, as the precedence of Andrew Johnson in the 1860s shows. Or does it? Increasingly, legal experts, academics, and members of Congress dig into the matter as to whether the President really can act unilaterally in rescinding trade contracts, and if so, with what exact meaning. For it appears that both pragmatically as well as legally, Donald Trump might be just falling into another trap of his own making. Firstly, even if the President can take the US out of NAFTA, it doesn't mean Congress will stand to attention and applaud – quite to the contrary. A vocal pro-trade faction – predominantly among the Republicans – is reported to be forming in Congress weighing options to force the President's hand. For Donald Trump's signature project in the first year of his administration for which he definitely needs Congress is tax reform, the votes for which might hang in the balance if pro-trade (and often anyway fiscally hawkish) members from trade-dependent Midwest and Southern states refuse to support the President in a tit-for-tat: One of the most pronounced effects of NAFTA – apart from an enormous upsurge in agricultural exports – has been the substantial cheapening of intermediate industrial goods imports such as car parts and chemicals, so much so that many states import way more than half of the total from Mexico and Canada, respectively (see table). And secondly, it becomes apparent that even though the President might declare NAFTA void, Congress still decides on the practical implementation as far as tariffs etc. are concerned; Capitol Hill might thus frustrate the Mr Trump's intentions, leaving his decision a void shell. The point is: As we have repeatedly commented on, the President has taken the art of consequent alienation of his own party colleagues to new mastery. If he repeals NAFTA over the heads of Congress, this might very well become the straw which breaks the camel's back. We thus project not an outright rescinding, but rather some form of mutually face-saving renegotiation of NAFTA – otherwise, an increasingly isolated President will find himself in the wilderness proper.

Imports of intermediate goods by state, 2015

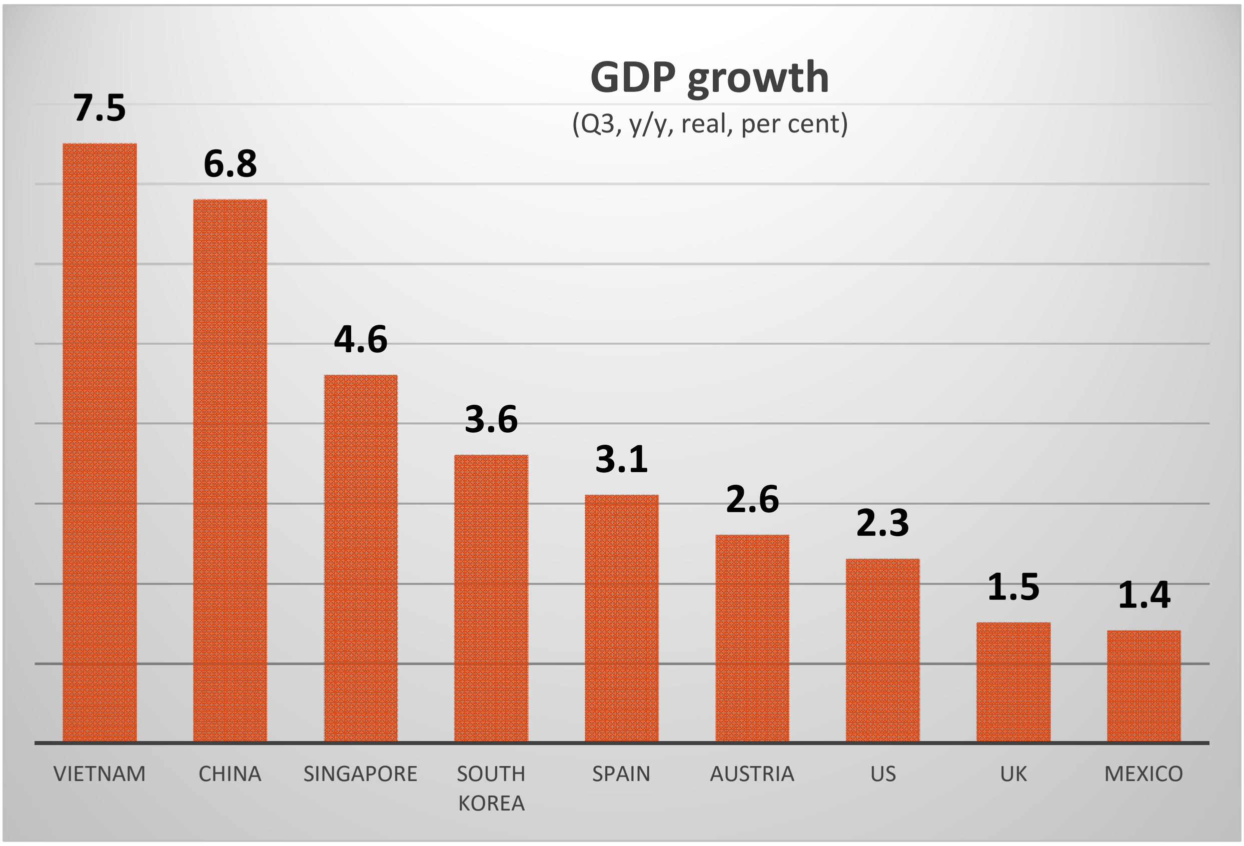
State	Share of imports from NAFTA
Montana	92.6%
Wyoming	85.2%
Vermont	82.7%
North Dakota	75.5%
South Dakota	70.9%
Maine	70.1%
Oklahoma	63.3%
Michigan	60.9%
Minnesota	60.6%
Utah	52.9%

Source: Brookings Institution

Statistical bulletin – facts & figures

--- **Business confidence** in Canada continued its recent merry climb. Indeed, the country's general economic sentiment is now trending upwards ever since its slump at the beginning of 2016. Quite the contrary in New Zealand: The shock formation of a government by Labour, the losing party in the country's recent general election, in a coalition with the populist New Zealand First left business confidence severely dented. --- **Manufacturing production** in China continued its sound growth without so much as a hiccup, even if now on persistently single-digit levels. In Portugal, production grew by a solid 2.4 per cent, consolidating a bit from a recent spike. --- **Inflation** in Thailand has barely moved in months, oscillating around zero. At least, with global prices starting to rise again, its being mired in a mild deflation ought to be history. In Ethiopia, however, inflation is at risk of running out of control: Its recent rise to a double-digit rate is the fifth consecutive acceleration. --- **Imports** into India continued to grow by frothy double digits in US Dollar terms, gathering additional steam over the past months. Down Under, imports never seem to stray from their solid, continuous growth rate ever since the aftermath of the Great Recession, rolling on and on and on. ---

Business confidence (Oct., pts.)	Manufacturing prod. (Sep., y/y, real)	Inflation (Oct., y/y)	Imports (Sep., y/y, USD)
•Canada: 63.8 ⇧ •New Zealand: -10.1 ⇩	•China (nom.): +8.1% ➲ •Portugal: +2.4% ➲	•Thailand: 0.9% ➲ •Ethiopia: 12.2% ⇧	•India: +18.1% ⇧ •Australia: +3.3% ⇧



Sources: Trading Economics, bloomberg, comdirect, own calculations

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