

22 March 2019

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Europe takes control over Brexit time-table, but rejects responsibility to decide on its fate

- **With a double deadline to Brexit, May is given a chance to fight, without enabling her to put UK fate into Europe's hands**
- **In Europe, the fragile recovery is not helped by the protectionist tone**
- **China's potential current account deficit could hurt US debt refinance**

Europe is taking back control over Brexit with a double deadline

Just when you think that the Brexit drama has reached its climax, there is another week that tops it. The week started with good hope for a third meaningful vote last Tuesday, when out of the blue the Speaker found a 400-year old rule that prevented the vote on PM May's withdrawal agreement for the third time. Yesterday, Theresa May asked the European Parliament for a short technical delay. Wednesday President Tusk told May that any extension would be conditional on an acceptance of the withdrawal agreement by the House of Commons.

Meanwhile in the EU, Emanuel Macron and Angela Merkel have been firmly disagreeing on the length of the delay. While Merkel took the stance that the EU should do all it can to avoid a no-deal Brexit, Macron warned that a long delay could do serious harm to the EU. Late last night the European Council decided to go along with Macron's view. President Tusk stated that the council "agreed to extend the Article 50 process until 22 May as long as the UK parliament approved the withdrawal agreement at the third time of asking next week. If that did not happen the extension would only run until 12 April."

We think however that the third meaningful vote next week does not have much chance of passing. For this to happen, 75 MPs would have to change their mind to win the vote. Last week, I wrote that the passing of the vote would depend on whether a long delay, that puts all options back on the table, even no Brexit at all, horrifies the Brexiteer MPs sufficiently to agree to the withdrawal agreement. But this week May stated that she is unwilling to accept any delay beyond June 30. Through this statement May has reduced the credibility of the 'threat' of a long delay herself, making it even less likely that this vote will pass. If there is no deal, the UK has until April 12 to decide whether it wants to leave without a deal or with a long delay. After April 12, a long delay including participating in the European Parliament election is no longer an option as UK won't have sufficient time to prepare for those elections.

In our view it is most likely that there will be last minute request to the European Council for a long delay rather than a no-deal. This could imply the resignation of PM May. A request long delay would imply a rethink of the whole approach to Brexit. This would likely get the support from Europe as well.

Labour market keeps spinning, while BoE sits tight

While the extreme political uncertainty is taking its toll on business investment appetite and consumer confidence, there is still no sign of contagion to the British labour market. In fact, the 3-month labour force employment change survey, revealed last Tuesday, shows that the labour market fizz is still ongoing. Employment rose by 222.000 (3M/3M), almost 100.000 more than forecasters expected. Other indicators that came out this week, such as CPI core inflation (1.8% yoy) and weekly earnings (3.4% 3M/yoy) remained steady. The Bank of England announced it would hold its policy rate at 0.75 as we expected, but announced it is ready to move in any direction depending on whether Brexit turns into chaos or into a long delay.

UK labour force change



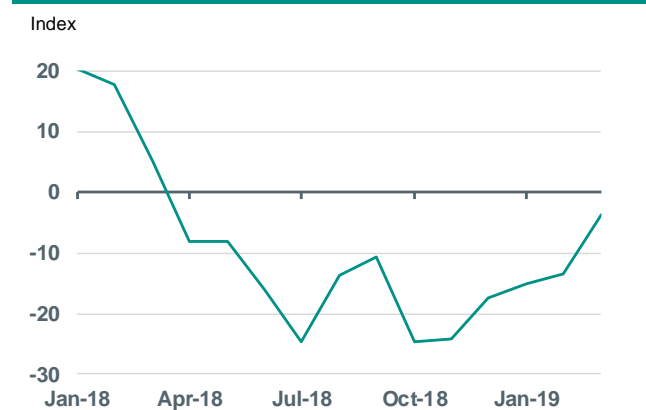
Source: Bloomberg

Europe changes its tone on China and moves toward protectionism

While in a much less dramatic fashion, the EU meeting this Thursday on how to deal with China, is also pretty remarkable. In a strategy paper ([see here](#)) prepared for the summit by the European Political Strategy Centre (EPSC), there is unprecedented criticism on Beijing being a “systemic rival promoting alternative models of governance”. The think tank advises EU members to agree on striking a new balance between openness and protectionism. Chinese FDI into European economies (63 billion euro in 2017) is aimed at taking control over strategic and systemic infrastructure, which have in the past often left recipient states with crippling debts, it states. The EPSC openly pleads for the creation of European Champions that are large enough to compete with Chinese and US competitors in ‘systemic’ industries. The new tone on China is in line with President Macron’s proclamation on March 4 in which he proposes a new era of government intervention in EU businesses. Since the beginning of the year, politicians across the continent are seeking business influence through regulation (China), nudging managers to do deals (Deutsche Bank – Commerzbank, Siemens – Alstom) or through increasing state ownership (Air France-KLM).

While worries about state-backed takeovers from China and dictates from the White House over where to build factories, seem justified, protectionism could put the still very fragile economy in the Eurozone and in particular Germany at risk. The ZEW expectations that came out this week shows that investor confidence is improving as global risks subside, but they are still slightly negative both for Germany (-3.6) and Europe (-2,5).

Germany: ZEW index



Source: Bloomberg

Looking at the German manufacturing and services PMIs also show that Germany is not yet out of the woods.

Germany: PMI Manufacturing

Index, 50=neutral



Source: Thomson Reuters Datastream

Germany: PMI Services

Index, 50=neutral



Source: Thomson Reuters Datastream

A trade deficit in China's should worry the US more than a trade surplus

Amidst the silence around the much hoped for trade truce between the US and China, economists are heavily discussing the consequences of China's melting trade surplus that could even turn into a deficit in the coming years. Without those large surpluses, China will probably cut back its purchases of US financial assets, both treasuries and corporate bonds. With about 1400 billion dollars of corporate debt maturing before 2020, this might pose a challenge for the US that is more urgent than the perceived unfairness of China's trade surplus with the US.

As a current account balance essentially represents the gap between its savings and investments, China could try to halt the deterioration of its current account by curbing

domestic spending and imports. Still, that is not very plausible given China's aim to rebalance from an export/investment-led to a consumption-led growth model fitting with the rise of China's sizeable middle class. Alternatively, China could try to prevent its inhabitants to travel the world and spend their savings abroad. With a rapidly ageing workforce, its savings are more likely to decrease further than 'tourism at home' plans could counter.

What is more, Beijing is aiming at a gradual opening of the capital account, to support inflows of foreign capital, tapping new sources of financing and enabling a deepening of capital markets. MSCI's plans to further increase the weight of mainland listed shares in its emerging markets stock index and the entering of China in the Bloomberg Barclays bond index are helpful in this respect. While allowing foreign funding into mainland China would imply that the government would have to relax its grip on the economy, the advantage would be (according to the IMF) that investments in government bonds increase the potential for using interest rates for monetary policy instead of administrative guidance.

Main economic/financial forecasts										
GDP growth (%)	2017	2018	2019e	2020e	3M interbank rate	14/03/2019	21/03/2019	+3M	2019e	2020e
United States	2.2	2.9	2.3	1.9	United States	2.61	2.60	2.60	2.60	2.50
Eurozone	2.5	1.8	0.8	1.3	Eurozone	-0.31	-0.31	-0.30	-0.30	-0.20
Japan	1.9	0.8	0.9	0.7	Japan	0.07	0.07	-0.10	-0.10	-0.10
United Kingdom	1.8	1.4	1.1	1.8	United Kingdom	0.84	0.84	1.00	1.00	1.25
China	6.9	6.6	6.3	6.0						
World	3.7	3.6	3.3	3.4						
Inflation (%)	2017	2018	2019e	2020e	10Y interest rate	14/03/2019	21/03/2019	+3M	2019e	2020e
United States	2.1	2.4	1.6	2.0	US Treasury	2.63	2.54	2.6	2.60	2.50
Eurozone	1.5	1.7	1.2	1.2	German Bund	0.09	0.04	0.0	0.20	0.50
Japan	0.5	0.9	1.1	1.6	Euro swap rate	0.59	0.56	0.6	0.80	1.10
United Kingdom	2.7	2.5	1.4	1.8	Japanese gov. bonds	-0.04	-0.04	0.1	0.10	0.30
China	1.6	2.1	2.5	2.5	UK gilts	1.23	1.06	1.7	1.50	1.80
World	3.0	3.5	3.8	3.2						
Key policy rate	21/03/2019	+3M	2019e	2020e	Currencies	14/03/2019	21/03/2019	+3M	2019e	2020e
Federal Reserve	2.50	2.50	2.50	2.50	EUR/USD	1.13	1.14	1.10	1.16	1.25
European Central Bank	-0.40	-0.40	-0.40	-0.30	USD/JPY	111.7	110.8	110	108	105
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.33	1.31	1.30	1.35	1.45
Bank of England	0.75	0.75	0.75	1.00	EUR/GBP	0.85	0.87	0.85	0.86	0.86
People's Bank of China	4.35	4.35	4.35	4.35	USD/CNY	6.72	6.70	6.65	6.60	6.60

Source: Thomson Reuters Datastream, ABN AMRO Group Economics.

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