

Does the Euro area still need or want stable national governments?

After several months Germany has put together a precarious coalition between the CDU, CSU and SPD. Like many Eurozone countries the old system of two main parties offering a centre left or a centre right alternative has broken down. Voters now vote for a wide array of different parties, and the politicians stumble to put together a government after the election. The one thing they can guarantee is no voter will get the government they voted for.

The progressive decline of the Christian Democrat/Social Democrat choice that was the continental version of Conservative against Labour is now well advanced everywhere in Euroland. In Greece Syriza has blown away the traditional socialist party altogether. New Democracy, the centre right party, has spent a lot of time in the 20s for support, but has recently recovered a bit to the mid thirties.

In Germany herself Merkel's CDU hit a new low of 26% in the last General Election, whilst her main socialist opponent polled just 20%. In the Netherlands the centre right retains the Prime Ministership with a shaky multi party coalition and just 27% of the vote.

In Italy PD, the centre left, is currently on 23%. The Christian Democrats have disappeared, and Forza has 16% in their place. In Denmark the social democrats have held on to 30% of the vote, but the centre right Peoples party is down to just 4%. In Spain the PP have 26% of the vote and the Prime Ministership with a minority coalition, whilst their socialist opponents are currently on 23%.

It probably suits the EU that the two party system is broken so comprehensively and no country now is capable of providing a single party majority government, with the breath taking exception of France who elected a totally new party to both the Presidency and a majority of the Parliament. There things have become so bad for the two traditional parties that neither had a candidate for the Presidency in the last two! A US Presidential election without either the Republicans or the Democrats is unimaginable.

The fact that some Euro area countries go long periods with no government at all, and then have periods of weak coalition government, helps shift more power to the EU. it raises the issue of accountability, and the possibility of more direct elections at the EU level. The German government is now likely to add its voice to that of France in seeking a bigger EU budget, an EU bail out fund for banks and more centralised decision taking. The exit of the UK makes achieving this much easier as they will no longer have a large non Euro country wanting to stop this process.

Visit of Jacob Rees Mogg to Wokingham

Wokingham Conservatives were pleased to have Jacob Rees Mogg as their speaker at a luncheon today in the constituency. 193 people came and heard Jacob set out how and why the UK should leave the Customs Union and single market as well as the EU, on 29 March 2019. Mr Rees Mogg said the main argument he used to persuade some Remain voters that Brexit is a good idea was to point out that he cannot as an MP take up and sort out many problems which fall under the powers of the EU, stifling democratic opportunity for change and improvement.

Why the EU paper on transition is unacceptable

I am glad David Davis objects to the language of the EU paper. I trust he also objects to the following in it

“The UK may not become bound by international agreements entered into in its own capacity in the areas of exclusive competence of the Union...”

“For the purposes of the Treaties, during the transition period the Parliament of the UK shall not be considered a national Parliament”
etc

The Bank seeks to slow the economy some more

As I have reported before, the Bank of England has been tightening money conditions for sometime because it wishes to slow the UK economy. It has recently increased the base rate to 0.5%. It used macro prudential policy to seek to rein in consumer credit. It has been particularly successful at reducing car loans and it refers to this in the latest Inflation Report. The government has also been active in cutting car demand with its high VED taxes on dearer vehicles introduced last spring and its attack on diesels. Mortgages are a bit dearer and higher Stamp duties and BTL taxes have also hit the housing market.

This month the Bank ends the Term Funding Scheme for the commercial banks, a

scheme designed to ease credit conditions a bit. Now in this Report we hear that the Bank wants to get back to the inflation target faster, and expects to have to raise rates again to do so. Meanwhile there has also been an additional monetary tightening through the increase in the exchange rate in recent months. So why is the Bank doing this when most people want to see a bit more growth?

The Bank has gone back to its idea that the UK economy can only grow at a fixed pace, and if it starts to grow faster than the trend increase in capacity it will cause more rapid inflation. The Governor himself has questioned this theory in a good lecture he gave pointing out that if you are capacity constrained then you can simply import more, keeping prices down. You can also invite in more workers from abroad, keeping wages down as has been happening on a large scale in recent years. It is difficult to know why the Bank thinks the UK trend growth can now only manage 1.5%, and why they ignore the sensible thoughts of the Governor on the impact of the global economy on prices and wages. They also need to ask how flexible the economy is to scale up capacity. We see new capacity going in and there is plenty of corporate cashflow to invest. Many companies are expanding capacity considerably by continuing to recruit extra staff.

It is also curious that they seem to have an asymmetric and distorted view of sterling and its role in inflation. Apparently a recent devaluation is causing most of the price rises we are seeing, but the more recent strengthening of sterling will not redress this sufficiently. They tell us sterling is 15-20% down on the levels of November 2015. That was of course a peak level. Sterling on the trade weighted is currently around the levels it was at for a long period from 2009 to 2014. Against the dollar is almost back to the pre referendum vote level. If you want to see a big devaluation which did not reverse you need to go back to 2008-9 when sterling was badly damaged by the banking crisis. That devaluation did not generate as much inflation as some expected.

The Bank claims that Brexit uncertainty is a big factor in the UK economic performance. There is precious little evidence to support that. The Bank, after all, has had again to scale up its growth forecast for the UK, which paradoxically gives it a better excuse to tighten money more. Consumption remains the main driver of the UK economy. I don't meet lots of people telling me they have cut back on their shopping because of Brexit. If, as the Bank now thinks, wages are going to pick up a bit that should be good news for consumption and therefore for economic activity.

Negotiating a deal

Both the EU and the UK government would be wise to study why their last negotiation before the referendum went so wrong. The two parties wanted the

same outcome – a deal which enable the UK to vote to stay in the EU. Their failure has left the EU struggling with the departure of one of its largest paymasters, and saw the end of the Prime Minister and Chancellor in the UK who signed off the deal.

On that occasion with full civil service encouragement the UK Prime Minister went round the EU asking leaders what they might grant the UK. They told him they could not grant much, so he asked for not much. As this was always going to be a negotiation the EU did not feel they could let him have all he asked for, so a low bid which he had made was scaled back further. When the UK voters saw it gave us no remission from high financial contributions, prevented us running our own migration policy and did not even fix the issue of letting us make our own decisions about benefit payments, they rejected it.

There is now a strange German movement to say they might be able to fix some of the things Mr Cameron said he wanted fixed, now they have seen the outcome. The truth is it's too late to do that. Many UK voters anyway do not think Mr Cameron asked for enough. He made a mistake, but so did the EU in refusing even his modest demands.

Today the UK government now needs to be sure to ask for enough from a Future Trade and Partnership Agreement, otherwise what has currently been outlined will be judged a bad deal by many UK voters. The EU would be wise to understand if they deliberately set out to make a tough deal which the UK thinks is an unfair deal that could backfire. It might result in the UK leaving with no deal. The UK government has rightly said on many occasions No deal is better than a bad deal. Past experience shows the EU quite likes bad deals. That is why it is facing the exit of one of its major paymasters and one of its main single country export markets.