Viewpoint

European Elections: Why They Matter, if They Do?

May 2019

Will upcoming European elections impact broader market sentiment?

In the past, European elections were viewed as more of a consultation on the popularity of EU member governments than a real vote on the future of the European Union.

This year is somehow different.

The Framework

For the first time, a real debate about Europe and its direction is taking place across the continent. Here is some anecdotical but telling evidence:

It is unprecedented that a European leader, through a direct message, addresses not only his national electorate but the whole European citizenry. I refer to the letter of 4th March from French president Emmanuel Macron to the European citizens outlining a plan for the Renewal of Europe and starting with the sentence “Citizens of Europe, If I am taking the liberty of addressing you directly….”.[1] The letter has been translated into 22 languages.

In our view, never has there been so much interaction between national politics and European themes in the electoral campaign. Parties in different countries are positioning themselves vis á vis European parliamentary groups, and national leaders are addressing this in the campaign trial. New alliances are being proposed, and a major re-composition of the European Parliament’s politics is envisioned; these issues were openly discussed in a recent press conference in Budapest by Hungary’s Premier Victor Orbán and Italy’s Deputy Prime Minister Matteo Salvini.[2]

National elections - even in smaller countries such as Slovakia or Finland, or partial elections in some southern Italian regions or English local councils - are receiving a new level of Europe-wide attention as if the Continent’s future depends on the de-assembling and re-assembling of all these local moving pieces. The affirmations of certain parties instead of others are scrutinised as bellwethers for the decline or rise of Euroscepticism across the continent.

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1. https://www.elysee.fr/emmanuel-macron/2019/03/04/for-european-renewal.en.
2. https://www.ft.com/content/f915a13a-6cf4-11e9-80c7-60ee53e6681d

This new attention towards European polity is finding its roots in recent developments such as Brexit and the rise of populist movements in most European countries. Brexit will deprive the Union of one of its key members and the populist surge is coloured with varying shades of Euroscepticism; their combined effect is deeply shaking the European Union (EU).

A new "justification deficit" of the European project seems to be emerging. Many ordinary citizens seem to have lost a clear understanding of the rationale for the European construction and particularly of why "more Europe" would be necessary. This year's elections are seen by many as the opportunity to address this issue, perhaps for the first time. The pro-Europe parties are being called to explain why more integration is needed. On the contrary, sovereigntist movements need to come out with their vision of "different Europe/less Europe" and how to achieve it.

What is at Stake?

This year, the key positions in the EU are all up for appointment. Not only will the President of the European Parliament, of the Commission and of the Council be nominated, but also the President of the European Central Bank (ECB). Markets will closely follow these appointments and will particularly focus on who will lead the ECB, following Mario Draghi's eight-year tenure.

While the European Parliament does not play a significant role in the appointment of the ECB President, the European elections may have a consequential impact on the choice made by Eurozone leaders.

The selection for key European posts is an arcane puzzle in which political affiliation, usually to one of the two main political families, nationality mix and political experience all play a role. The ECB's executive board is only partially shielded from this dovetailing exercise; the search for a nationality balance will become a pressing factor in all choices, especially once agreement for certain posts is reached. For example, if – as we believe seems likely - the Popular group has the most seats in Parliament and the Spitzenkandidaten principle is retained, the President of the Commission will be Manfred Weber, a German national. This outcome will largely reduce the chances of also having a German at the helm of the ECB.

This is just an example however, and there are still too many unknowns in a very complex political equation to make meaningful predictions. The results of the elections will provide some indications, but only the late-night negotiations at the European Council of the 20th - 21st June will lead to decisions for who will take the top jobs at the Commission and Central Bank.

Market Impact

The EU is the world's largest economic block and its economic policies have a huge impact on markets. However, the role of the European Parliament is somehow limited.

The Parliament does not play any part in monetary policy, an area in which the ECB is "sovereign" and independent. Equally, Eurozone fiscal policies are governed by the "growth and stability rules" set by the member countries and implemented by national governments under Commission monitoring. Instead, the European Parliament plays a co-decision-making role in setting the framework for those structural policies which are within EU competence, such as competition, trade and, to a certain extent, industry and innovation. However, structural reforms have longer-term impacts on which markets do not usually focus.

The markets will observe the European Elections results, but only in a quest for determining downside risks and particularly tail risks.

The growth in popularity of a sovereigntist party in the coming polls will not rattle markets in our view. Important gains by these movements are already factored in, as are the chances of a more fragmented Parliament in which the two traditional and largest groups - Popular and Socialist - will not be able to form a stable majority but will have to find alliances with the Liberal Democrats and possibly the Greens. Only the case in which Eurosceptics will be capable of blocking the works of the Parliament and, for example, the appointment of a new Commission would spook markets. Most observers consider this event unlikely…a tail risk.

Markets will also be observant of national political developments which the elections could unleash. The elections could indeed be the catalysts for changes in national politics, particularly in those countries where government coalitions look unstable.

The impact on Brexit could also be significant. The UK electorate's participation in the polls is the result of the "lack of Brexit" and the outlook for UK MPs* is uncertain. It could be a telling moment on the electorate's view on Brexit. Markets will not be shocked by these results, unless they lead, by accident or purpose, to a no – deal Brexit. Is that another tail risk?

* MP - Member of Parliament.