

CIO Viewpoint

European elections – Litmus test or wake-up call?

Investment Solutions

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Every five years the European Union tests its political climate with a continent-wide vote to the European Parliament, the bloc's only directly-elected institution. This year's elections, 23 through 26 May, are closely watched. An increasing minority of the region's 370 million voters appear disillusioned enough to vote for parties who want Europe's 62-year old political and economic union overturned.

As elsewhere in the world, political opinion is polarising. While support for the European Union, the globe's largest trade bloc, is at a level only before equalled in 1983 according to [Eurobarometer](#), the future of the EU has rarely been so in doubt. A majority of EU citizens now say the bloc is "very likely" or "fairly likely" to fall apart within two decades.

There are signs of populism throughout Europe. Germany, France, Italy, Poland (and the Brexit-embattled UK) may all elect more anti-Europeans to the European Parliament this month, triggered, arguably by a mishmash of fears over immigration, austerity, stalled wages, and precarious employment. But even this far end of the spectrum is divided, between those who are against the existence or expansion of the EU, and those who want it to provide more protectionism in some form.

Euro-awareness

The widespread arrival of (in particular) right-wing populism, and what Hungarian Prime Minister Viktor Orbán calls "illiberal democracy," is starting to spur an early form of pro-European political awareness of what is at stake.

Projections for this month's vote are for a European Parliament of eight groupings balanced three ways. One bloc is made up of socialists and green MEPs, a second consists of the European People's Party (a loose alliance of social conservatives which may see its 20-year dominance in a European Parliament slip), and finally the anti-European parties.

Three-fifths of the EU's electorate see populist politics as a concern, according to Eurobarometer. However so far, even as the traditional parties face losing ground to populists, the elections have not focused their determination sufficiently to coordinate. The nationalists, ironically, while they are busy looking to form international connections, hardly form a united front and include both left and right wing elements with little prospect of coordinating, nor agreeing on anything beyond their Euro scepticism.

While there is much debate about what this will mean, the European Union has come through significant challenges in recent years, and the result is not likely to alter the status quo dramatically. In comparison with today's make up in the European



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Key Asset Allocation Views

- While global macro data have held up well recently, confirming our expectation that late-2018 was the worst point of the slowdown and that domestic demand remains resilient, global trade and manufacturing remain weak
- Trade remains key, as the recent increase in US-China tensions have set a worrisome trend. While we believe the most likely scenario is an eventual agreement, the risks of a breakdown have risen
- In the light of these uncertainties and their effect on business sentiment and earnings outlooks, we have reduced portfolio risk exposure. We are now underweight emerging market equities, which we believe to be the most vulnerable asset class if the US-China trade dispute escalates. In currencies, we have increased the allocation to safe-havens
- The European Union faces a test over its long-term viability which, in the longer run, is threatened by populist criticisms.

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Parliament, we will most probably see a slightly more right-leaning, slightly less pro-EU assembly.

Spanish coalition, Italian debt again

April's elections in Spain were watched in case they offered a taste of things to come. While much attention surrounded the arrival of the far right in Congress, the result saw the Socialist Party increase its share of the vote. Acting Socialist Party prime minister Pedro Sánchez, while still short of an absolute majority, is now in a lengthy negotiating phase with the left-leaning Unidas Podemos. That would still leave them potentially dependant on Catalan separatists to form a coalition.

Meanwhile Italy's deputy prime minister, Matteo Salvini, last week stressed that his government is ready to break the country's commitment to limiting its deficit to 3% of GDP and increasing the debt to GDP ratio to 140% (compared with the current 132%). Salvini's comments underlined discord between the Italian governing coalition and in response the spread between the 10-year Italian and German Bund yields widened to the most in three months last week.

Gate crashers

The [European Parliament](#)'s 751 seats include 46 for the UK. Until the UK leaves the EU these British MEPs will be in Brussels and Strasbourg drawing an EU salary. In the meantime, the Brexit Party, created this year and committed to supporting a no-deal/hard departure from the EU, may record 32% of the British vote according to polls. Once the UK does leave, these seats will be allocated to countries that are underrepresented, including France, Spain, Italy and the Netherlands.

The problem is that the UK's parliament cannot agree on a model for the country's relationship with the EU post-membership. The consequence, as seems likely at the European Parliamentary elections in the UK, is that parties with a clear for-or-against EU position will benefit, punishing the British government and Labour Party, in favour, in particular, of the most extreme leave-at-all-cost option. For all its chaos, Brexit has at least given the rest of the EU a live example of the difficulties of leaving.

As German Chancellor Angela Merkel pointed out in an interview with *Süddeutsche Zeitung* last week, if the UK wants to leave the EU "there needs to be a parliamentary majority in London for, rather than merely against, something." In what is likely to be a more fractious European Parliament after this month's elections, that may not make a bad motto for Europe's political class to remember over the next five years.

Construction not criticism

At every level of the EU, a version of the 'reform-it-or-scrap-it' debate is playing out. The need to reform the EU has only been strengthened by populism in its various forms. The reformers' self-appointed spokesman is undoubtedly French President Emmanuel Macron, whose own domestic issues with "gilets jaunes" protesters over the last six months have dampened his calls for a European "new deal" to address the socio-economic challenges facing the continent.

Germany is in a transition phase as German Chancellor Angela Merkel hands over to successor Annegret Kramp-Karrenbauer. That transition may be in the process of accelerating as AKK, as she is known, [is reported to have called last week on Merkel to stand down](#) before the end of her September 2021 term.

"We are confronted with currents... who want to destroy the Europe of our values, and we must stand up to that decisively," Merkel told reporters on May 18 after recordings that appeared to show Austrian right-wing Freedom Party leader and Vice-Chancellor Heinz-Christian Strache promising public contracts in return for help from a fake Russian sponsor.

The European political project can survive and thrive in the long run only if today's leaders are able to articulate a coherent, common vision on the issues facing Europe, ranging from security to climate change, migration, or economic prosperity. Anything less worthy of a vision that founded the EU's institutions more than six decades ago is at risk of being punished by voters.

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