

European politics in 2019: United in even more diversity

In European politics, 2017 was the year of hope for new momentum towards further integration. For a while, there was a real 'Europhoria'. In contrast, 2018 was the year of a disappointing and disillusioning return to reality (and a de facto standstill). Will this disappointment reach a climax in 2019 or could we see another turnaround?



European leaders in Salzburg, Austria in September 2018

Leaving Italy's fiscal escapades aside, three main political themes should get financial markets' attention next year: elections for the European Parliament in May (held every five years), a changing of the guard in European top jobs, and German politics. Let's try to put these three potential risks into perspective.

1 European elections: Rise of the anti-EU parties?

It is hard to remember any single election which has not been labelled as important, crucial or trend-setting. Next year's European elections are no exception. While past European elections have been a low-key event with low participation rates, many financial market participants now pay a lot of attention to them, fearing a significant rise of EU-sceptical forces. However, as so often is the case, the reality is less exciting.

In fact, despite the rise of populist and EU-sceptical parties in national elections, there are several reasons to expect no significant change in the election result of the EU-sceptical parties compared with the last elections in 2014 (when they received some 20% of the seats in parliament):

- Brexit in itself will be a hit to the share of EU-sceptical parties in the European parliament. Currently, more than 50% of the 73 British MEPs sit in EU-sceptical political groups. As not all British seats will disappear (only 46 out of 73) and no other national election will see similar relative performances of eurosceptic parties, Brexit is a bumper for EU-sceptical parties.
- The 2014 European elections were a leading not lagging indicator for EU-sceptical parties' national election performances. Many parties saw significant gains in the 2014 elections already, followed by similar performances at subsequent national elections, particularly in the case of Front National and the Dutch PVV. It is questionable whether these parties could see further gains. Given recent polls, gains should only be expected from parties which had not done well in 2014 but in the more recent past, for example, the German AfD, the Italian Lega or the Austrian FPÖ.

An additional issue for the anti-EU-sceptical parties will be whether they can manage to get organised in one political group in the European Parliament. Currently, there are three political groups, the ECR (European Conservatives and Reformists, mainly dominated by the UK Conservatives and Polish PiS), the EFDD (Europe of Freedom and Direct Democracy, mainly dominated by UKIP and Five Star Movement) and the ENF (Europe of Nations and Freedom, mainly dominated by the French Front National and the Dutch PVV). Previous efforts to form a political group only succeeded in the case of the ENF. A lot of the EU-sceptical parties' impact after the elections will depend on whether or not they are able to work in and as one single group.

Gains of EU-sceptical parties in the percentage of total seats could be more limited than anticipated

In our view, next year's European Elections results could be less of a shock than many fear. Some erosion of the political centre, with social democrats and conservatives for the first time since 1979 losing their absolute majority, would continue recent national trends but could be mostly offset by gains of the liberals and Greens.

Due to the Brexit effect, gains of EU-sceptical parties in the percentage of total seats could be more limited than currently anticipated. Rather than an overall sharp increase, there could be a power shift within the group of EU-sceptical parties. As a result, the political centre could be more fragmented than in the past but the overall sentiment in the European Parliament should remain pro-EU. A former slogan of the European Union will probably have to be changed from "United in diversity" into "United in even more diversity".

2 European Musical chairs: An update

With the European Elections, the musical chairs game for European top jobs will enter its final round. All EU top jobs are up for grabs next year: President of European Parliament, President of the European Commission, President of the European Council, President of the ECB and two jobs at the ECB Executive Board. Filling these vacancies will be a masterpiece for game theory experts as a balance between nationalities, East and West, big and small, gender, experiences, political colours and previous jobholders as well as between institutions (the European Council and the European Parliament) will be required.

The likely fragmentation of the political centre will be an additional complication of the musical chairs game. In the past, social democrats (SD) and conservatives (EPP) held a majority in the European Parliament and were able to do horse trading between each other. This will probably no longer be the case next year. However, despite an even more complicated nomination process, there is de facto no risk that any European institution will be headed by an EU-sceptical president.

The vacancies at the ECB are most interesting for financial markets

For financial markets, the upcoming vacancies at the ECB are most interesting. Chief Economist Peter Praet's term in office will end already in May next year. The terms of ECB president Mario Draghi will end in October and Executive board member Benoit Coeure in December. Normally, a successor for Praet will have to be found at the Spring Summit, but we would not be surprised to see government leaders leave the vacancy open to add it to the 'grand bargain' after the European Elections.

Currently, the Irish central bank governor Philip Lane is our favourite to succeed Praet. A highly skilled and another out-of-the-box thinker, Lane would likely continue Praet's very pragmatic approach. However, we would not even rule out Lane as a compromise candidate for the Draghi succession in case of a stand-off between France and Germany and obviously depending on the decision on the other European top jobs. When it comes to the potential Draghi successor, Bundesbank president Jens Weidmann could eventually return from the declared dead. There simply is no single candidate who ticks all the boxes and has emerged as the uncontested front-runner. Next to Weidmann and Lane, the list of potential next ECB presidents is still long and includes names like (strongest counter-arguments between brackets) Villeroy de Galhau (another Frenchman?), Liikanen (age and no longer active governor?) and outsiders like Hansson (who?), Rehn (too much a former politician) or Knot (anti QE and another Dutchman?). In our view, the nomination of De Guindos as vice-president has reduced the chances for former politicians to make it to the ECB top.

As regards the vacancies at the ECB, it is too early to come up with an estimated guess but we question is whether the ECB's monetary policy will actually change. Here, we would be cautious. No matter who will fill the vacancies, do not expect the ECB to return to a more dogmatic approach. The Draghi-Praet legacy of a very pragmatic and sometimes unconventional monetary policy will in our view survive the changing of the guard.

3 German politics: The new unknown

For many years the stability anchor of European politics, Germany is now in the final stages of the Merkel era and some fear this could become a source of instability. Listening to Angela Merkel at public appearances in recent days shows a relieved chancellor, freed from the restraints of her own party and coalition conflicts. Whether this will be enough for Merkel to push forward with further reform proposals at the European level remains to be seen. In the past, Merkel had been at her best when she could react not when she had to act.

While we do not believe the race for Merkel succession in the CDU will hardly undermine national

or European politics, given the continuous fall of the SPD, another disastrous result at the European elections would increase the odds for a snap election towards the end of 2019.

Muddling through

No panic, this is Europe. This is probably the best label for our base-case scenario for European politics in 2019. Regarding potential political risks, 'Europhoria' might be gone but this does not mean that the Eurozone is about to disintegrate or be taken over by EU-sceptics. Progress towards deeper integration is still being made. The acid test for the Eurozone and greater Eurozone integration will be the next recession but not politics in 2019.

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