

European elections: Four key battlegrounds for markets

Elections to the European parliament take place over the next four days. Concerns are high that the centre ground continues to fragment and that populists succeed in sufficient numbers to derail further European integration. In this article we focus on four key battlegrounds to measure the march of the populists and assess its impact on FX and bond markets

Three scenarios and four key battlegrounds for markets

	Overall European Parliament	Italy Lega/5-star gap	Germany SPD/CDU support	France RN/LREM race	Markets
1 European dream lives on	Eurosceptic share falls Grand coalition of three to four parties pushes forward with more integration	Lega and 5SM both in 20% area Current coalition stays on, in a less challenging mode versus Europe	CDU wins & SPD remains stable Current coalition stays on, smooth transition to Merkel succession over next 2 years	En Marche! Wins Macron repeats 2017 success and pursues reforms with renewed vigour	EUR/USD 1.13 10Y Bund yield -0.05% IT-GE 10Y spread 250bp
2 Muddle through	Greater fragmentation Eurosceptics gain ground but struggle to unite on policy goals	Lega gains <30%, 5SM >20% Current coalition stays on, but tensions on 2020 budget increase in due course	Small losses for CDU and SPD, SPD wins Bremen Government stays on but with ongoing tensions	Unconvincing win for Macron Further weakens his leadership politically, slows reform pace	EUR/USD 1.11 10Y swap rate -0.10% IT-GE 10Y spread 265bp
3 Populist revolt	Eurosceptics gain 30%+ If able to work together, EU sceptics could block some policies, budget and nominations	Lega gains 34%+ vote Early elections more likely as Lega bids to grow position in Parliament	SPD falls below 15%, loses Bremen Coalition break-up becomes more likely	Heavy defeat for Macron Undermines his European credentials & reform ability. Government reshuffle	EUR/USD 1.08 10Y swap rate -0.20% IT-GE 10Y spread 290bp

Source: ING

1 Eurosceptics gain one third of seats in the Parliament

Eurosceptic parties look set to make gains in the elections this weekend, led partly by the emergence of Italy's Lega since the 2014 election. [According to Politico](#), the three main eurosceptic factions within the European Parliament look set to secure just shy of a quarter of seats at this election which, combined, would be more than the traditional European People's Party (EPP) or Socialist and Democrat (S&D) groups.

However, the big question will be [whether the eurosceptic parties can organise into a united front on policy goals](#). While most populist/eurosceptic parties gained support on the refugee topic, they currently differ on possible solutions, as well as on other topics.

In other words, the European Parliament could become more fragmented, but not necessarily significantly more eurosceptic (these parties already hold 20% of seats collectively). For markets, the two things to watch will be a) if the collective eurosceptic share of the vote significantly exceeds 25% and b) whether these parties can work together as a united group over coming months.

2 German social democrats (SPD) support falls below 15% and loses in Bremen

The German Social Democrats (SPD) only very hesitantly joined the federal government last year and have pledged a mid-term review of the government's work after the summer. The party is forecast to lose seats at the European elections, but there is also a risk of a symbolic defeat in the historic stronghold of [Bremen in Sunday's regional vote](#).

This, coupled with frequent speculation about Chancellor Angela Merkel stepping down before the 2021 elections, make for a stormy political summer.

Admittedly, neither a weakened CDU nor a defeated SPD have an interest in imminent snap elections, fearing further electoral losses. But a sufficiently heavy loss for the SPD on Sunday – particularly in Bremen – would increase the risk of the party pulling the plug on the government, preferring to rebuild support from the opposition.

3 Salvini's Italian Lega gains more than 34% of the vote

These elections will be very relevant in determining the destiny of the current 5SM/Lega coalition government. If opinion polls prove accurate, Matteo Salvini's Lega stands to reverse the balance of power and Salvini may be tempted to take advantage and move towards forming a new right-wing government. Here, a 34% share of the vote (compared to 17% at the last election) would leave Salvini in an extremely strong position.

A formal policy shift towards the need for aggressive tax cuts might be telling and stand in contrast to commitments made by Finance Minister Giovanni Tria. A collision course with the EU would be set.

The challenge for an emboldened Salvini will be crafting the new budget (budget season officially starts in early September, but the relevant political debate will kick off earlier). Government tension around that budget could easily result in a new election being called in the autumn. Ratings agencies will be scrutinising the budget negotiations during this period, at a time where Italian sovereign debt is already one-to-two notches from junk.

4 National Rally becomes France's most popular party

[There's a lot at stake for President Emmanuel Macron in these elections](#). His poll ratings have recently recovered, having fallen to a low of 15% in early December amid the "yellow vest" crisis. However, the latest seat projections for the European Parliament suggest that Macron's LREM (La Republique En Marche) party could be narrowly defeated for first place by Marine Le Pen's Rassemblement National (or National Rally). This would reduce his ability to drive reforms, and a government reshuffle would become likely.

It would also undermine his push to change the political balance in the EU. In theory, if he

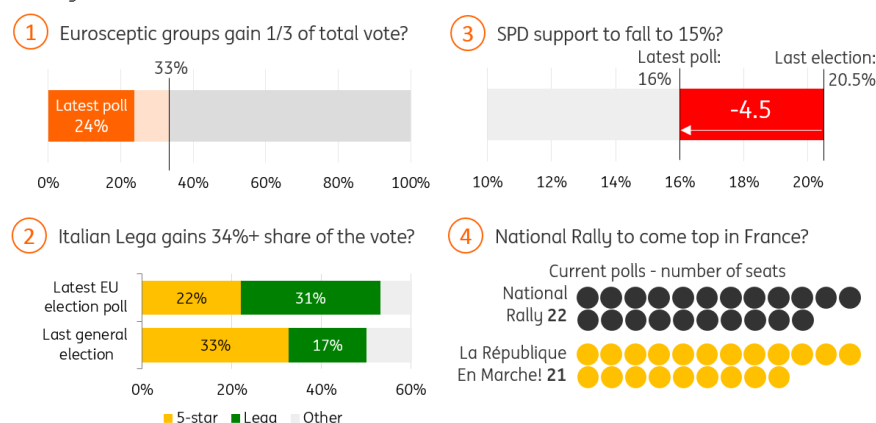
managed to enlarge ALDE (the Liberals and Democrats group within the Parliament), he would have a strong say in who the next head of the Commission will be (and therefore the ECB President). If the LREM result is perceived to be a defeat however, then this push for change would probably become more challenging.

A heavy defeat for Macron by eurosceptics could also embolden him to continue pursuing his hardline stance if the UK applies for a further extension to the Article 50 process in October. For now, most political commentators expect the UK to be granted a further delay if it ends up asking for one (which we think is likely). But if the wave of UK MEPs from the newly-formed Brexit Party seeks to disrupt the process of appointing leaders to the top Brussels jobs over the next few months, there is a risk that this hardline stance towards further Brexit delays could broaden out to other member states.

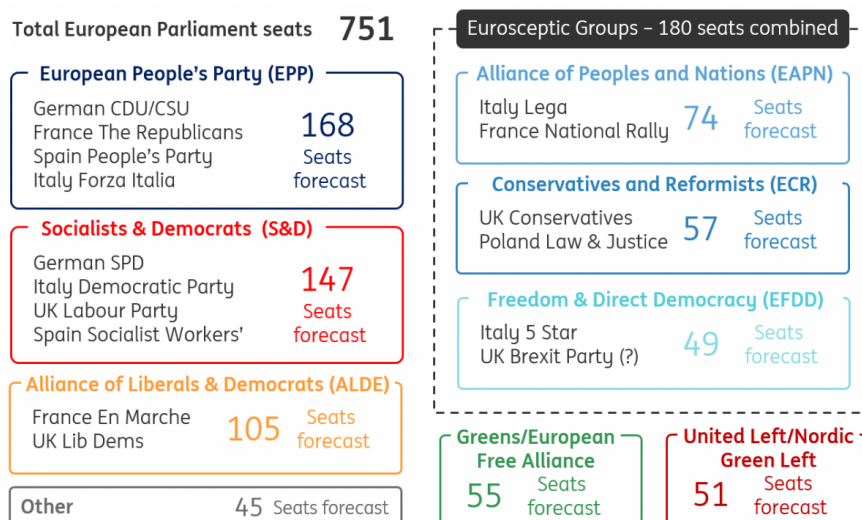
Four battlegrounds for markets

ING European Parliamentary election scorecard

The key risk barometers to watch this weekend



A guide to the political groups within the European Parliament (projected seats)



Authors

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

James Smith

Developed Markets Economist

james.smith@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.