

Why the European Parliament elections really matter

Jan von Gerich

May's European Parliament elections have been described as the most important ever. They are important also for the economy and financial markets, but not for the reasons commonly thought. The main market focus will be in Italy, France and the UK.

- The EU elections matter for markets mainly because of the issues at stake in Italy, France and the UK
- In Italy, a strong result for Lega Nord could lead to early elections, deepened political uncertainty and further market worries
- In France, the election results will matter greatly for Macron's reform agenda
- In the UK, the outcome could again increase the odds of a no deal Brexit
- Decision-making in the new European Parliament will become more difficult...
- ...but it should have only limited near-term consequences for the economic and market outlook

Elections for the European parliament will take place between 23 and 26 May. A total of 751 Members of the European Parliament will be elected, but the number will fall to 705, if the UK eventually leaves the EU.

The new parliament is set to become even more fragmented, which will make decision-making more difficult (see more below). However, **it is unlikely that the new composition of the parliament will have a material impact on the shorter-term economic and market outlook**, even if it will have longer-term implications.

Nevertheless, **the vote matters a lot for the shorter-term outlook as well, but mainly because of the issues on ballot in a number of member states.**

Triumph for Lega Nord could lead to early elections in Italy

The disagreements between the ruling Italian parties, the Five-Star Movement (M5S) led by Luigi Di Maio and Lega Nord led by Matteo Salvini, have increased lately. Boosted by the polls, Salvini has started to behave even more as if he was the Prime Minister, even if he is the leader of the clearly smaller government

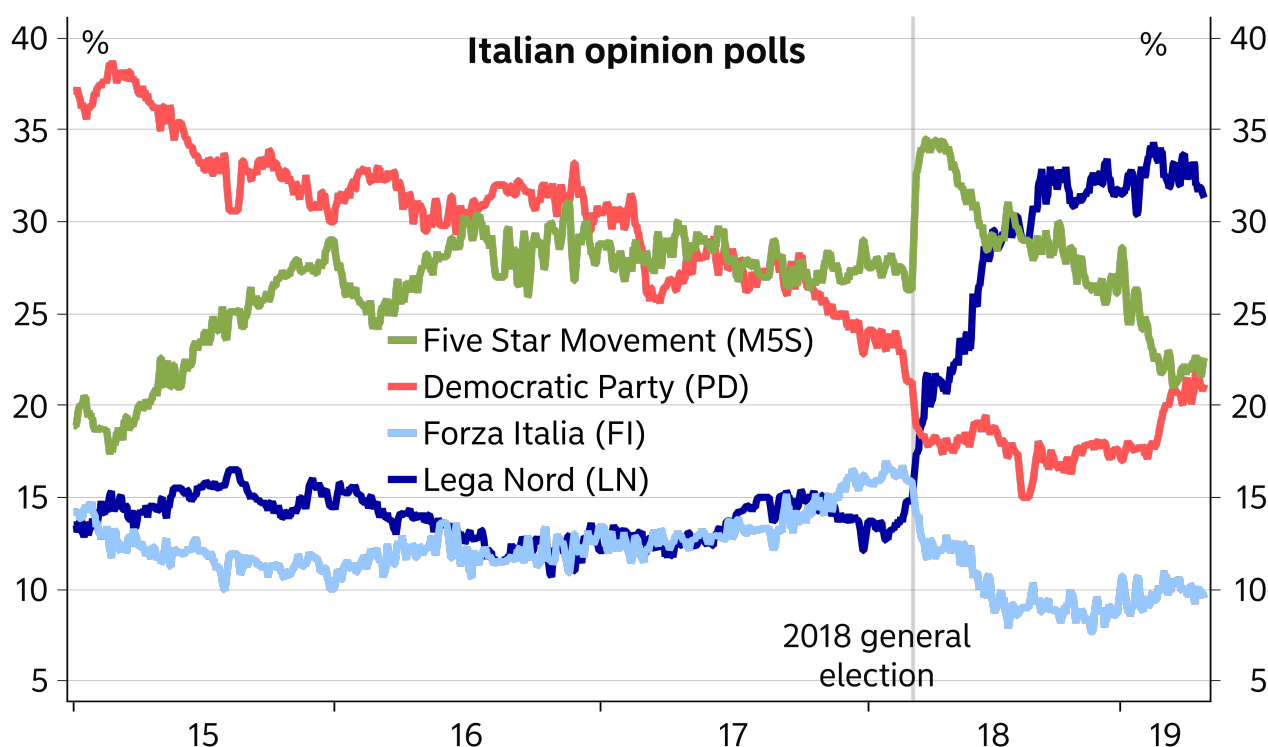
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party. M5S, on the other hand, which was some years back seen as the greatest threat to the Euro area, has moderated its stance in the government – and seen its support wane in the polls.

If the Lega does well in the EU vote, **Salvini may not be able to resist the appeal of breaking the current government and trying to push Italy to early elections**, where he could aim for the Prime Ministerial post with his more traditional allies, including Silvio Berlusconi's Forza Italia.

Irrespective of the eventual outcome, **the prospect of Prime Minister Salvini, with his known EU scepticism and open defiance of the EU rules, would scare financial markets**, which would most likely lead to renewed volatility in Italian government bond markets, and probably hurt economic confidence on the Euro-area level as well.

Lega riding high in the polls



Source: Nordea and Macrobond

Macron's reforms at stake in France

In France, President Macron's reform agenda has been paralyzed by the yellow-vest protests. The protests have been calming down lately after concessions by the President and Macron's popularity has rebounded from the lows seen late last year. It would be premature to throw in the towel regarding Macron's reform programme.

Reform of the European Union is close to Macron's heart, which is why the EU elections are very important for him. **The outcome will also be important for the outlook of his domestic reform programme.** Macron's La République En Marche! (LREM) is polling close to Marine Le Pen's Rassemblement National (RN), and a victory for Macron would give his agenda a boost. Conversely, if RN is the biggest party in the French vote, it will be more difficult for Macron to carry out his agenda.

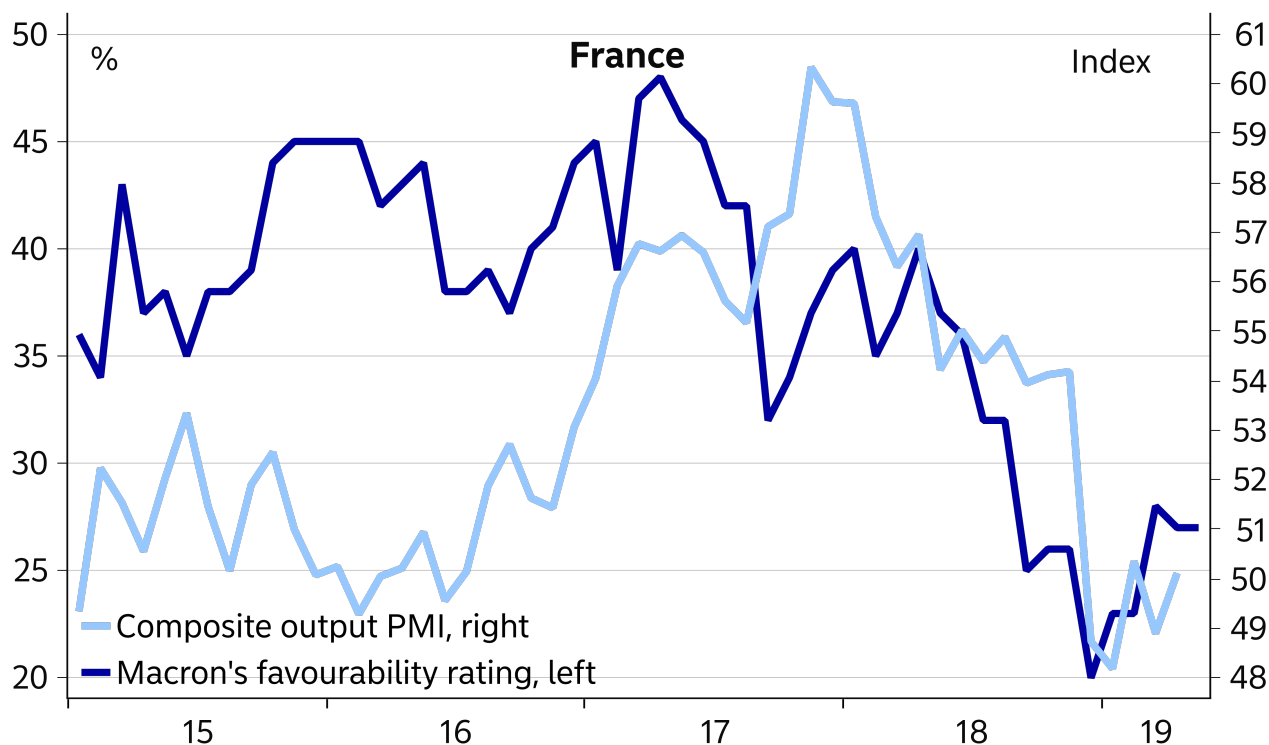
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Macron's reforms have brought hope to the Euro area as a whole, showing that there is an alternative to the rising wave of populism offering simple but flawed solutions. In other words, **Macron's reforms matter not only for the French outlook but for the Euro area as a whole.**

Without continued structural reforms, **the focus could shift back to the sizable French public deficits**, which are already seeing upward pressure due to Macron's concessions to the yellow-vests.

Macron's popularity rebounded from the lows



Sources: Nordea and Macrobond

No deal Brexit back on the table

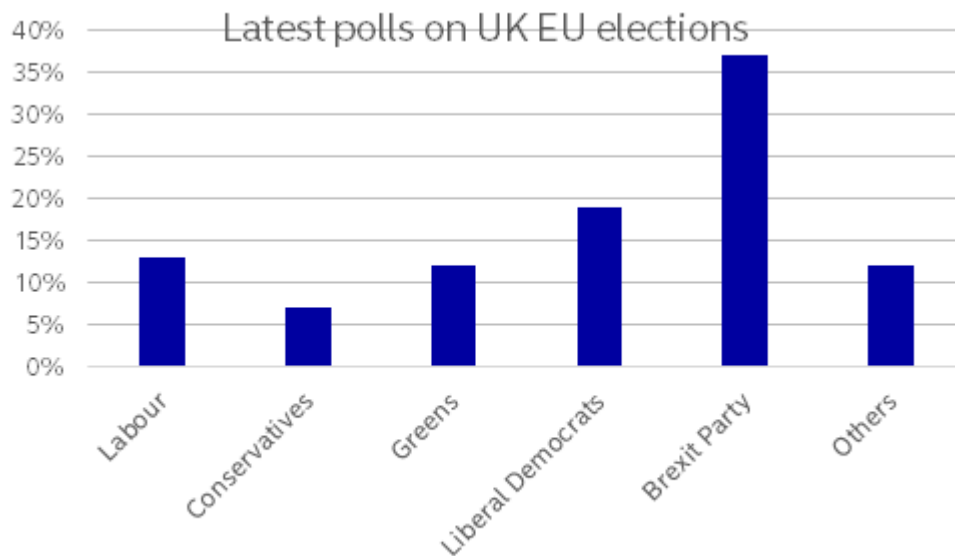
It has become increasingly clear that Prime Minister May will not be able to find a parliamentary majority for her agreement, while she probably does not have many months or even days left as Prime Minister. However, **the results of the EU elections are increasingly seen as another referendum on Brexit**, and the outcome will matter for the selection and stance of May's successor.

Nigel Farage has formed a new political party, the Brexit Party, which supports the UK leaving the EU without a formal withdrawal agreement. At the same time, the Liberal Democrats, along with smaller parties like the Change UK, are supporting the UK staying in the EU. May's Conservative party, in turn, may end up being only fifth largest party in the vote.

A strong showing for the Brexit Party would be read as voter support for a harder form of Brexit, and should also intensify market worries that such an outcome would be again back on the table and further cloud the outlook for the GBP. However, rather than the support for individual parties, **it will be the total support for parties supporting a certain Brexit outcome that will be in focus.**

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Brexit Party clearly in the lead in voting intentions



Sources: Nordea and YouGov / The Times

Rise of extreme parties worrying, but...

It looks clear that the new parliament will become more fragmented compared to the current one.

Currently, the two biggest European Parliament Groups, the centre-right European People's Party (EPP) and the Progressive Alliance of Socialists and Democrats (S&D), constitute a majority in the parliament, while it looks very likely that at least three parties will be needed for a majority in the new parliament.

Generally, the biggest focus seems to be in the rise of the various extreme parties in the polls. This is a phenomenon that has been evident also in many national elections but is amplified in the European elections, where it appears easier for people to vote against their government and give a protest vote. In other words, it is not always the matters that the European Parliament actually has authority over that determines who people vote for.

Polls suggest such extreme parties could capture as much as third of the seats in the new parliament.

There is no doubt that finding majorities will be more difficult in the new parliament and decision-making may become even more cumbersome. However, **the extreme parties are a very divergent group.** They have not been able to unite under a single umbrella, **which limits their influence in the new parliament.**

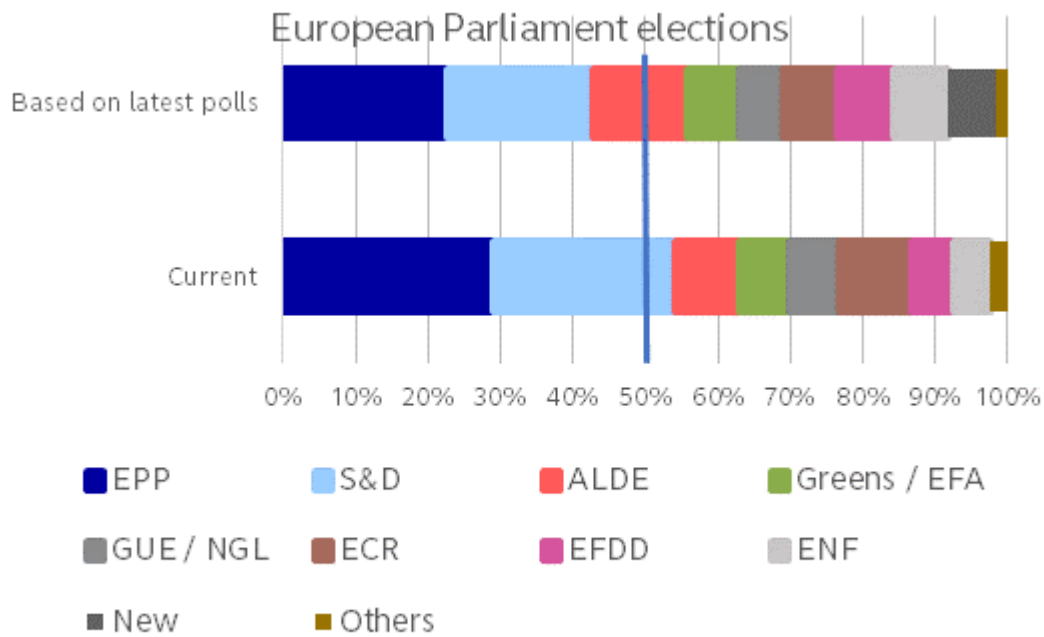
Further, **the broad political direction and priorities of the European Union and the Euro area are defined elsewhere:** in the European Council, consisting of the heads of state of the EU member states.

The President of the European Commission matters a lot as well, and there the view of the parliament matters as well. **The discussion on the top EU jobs will probably pick up steam after the elections,** and from a market perspective the most important question will be the name of the **Mario Draghi's successor,** who will start in November.

As a result, the future composition of the parliament matters more for the medium-term outlook than the short-term economic and market outlook.

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The European Parliament set to become more fragmented



Sources: Nordea and Financial Times

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