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POLITICAL UPDATE: LE PEN, BREXIT, RENZI, MERKEL, GREECE

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FRANCE: A SLIGHTLY TIGHTER RACE

Five days ahead of the decisive vote on 7 May, the French presidential race has tightened slightly. Four of the last five opinion polls put support for the centrist reformer Emmanuel Macron at 59% versus 41% for far-right Marine Le Pen, with one poll at 61% for Macron. A week ago, the polls had projected 62% on average for Macron. To broaden her base, Le Pen has struck a deal with ultra-Gaullist Nicolas Dupont-Aignan, promising to appoint him as prime minister in return for his support. In the first round of the presidential vote on 23 April, Dupont-Aignan had come as No. 6 with 4.7% of the vote. Adding that to the 21.7% for Le Pen, the pair had a stronger following than front-runner Macron with 24%. But most of those who like Dupont-Aignan would probably have fallen for Le Pen anyway in the second round. Like Le Pen, Dupont-Aignan wants France to leave the euro and the EU.

On the far left of the political spectrum, Jean-Luc Melenchon has edged slightly closer to Macron. While criticising Macron heavily and still refusing to endorse him, Melenchon warned that a vote for Le Pen would be a “terrible mistake”. According to polls, the Melenchon supporters who had given him 19.6% on 23 April are two to three times more likely to vote for Macron than for Le Pen. Although a tail risk remains and polls may well tighten further over the next few days, Macron remains the clear favourite to win on 7 May.

BREXIT: TOUGH DINNER, EASY SUMMIT

Rarely has the EU27 been so united. At the special Brexit summit last Saturday, EU leaders needed less than 15 minutes to agree their strategy for the Brexit talks. That probably sets a new European record. Of course, the EU27 have many problems. Just think Le Pen, Beppe Grillo, Poland and Hungary. But when it comes to Brexit, their interests overlap to an unusual degree. They all want to safeguard the rights of the 3.2 million EU27 citizens living in the UK and to make sure that the UK pays its bills before leaving the EU. Accordingly, the EU27 agreed that these two key divorce questions need to be largely agreed before the EU27 and the UK can start to negotiate their future relationship including future UK access the EU27 market.

This approach spells trouble for the UK in two ways. First, the longer it takes to settle the headline-grabbing and highly contentious Brexit bill, the less time will be left to discuss what the UK needs most, namely some degree of clarity about its future relationship with the much bigger EU27. Second, now that the EU27 have agreed on a sequencing, they won't back away from that. Anything that is based on the explicit approval of 27 different countries cannot be changed easily. Once UK Prime Minister Theresa May has won her snap election, she will be heading for tough talks. For her, it probably makes a lot of sense to strengthen her parliamentary base before she has to start making the hard choices that Brexit will involve.

A dinner with EU president Jean-Claude Juncker last Wednesday may have given her a foretaste of what may be to come. According to various media reports, Juncker came away from the dinner “ten times more sceptical” about the prospects of a Brexit deal between the UK and the EU27 than he was before, suggesting that the UK may still have “delusions” about what kind of deal may or may not be possible. Juncker's advisers now reportedly see a risk of more than 50% that the Brexit negotiations will fail, with the UK simply crashing out of the EU on 29 March 2019 without any follow-up arrangement to cushion the blow. We may not have to take this “more than 50% risk” at face value. But that details of the dinner have been so widely reported suggests that Brussels wants to send a clear warning to the UK: London will have to shift its positions substantially in order to clinch a deal with the EU27. That Angela Merkel on Thursday told the German parliament that “some in the UK” still seem to harbour “illusions” about a potential Brexit deal is probably a direct consequence of the Juncker-May dinner.

As an EU member, the UK had been granted various special deals ranging from a series of opt-outs to a special budget deal. Leaving the EU will mean the end of such cherry-picking. While the EU27 does not want to “punish” the UK in any way, it will withdraw the benefits that come with membership of the club. We do expect noisy talks that will lead to a



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divorce settlement and a hastily conceived transitional deal in time for the 29 March 2019 divorce, to be followed by a transition period of at least three years in which a final deal will need to be hammered out.

ITALY: RENZI IS BACK – BUT WHAT IS HE UP TO?

At least one gamble paid off. Having lost a constitutional referendum and the office of prime minister last December, Matteo Renzi is returning to the helm of the centre-left Democratic Party after a leadership contest he had triggered himself. 72% of the two million centre-left supporters who took part in the Democratic Party's open primary on Sunday voted for him. While that gives Renzi a clear mandate to lead the party, the turnout was less impressive than it had been at the last open primary in 2013 when 2.8 million Italians cast a vote.

Renzi may use his position to go for early elections instead of waiting for the regular elections in spring 2018. However, we consider it significantly more likely that even the somewhat impatient Renzi will have to bide his time. First, having lost its left-wing in late February, the Democratic Party is now trailing slightly behind the radical "Five Stars" Movement in most opinion polls. An Ixe poll of 26 April projects 28.4% for the Five Stars and 27.3% for the Democratic Party. Renzi will need time to strengthen his party. Second, most parliamentarians of the Democratic Party would probably prefer to keep the current centre-left government of Paolo Gentiloni in power until the end of the term instead of running a risk of losing their seats at snap elections. Third, Italy's president Sergio Mattarella wants the two houses of parliament to reform Italy's election law first before holding new elections. Such reforms could take time, especially as Renzi will have to agree them with the "Forza Italia" party of former prime minister Silvio Berlusconi.

Once the French elections are out of the way, we will need to pay more attention again to the Italian political risk. But chances are that it will not come to the fore before early 2018. By then, firmer economic growth, the example of reforms in France and outlines of a new deal to strengthen the cohesion of the EU27 and the Eurozone in the wake of the French and German elections could help Renzi to take on Italy's left-wing and right-wing radicals in new elections.

GERMANY: ADVANTAGE MERKEL

Opinion polls show a further modest gain in support for Chancellor Angela Merkel's CDU/CSU. At 36% in most polls, her centre-right is now 6 points ahead of the centre-left SPD led by her challenger Martin Schulz. As expected, Germans currently seem to care more about issues of domestic security (a strong point for the centre-right) than they do about the traditional selling point of the centre-left, namely issues of social policy. Although it is still early days, our assessment after the sudden rise of Martin Schulz three months ago that Merkel has a 75% chance to be elected for a fourth term on 24 September still holds. If anything, the probability that Merkel will win could rise beyond 75% on current trends. The upcoming state elections in Schleswig-Holstein (7 May) and big North Rhine-Westphalia (14 May) will provide further clues about the political outlook.

GREECE: A DEAL

Early this morning, Greece and its official creditors agreed a set of measures that should allow Greece to receive the funds it needs to stay afloat over the summer. Eurozone finance ministers are expected to endorse the deal on 22 May. Both Greece and its creditors are de facto buying time before talks including those on the details of debt relief can advance after the German elections later this year.



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