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POLITICAL UPDATE: ITALIAN ELECTION RISK; ADVANTAGE MACRON AND MERKEL

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ITALY: SNAP ELECTIONS IN LATE SEPTEMBER?

The Italian political risk is back. Ex-prime minister Matteo Renzi told *Il Messagero* newspaper on Sunday that it "would make sense... from a European perspective" to hold snap elections at the time of the German vote on 24 September. That would be some six months ahead of the regular date for new Italian elections between March and early May 2018. According to various media reports, Italy's four major parties including Renzi's centre-left Democrats could be willing to agree on a new election law based on the German version of full proportional representation with a 5% threshold needed to enter parliament. Italy's president Sergio Mattarella, who remains reluctant to call snap elections, has made a new election law a precondition for an early vote.

Whether the major parties will agree on a new election law fast and whether the current government led by the centre-left will indeed step down or disintegrate to possibly trigger early elections remain open questions. But we have to take the risk serious. Opinion polls project that no single party would come close to a majority in parliament with a neck-and-neck race for the pole position between the pro-European centre-left Democrats and the radical Five Stars. Support for both parties stands close to 30%. Of the last seven polls, three give the lead to the Five Stars and four to the Democrats who have bounced back by around 4 percentage points since Renzi returned to the helm of his party after winning a primary vote on 30 April. Berlusconi's centre-right Forza Italia and the right-wing Lega Nord would also clear a hypothetical 5% threshold, each with roughly 13% of the popular vote.

Among the four major parties, the Democrats are staunchly pro-European, the Five Stars demand a referendum on euro membership, Forza Italia with a somewhat unclear position seems to argue for reforms in Europe whereas the Lega Nord wants to leave the euro. In case of early elections under German-style proportional representation, the most likely outcome would be a government led by Renzi, either in a formal coalition or an informal alliance with the centre-right Forza Italia. Such a government would likely contribute to a reform debate in the EU and the Eurozone without rocking the boat. It may not be stable for a full term, though.

For three reasons, the ultimate tail risk, namely that the Five Stars could team up with the Lega Nord to take Italy out of the euro, remains very small, in our view. First, many left-wingers among the Five Stars would likely object to any alliance with the radical right. Second, whereas the Five Stars argue for a referendum on the euro, quite a few of them would probably not choose to leave the euro in such a vote. Third, preparing a referendum on leaving the euro would take many months. To allow such a referendum, the Italian constitution would have to be changed, which most likely would have to be approved by a referendum first. The inevitable period of market uncertainty and economic anxiety would probably force any Italian government to abandon such plans fast.

FRANCE: ADVANTAGE MACRON

The new French president Emmanuel Macron continues to ride a wave of success. Opinion polls project that his upstart "Republique En Marche (REM)" party may even win a majority of seats at the parliamentary elections on 11 and 18 June. According to OpinionWay, a likely 28% share of the popular vote in the first round on 11 June could translate into 310-330 of the 535 seats at stake in metropolitan France in the end.



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Even if Macron does less well in Corsica and the overseas departments, that would give him a clear majority of the 577 seats in the National Assembly. Other recent opinion polls, which usually do not explicitly project a number of seats in parliament, give Macron's REM an even higher share of the vote in the first round, ranging from 29% (Odoxa) to 31% (Ifop-Fiducial, Harris) and 33% (Elabe). Most of the polls show steady or rising support for Macron over the course of May. The confident way in which he has handled his meetings with Trump (including the firm handshake) and Putin (including outspoken criticism of fake news spread by Russia's state media) may well bolster his appeal a little further. Chances are that Macron will be able to implement a significant reform agenda for France in coming months and prepare with Germany and other European partners some measures to strengthen the cohesion of the Eurozone and the post-Brexit EU27. At the margin, such successes for the youthful pro-European Macron could also help the pro-European reformer Renzi a little in Italy.

GERMANY: FURTHER GAINS FOR MERKEL

Solid growth, low inflation, record employment and a fiscal surplus: the economic backdrop for German chancellor Angela Merkel could hardly be better. In addition, the antics of Trump, Putin and Erdogan have reminded many Germans why they value their low-key but effective chancellor as a safe pair of hands. With less than four months to go until the German election on 24 September, support for Merkel's centre-right CDU/CSU has rebounded to an average of 37%, well ahead of the centre-left SPD at 26%. Merkel's SPD challenger Martin Schulz, who had enjoyed a major bounce in February and March to the point of briefly overtaking Merkel in some popularity ratings, is now trailing far behind again. Encouragingly, the far-right AfD has fallen back from a peak of almost 14% in early 2017 to around 8% now. Further strengthening Germany's political centre, the liberal FDP at 8.5% is now ahead of the centre-left Greens (7.2%) and the ultra-left Left Party (8.2%) in the polls. Although it remains unclear what kind of coalition Merkel will lead after the vote (again with the SPD, or rather with the FDP and/or the Greens?), her chances to win a fourth term in office look good.

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