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POLITICAL UPDATE: ADVANTAGE FILLON, MERKEL RUNS AGAIN

Berenberg Macro Flash

FRANCE YEARNS FOR CHANGE

Good news for Europe. The risk that a widespread yearning for change in France could sweep far-right Marine Le Pen to power next year has receded a little further. Instead, chances are that France may finally get some overdue economic reforms under a centre-right president. Following a late surge in support, ex-prime minister Francois Fillon has won the first round of the centre-right primaries. He is now the top favourite to be the next French president. Partial results based on 73% of the 10k polling stations for the Republican primaries show Fillon with 43.7% far ahead of another ex-prime minister, Alain Juppé with 27.8%, and Fillon's former boss, ex-president Nicolas Sarkozy, with 21.7%. If confirmed, Fillon will face Juppé in the run-off primary on 27 November. Ahead of that vote, Fillon now has momentum on his side as both Juppé and Sarkozy did significantly worse than expected. One other centre-right candidate, Le Maire with some 2.7% of the vote today, has already stated that he will back Fillon next Sunday. Of course, some caution remains warranted as the first round of the first-ever open primary of the centre-right has shown again how unpredictable such votes can be, especially in a primary not restricted to party members.

If opinion polls are any guide, the centre-right candidate will likely beat Le Pen from the ultra-right Front National in the run-off presidential vote on 7 May 2017. France now looks set to avoid a Le Pen versus Sarkozy contest in the decisive run-off for the presidential election. Such a contest could have been seen as a somewhat unpredictable French version of the Trump versus Clinton campaign in the US, with a divisive candidate from the odious right running against a mainstream candidate with significant baggage. Sarkozy is more associated with a string of potentially embarrassing scandals than Fillon or Juppé. That France will now apparently avoid this scenario reduces the political risks in France and Europe. Despite Fillon's comparatively radical reform ideas, centrist and centre-left voters in France may find it less difficult to support him rather than Sarkozy on 7 May.

Both Fillon and Juppé propose serious economic reforms, with Fillon sounding a bit more radical - almost Thatcherite - than Juppé. Remarkably, the widespread anti-establishment sentiment in France is not just bolstering ratings for the Front National's Le Pen, who scores around 30% in opinion polls. It also strengthens the more reformist politicians in both the centre-right (Fillon and, to a lesser extent, Juppé) and the centre-left (Macron, Valls). With luck, French politics in 2017 could be more an opportunity - namely a wave of pro-growth reforms mirroring earlier reforms in Germany (2004), Spain (2013-2014) and Italy (2015) - than a risk (Le Pen as president).

Jointly with Germany, France is one of the two indispensable countries in the EU and the euro. After a history of many wars, French-German friendship - as crystallized in the EU and the euro - has become the cornerstone of European integration that underpins peace and prosperity in Europe. In this sense, the tail risk that the anti-EU Front National may win the French elections next year and try to take France out of the EU or the euro poses a grave threat. The risk is clearly not zero. Opinion polls suggesting that the Front National's Marine Le Pen clearly won't make it can be wrong. The Brexit vote and Trump's triumph in the US argue for caution. However, the French situation could be somewhat different for three reasons. First,



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Le Pen has been around for a long time. Unlike the Brexit vote and the Trump campaign, she is not a novelty that pollsters can't get a grip on. As discussed in our [Chart of the week - After Trump: could France be next?](#), French opinion polls did not systematically underestimate her support in French elections in the last four years. Second, neither the horrific terror attacks in Paris and Nice nor the recent migration crisis seem to have given Le Pen much of an extra boost beyond the support she had secured before. Third, even in the unlikely case that Le Pen would do as well in France as Trump did in the US, she would still lose. France has no electoral college. Only the popular vote, which Clinton won in the US, counts in France. Of course, a significant degree of uncertainty remains (see also our [Update on European political risks](#)).

GERMANY: MERKEL WILL RUN AGAIN

Ending months of nagging uncertainty, German chancellor Angela Merkel confirmed this evening that she will seek a fourth term at the national election in September 2017. No surprise. While she had kept observers guessing, Berlin has worked for weeks on the assumption that she would run again. According to Merkel, the decision was "far from trivial" for her.

Merkel's widely expected decision makes it even more likely that Germany will remain a pillar of stability in Europe. At home, she has no obvious successor or rival. Germany's strong economic position with satisfactory growth, full employment, a small fiscal surplus and virtual price stability means that the yearning for change is far less widespread in Germany than in many other countries in the western world.

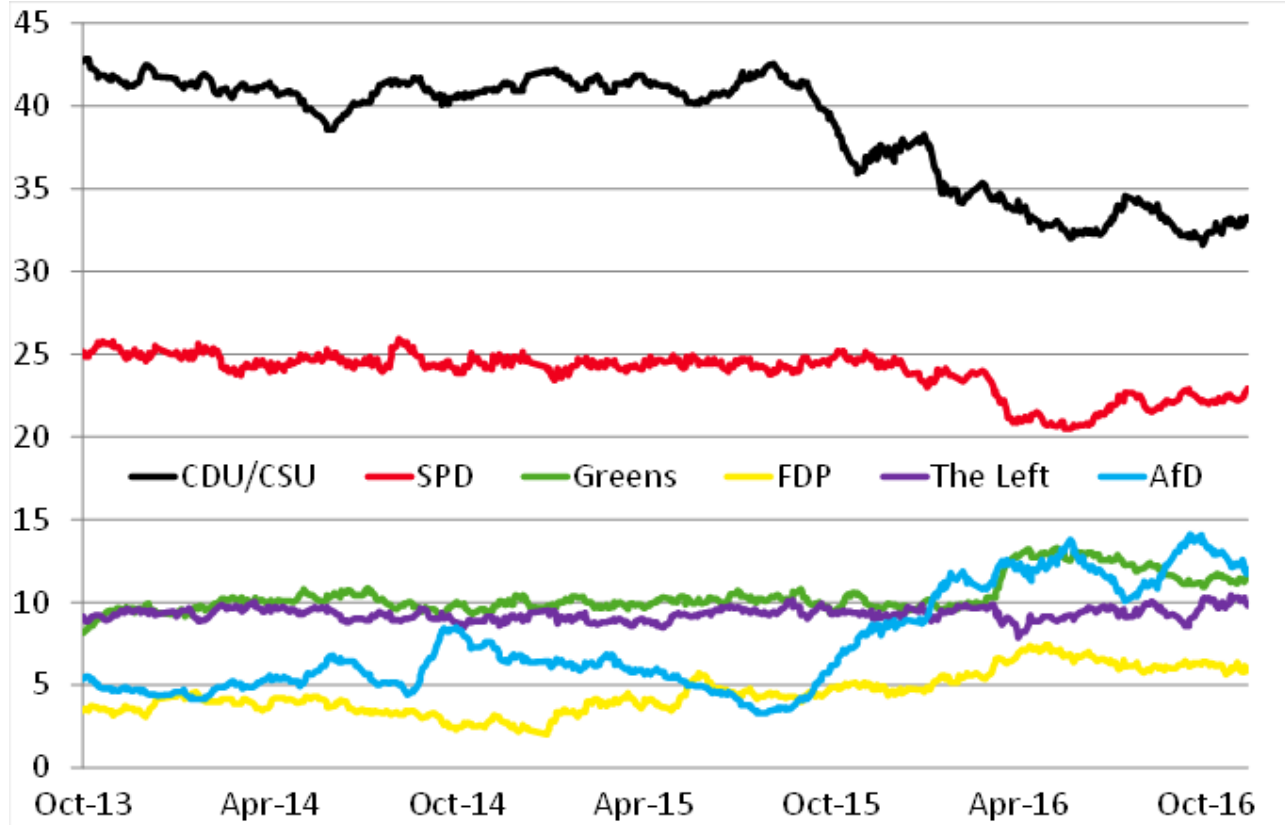
Although Merkel lost some of her erstwhile popular appeal in the wake of last year's migrant crisis, her chances to be re-elected look rather promising. After a long slide, support for her centre-right CDU/CSU seems to have stabilised at 33% amid tentative signs that the ultra-right AfD may have peaked (see chart). We expect the CDU/CSU to rebound to at least 35% as the election approaches and the centre-right leaves behind some of the recent mid-term blues. Under realistic assumptions about the potential strength of other parties, a share of the popular of 35% or more would probably mean that no realistic coalition could be built against Merkel's CDU/CSU next autumn (see our [Update on European political risks](#)). As the Greens have turned somewhat to the left in recent months, Merkel would probably continue to rule with a "grand" coalition between her CDU/CSU and the centre-left SPD rather than switching partners and form a novel alliance with the Greens.

Two developments should help Merkel to bolster her popular support in coming months. First, following a major drop in the number of asylum seekers since April to an annualised rate below 200k, the divisive migration issue has receded a little into the background. Second, preparing the ground for her re-election bid, Merkel has over the last six weeks managed to defuse the noisy conflict with the CDU's Bavarian partner CSU. Although Merkel and CSU leader Seehofer have not fully settled their mostly backward-looking dispute (he wants a hard cap of 200k on the number of asylum seekers that can be admitted per year, she wants policies to keep the number of asylum seekers low without a legally dubious hard cap), both sides have emphasised recently that they agree on most other aspects of migration policy.



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Support for German political parties



Average of last seven opinion polls. Source: www.wahlrecht.de

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