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EUROPEAN POLITICAL UPDATE: MERKEL, MACRON, RENZI

Berenberg Macro Flash

The economy is on the right track. We just raised our 2017 growth forecast for the Eurozone from 1.5% to 1.7%. Amid resilient economic growth, we need to watch the politics even more closely than usual this year. In **Germany**, the centre-left challenger to Chancellor Angela Merkel has enjoyed a surprisingly strong start; in **France**, the troubles of centre-right candidate Francois Fillon still benefit his centre-left rival Emmanuel Macron more than the anti-EU Marine Le Pen; in **Italy**, the risk of early elections has receded a little as ex-prime minister Matteo Renzi now sounds less eager to seek a immediate second chance for him at the polls.

GERMANY: THE SCHULZ BOUNCE

Since selecting the ex-president of the European Parliament, Martin Schulz, as its new leader two weeks ago, support for Germany's centre-left SPD has rebounded by some 7 percentage points. Opinion polls published in February so far put the SPD at an average of 27.5%, well above the average of 20.8% in the first half of January (see chart). Schulz still seems to be gaining momentum, with the latest Emnid poll even giving 29% to the SPD. The advance for the SPD has come from almost all other parties except small FDP (steady at 6%).

Could Schulz really push Merkel out of office? That remains rather unlikely, but a little less so than before. The SPD is still trailing Merkel's centre-right CDU/CSU (down to 33.8% from 36%). To unseat Merkel with a red-red-green coalition, the combined left would need roughly 47.7% of the popular vote at the federal election on 24 September. Because some fringe parties never make it into parliament, the threshold for a majority of seats is somewhat below 50%. As some of the SPD's surge has come at the expense of the Greens (8.3% after 9.8%) and the ultra-left Left Party (8.5% after a 9.7% average for the first half of January), support for the combined left has risen from 40% to 44.3%, still well short of the success threshold.

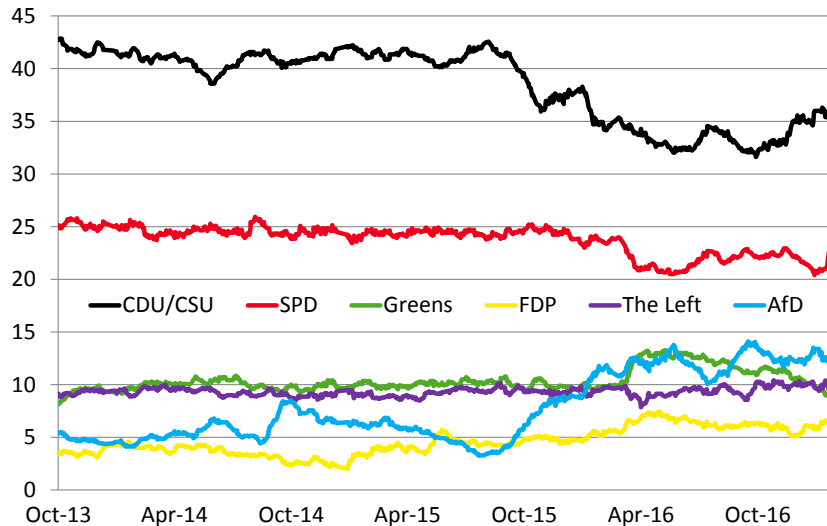
Reacting to the stronger challenge, the centre-right CDU/CSU is trying to close ranks. While agreeing to disagree whether Germany needs a hard cap on the number of refugees and migrants it can accept per year, CDU and CSU leaders are now emphasising that they agree on almost everything else. As the public dispute about migration within the centre-right had hurt Merkel's ratings, this should be modestly supportive for her election outlook. Today, the CDU and Bavarian CSU will proclaim Merkel as their joint candidate for a fourth term as German chancellor.

On balance, the rebound of the centre-left SPD should be good news for the German political outlook. It reduces the appeal of the left-wing and right-wing fringes somewhat. The Schulz surge seems to be driven partly by a relief that the SPD has gone for a steady and energetic leader. Whether Schulz can maintain that momentum through the heat of a campaign against a seasoned Merkel is a different question. In the unlikely case that Schulz would win, would it make a difference? It would accentuate a little the trend towards more public spending in Germany (already up by more than 4% in real terms in 2016). But Schulz is as solidly pro-euro, pro-EU and pro-NATO as Merkel. For the major issues that matter for Europe, the difference would be minor. Both Merkel and Schulz reflect the German mainstream on these issues.



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German opinion polls: the Schulz bounce



Support for political parties in %; average of last five polls. Source: Allensbach, Emnid, FG Wahlen, Forsa, GMS, Infratest Dimap, INSA

FRANCE: ADVANTAGE MACRON

The French election campaign has already thrown up a number of surprises. We thus need to watch it closely for the tail risk that ultra-right Le Pen could win the presidential race this year. But on balance, the scandal engulfing the centre-right candidate Fillon has lifted the prospects of the centre-left reformer Macron more than those of Le Pen. Although Fillon's troubles have made it even more likely that Le Pen will make it into the second round of the French election on 7 May, opinion polls suggest that Macron would beat her by 65% to 35%. For the first round on 24 April, the last four opinion polls give an average of 21% for Macron, 19% for Fillon and 25% for Le Pen. While Macron has moved up at the expense of Fillon, support for Le Pen has not increased in response to the Fillon family affair.

Presenting her 144-point election manifesto on Sunday, Le Pen renewed her call to scrap the euro and promised a referendum on France's EU membership unless the EU were to de facto agree to dismantle itself within six months of Le Pen assuming the French presidency. Even in the unlikely case that Le Pen would win the presidency, she would find it almost impossible to win a majority of seats for her Front National in the parliamentary elections on 11 and 18 June. Without such a majority, she would be unable to implement most of her anti-EU manifesto.

On the centre-right, pressure on Fillon to withdraw his candidacy continues to grow. If he stepped aside for either Juppe or a fresh face – or if he managed to put the scandal behind him, the fortunes of the centre-right could still revive in time for the first round of the presidential vote on 24 April.

ITALY: RENZI BACKING DOWN?

The risk of early elections in Italy seems to be receding somewhat. On Friday, ex-prime minister Renzi dropped a hint that he may not seek early elections, which could have given him a popular mandate to become prime minister again, telling Corriere della Sera newspaper that "elections can't be the 'second half' after the referendum". Unlike Renzi, significant parts of his Democratic Party, notably the left wing, oppose elections this year. The regular parliamentary term runs until early 2018. As the current Italian government has a slim majority in both houses of parliament, a need for early elections in Italy is difficult to see any-



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way. Early elections would run the risk that an informal alliance of the radical Five Stars and some ultra-right parties (Lega Nord, Fratelli d'Italia) might come to power. The less acute that tail risk looks, the more may the Italian economy benefit from the general economic upswing in the developed world, blunting the appeal of anti-EU populists over time.

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