

FIXED INCOME

European Elections: Big Changes, or Business as Usual?

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Many observers are predicting that European elections later this month will usher a wave of populist representatives into the European Parliament. David Zahn, Head of European Fixed Income, Franklin Templeton Fixed Income Group, believes there may be a shift in political balance, but suggests the ability of extremists at either end of the political spectrum to dramatically alter the direction of the European Union is likely to be limited.

As investor attention in Europe focuses on European parliamentary elections later this month, there has been a lot of talk about a possible surge in populism and the likely impact on financial markets.

Our view is that there'll be little change for markets, whatever the outcome.

For fixed income investors, the major themes in Europe over the past decade have been politics and monetary policy.

Nothing in the political field strikes us as likely to change enough to prompt the European Central Bank (ECB) to change its accommodative stance. We'd expect the ECB to remain in an accommodative mood for the foreseeable future. Our current estimate doesn't see eurozone interest-rate hikes before 2022.

European Parliament Makeup

The European Parliament is already quite diverse in terms of the spread of political views represented. We don't expect that to change dramatically after the elections, although there may be some shift in the balance.

We also don't expect this election to alter the political paralysis in Europe. In fact, it could exacerbate it.

We'll likely see more representation from populist and extremist parties than currently. As a result, European politics will probably get a lot noisier and we'd expect more volatility in discussions taking place in the European Parliament. That could prompt more uncertainty about European Union (EU) policy which could mean Europe continuing to stagnate if it can't make the changes it wants.

But we don't foresee a dramatic change in EU policy direction.

We would anticipate a lot more parties in the European Parliament will demand reform of the EU. In our view, Europe does need reform, but whether the new representation in the parliament will push for what we'd consider the right kind of reform remains to be seen.

In addition, new political leadership is expected across the main European bodies. In the coming months, there are due to be new presidents of the European Commission, European Council, the European Parliament and the ECB.

We'd expect those new presidents to be pragmatic in the face of the new political landscape. However, promising reform is a lot easier than delivering reform. Reforms are rarely welcomed by everyone.

If the far right does better than predicted and gains control of the parliament, that could spur more of a change, but Spain's recent general election result suggests some commentators may be over-estimating the lure of the right-wing populism.

Still, one has to be careful about reading too much into past results as voters have often used European Parliament elections as an opportunity to register a protest vote.

The UK's Role in the European Parliament

A further fly in the ointment is the fact that it seems as though the United Kingdom will participate in the European parliamentary election. But UK Members of the European Parliament (MEPs) will serve only until Brexit is finalized.

In the United Kingdom, the nascent Eurosceptic Brexit Party is polling very well at the expense of the Conservative Party. We'd expect Brexit Party MEPs to be quite disruptive to the EU's political agenda.

Separately, we think another poor election performance could spell the end of Theresa May's tenure as prime minister.

Spanish Election Results Reinforce our Positive View

In the light of the Spanish election result, we expect more of the same from Spain. We already thought it was one of the most interesting countries in Europe from an investor's perspective. And the election result has reinforced that sense.

The country's socialist party secured the most number of seats and we'd expect it to continue to run the country. That said, we don't think it will be in a hurry to finalize a coalition government and believe it will wait until after the European parliamentary vote.

A lot of commentators have focused on the apparent success of the right-wing Vox party, which won 24 seats in the election. However, we'd note Vox didn't perform as well as it had hoped.

From an investor's perspective, we think the Spanish authorities' fiscal focus recently has been positive. Spain is one of the fastest-growing countries in Europe, with gross domestic product (GDP) growing at an annual rate of more than 2% in the first quarter of 2019.^{[1](#)} Its debt-to-GDP has gone up somewhat but its budget deficit is under 3%.^{[2](#)}

In our eyes, Spanish bonds are offering a significant premium over those of both France and Germany.

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[1.](#) Source: Instituto Nacional de Estadística

[2.](#) Source: Eurostat