FOCAL POINT

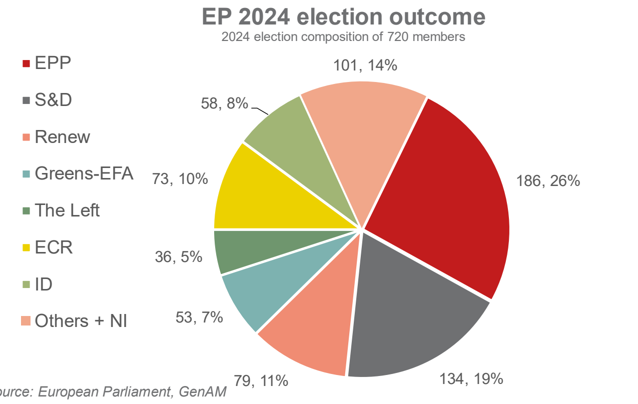
European Elections: more fragmentation and a thinner pro-EU majority

Authors: Martin Wolburg, Paolo Zanghieri
June 10, 2024

Our Focal Point series explores topical issues on macro, markets and investment

- **The June 6-9 European Election resulted in a more fragmented parliament (EP): The share of Eurosceptics (ECR and ID) and independents (NI) rose, largely at the expense of the Euro-friendly coalition (EPP, S&D, Renew). Also the Greens lost heavily. Still, the centre coalition maintains a narrow majority of seats (55% from 59% before).**
- **Notwithstanding the EU-friendly coalition, the gain of the Eurosceptics might slow down or even prevent integration in important areas like banking union. It may further dampen climate ambitions. The discussion over the composition of the new Commission and the choice of the President may take longer than usual.**
- **A more nationalistic tilt will also weigh on the negotiation of the next (2028-34) EU budget and the execution of the new Stability Pact. Deeper debt mutualisation and increase in EU direct funding to e.g. finance climate transition or defence spending may prove even more difficult.**
- **The results unexpectedly triggered a snap parliamentary election in France. A full extreme-right majority looks unlikely, but President Macron may find it difficult to gather the grand coalition he is dreaming of. The risk of stalemate is large. . In Germany PM Scholz's SPD party lost severely, raising the risk of a coalition breakup and snap elections in the not-so-distant future.**
- **The Euro lost against the dollar, and European equities (especially French banks) suffered. Medium term, indirect effects from the 2024 election related to fiscal governance could impact government bond markets, as hopes for a follow-up to the NGEU bond experience will waver.**

The 2024 European election strongly impacts on composition EU policies over the coming five years. Later in the year (likely in September) a new European Commission (EC) will be installed and thereafter (probably in December) a new President for the European Council will be chosen. In what follows we take a deeper look at the June 6 to 9 election outcomes. How much of a threat is the increased fragmentation? Who will the next EC President be? Will there be a change in politics? What to expect for markets?



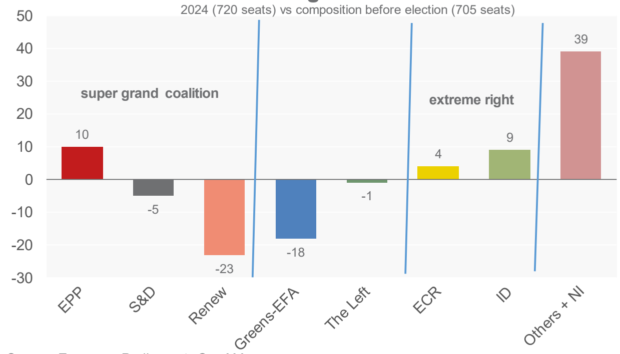
Source: European Parliament, GenAM

A more fragmented European Parliament

The new composition of the 720-members Parliament (up from 705 before) is tilted markedly towards right wing Eurosceptic parties. According to the (still provisional results) at the time of writing the ECR (European Conservatives and Reformists) gained 4 seats, to 73 and the hard right ID (Identity and Democracy) won 9, to 58. The German AfD (Alternative für Deutschland) was suspended from the ID group just before the election. Adding its 15 seats (up 6) the gain of the extreme right would look even stronger. The current majority of conservatives (EPP), socialists (S&D) and liberals (Renew Europe, RE) maintains a thin majority (399 out of 720). While the EPP gained (+10 seats, to 186), S&D suffered somewhat (-5 seats to 134s) and Renew lost heavily (-23 seats to 79). Independents (NI or non-affiliated), which included Germany's far right AfD and Orban's Fidesz and others, enjoyed the largest gains. All in all the new EP is more fragmented than the previous one, which will have an important bearing on its capability to steer policies.

New EP: gains and losses

2024 (720 seats) vs composition before election (705 seats)



Source: European Parliament, GenAM

Still a euro-friendly majority but different policy focus

A rerun of the EPP, S&P and Renew coalition, with a smaller majority than in 2019, appears most likely, as other possible groupings, like centre-right or centre-left are lacking a majority.

A stable majority exists at least on paper, but the results of last weekend's election raise the possibility that, given dissenters within their parties, the EPP-S&D-RE coalition will have to resort to the external backing of other parties on specific issues, as it happened already in the last term. This may further dilute policy ambitions. The rebalancing of power within it will also lead to an adjustment of the priorities rather than a complete change of the agenda:

- The need to strengthen the internal market to promote competitiveness and growth (as highlighted in the report by former Italian PM Enrico Letta, and in the Draghi report which will be officially published later this year), may clash with a more inward, nationalistic orientation.

Possible coalitions in the EP

% of seats

Name	Members	2024	2019
Grand coalition	EPP, S&D	44%	45%
Super grand coalition	EPP, S&D, Renew	**55%**	**59%**
Centre right	EPP, ECR, Renew	47%	49%
Far right	EPP, ECR, ID	44%	42%
Centre left	S&D, Renew, Greens-EFA, Left	42%	**50%**
Left	S&D,Left, Green-EFA	31%	35%

- Likewise, the completion of the banking union might be delayed or watered down.
- This may tilt the attention on how to mobilise resources (CMU) as the appetite for further mutualisation may fade. This casts doubts on the possibility of further debt mutualisation (potential successor to the EU Recovery Fund, NGEU). Albeit right-wing parties differ on that, we suspect that there might all in all be less support than from the previous parliament. This also risks scaling down projects like common defence, infrastructure spending and investment to adapt to climate change.
- An additional risk is that European policies will become more geared to the protection of localised constituency, such as farmers, in a more challenging global environment (trade war). This may impact the allocation of spending in the process of the next multi-annual financial framework (MFF) 2028-34.
- On foreign policy, the current support to Ukraine should not be under discussion, as the ECR is clearly supportive of NATO. On immigration the current stance is likely to be tightened further.

The EP plays an important role in the election of the European Commission, hence on EU fiscal governance. The new Stability and Growth Pact foresees country-specific fiscal adjustments that are the result of discussions with the EC. The EP's confirmation of a fiscal dove or hawk as Commissioner for Economics would make a difference.

EPP win does not imply new term for von der Leyen

The initial job of the newly elected EP will be to elect its President in the first plenary session on July 16-19 before the break in August. Then (likely in September) the EP needs to approve by an absolute majority or veto the European Commission President, which is proposed by the European Council "*taking account for the latest European elections*." After that the Council proposes Commissioners, one from each Member State. They then must appear before parliamentary committees for hearings. Thereafter, Parliament is asked to consent to the Commission as a whole. With this approval, the new Commission is formally appointed by the European Council by qualified majority for a five-year mandate, until the next elections in 2029.

The Role of the European Parliament

Legislative:
- Passing EU laws, together with the Council, based on EC proposals
- Deciding on international agreements
- Deciding on enlargements
- Reviewing the Commission's work programme and asking it to propose legislation

Supervisory:
- Democratic scrutiny of all EU institutions
- Electing the Commission President and approving the EC as a body. Possibility of voting a motion of censure, obliging the Commission to resign
- Granting discharge, i.e. approving the way EU budgets have been spent
- Examining citizens' petitions and setting up inquiries
- Discussing monetary policy with the ECB
- Questioning Commission and Council
- Election observations

Budgetary:
- Establishing EU budget with the Council
- Approving Multinannual Financial Framework

Source: https://europa.eu/european-union/about-eu/institutions-bodies/european-parliament_en#what-does-the-parliament-do?

It is important to bear in mind that with the EPP prevalence as the the strongest group does not automatically imply that EPP's Mrs von der Leyen remains EC President. The so called Spitzenkandidat or lead candidate approach means that the candidate from the largest group would assume Presidency. This process took place in 2014 for the first time but its legitimacy was contested by the Council and not applied after the 2019 elections. Mrs von der Leyen needs 361 votes, about double of the EPP's seat, and it is not even clear that the whole EPP will uniformly back her. Voting history shows that between 15% and 30% of MEPs are not aligned to the group orders on specific secret votes and given the thin majority of the expected super grand coalition, a mere 10% defect within the coalition would undermine her candidature. Let's not forget that in 2019, the majority backing von der Leyen had on paper a 79-votes advantage, but ultimately her bid won by just 9 votes, thanks to the critical support of the non-aligned M5S members. Therefore the process for the composition of the Commission and the choice of its president may take longer than expected and stretch into Q4.

Potential instability in key national governments

The election results had bearings in internal politics in several member states, potentially raising instability. In France President Macron dissolved the Parliament and called for snap election (two rounds on 30 June and 7 July), to undercut the far-right momentum. The strength of the RN polls and the electoral system may well deliver a relative far-right majority. A full majority is less likely, however, and it would be hard for the extreme right to find coalition partners. Marine Le Pen's party has tuned down its anti-EU tone, but it is completely untested in power. President Macron hopes to be able to form a grand national coalition, calling for the traditional left (Socialists) and Right (Les Républicains) to act responsibly. This is a risky gamble, however, that may result in stalemate or a deeper political crisis. In Germany the very poor score of Chancellor's Scholz SPD (14%) will most likely undermine his leadership; the stability of the government, already under pressure from poor growth and deteriorating fiscal metrics, may suffer. On the opposite, in Italy the good performance of Brothers of Italy will cement President Meloni's standing.

The return of political uncertainty spooks markets

The EUR lost against the Dollar immediately after the first data were released. European equities suffered too, especially French banks. Medium term, indirect effects from the 2024 election related to fiscal governance and the chance of greater integration could impact markets, especially government bonds. Mutualisation initiatives benefitted the higher indebted economies; instead, greater fragmentation and the lack of progress on key milestones to complete EMU and restore EU competiveness would work in the opposite direction.

.

Imprint

Issued by:	**Generali Asset Management S.p.A.** **Società di gestione del risparmio, Research Department**
Head of Research:	**Vincent Chaigneau**
Head of Macro & Market Research:	**Dr. Thomas Hempell, CFA**
Team:	**Elisabeth Assmuth |** Research Operations **Elisa Belgacem |** Senior Credit Strategist **Radomír Jáč |** GI CEE Chief Economist **Jakub Krátký |** GI CEE Financial Analyst **Michele Morganti |** Head of Insurance & AM Research, Senior Equity Strategist **Vladimir Oleinikov, CFA |** Senior Quantitative Analyst **Dr. Thorsten Runde |** Senior Quantitative Analyst **Dr. Christoph Siepmann |** Senior Economist **Dr. Florian Späte, CIIA |** Senior Bond Strategist **Guillaume Tresca |** Senior Emerging Market Strategist **Dr. Martin Wolburg, CIIA |** Senior Economist **Paolo Zanghieri, PhD |** Senior Economist

"Edited by the Macro & Market Research Team. The team of 14 analysts based in Paris, Cologne, Trieste, Milan and Prague runs qualitative and quantitative analysis on macroeconomic and financial issues. The team translates macro and quant views into investment ideas that feed into the investment process."