

## Global Economy

# Europe: The election backlash

Expansión (Spain)

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The European election results were less negative than feared by pro-European parties, but it is still too soon to determine the changes that may come about in terms of economic policy. Currently, they are contributing to the aggravation of political problems in some countries.

The election resulted in a more fragmented European Parliament, in line with trends that had been observed in EU countries, but with a less-than-expected advancement of more Eurosceptic movements, which were still divided enough to bring about a significant change in economic policy. Pro-European parties are still the majority, with traditionally centrist parties (PPE and the social democrats, which no longer have a majority together) losing ground in favour of the liberals and greens. Nevertheless, this fragmentation, with more disparate stances in terms of both economic and social and environmental policies, may hinder the election of the top jobs in the European institutions and could delay the agenda of reforms required to deepen the integration of the region, such as the completion of the banking and capital markets union, and progress towards a common fiscal policy.

At European level and in the short term, there is increased concern that this new scenario will endanger the consensus reached to date in Europe on crucial issues such as Brexit and trade disputes with the United States. Equally significant is the change of direction that could be brought about by the new president of the European Central Bank, given the important role of monetary policy during the crisis. The prolonged uncertainty regarding the UK's exit and the possible increase of US tariffs for the automotive industry could derail growth in the eurozone, following the slowdown observed since the second half of last year due to the poor performance of world trade and the industrial sector in particular. This, added to less room for manoeuvre and a lack of co-ordination between monetary policy and national fiscal policies, continues to be a risk for European growth, which could reach around 1% in 2019 and 1.3% in 2020, amid a context of slowing global demand and much more uncertainty.

At national level, the election results have exacerbated political problems in some countries. In Germany, the poor results achieved by the Social Democrat party could endanger the sustainability of the coalition government, which may constitute a significant drawback when having to co-ordinate many important decisions at European level in the second half of the year (key appointments, Brexit policy, reaction to potential tariffs). In Italy, the strong support secured by Lega and the decline of the Five Star Movement has sharpened the differences between the two parties, which govern in coalition, with an early election not being ruled out. This climate of political instability, along with Lega's more radical position against compliance with European fiscal rules, which has not waned since the end of the electoral campaign, has increased Italian risk premium to levels of around 280 basis points (bp). In this context, confrontation with the European Commission has reopened, with the EC having taken the first step towards including Italy in the corrective process after verifying that it had failed to meet the public debt target in 2018 (132% of GDP) and will also fail to do so in 2019 and 2020 unless strong savings measures are put in place (such as increasing VAT rates). Moving beyond the economy's cyclical situation and the need for fiscal stimuli, as well as the possible fine for Italy, the most concerning issue continues to be low potential growth, along with an increased financial burden. Another issue at risk is the capacity of European fiscal rules to reduce country risks, which for the time being seems to be a necessary condition to start to agree on common stabiliser mechanisms in the eurozone.

In short, as has been the norm in recent years, the main risks of the economic scene will continue to be predominantly those of a political nature.

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