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French and UK elections in focus

Euro Politics: French election Q&A – In our publication French election Q&A (please see here) we have set out and answered a number of key questions regarding the upcoming presidential and parliamentary elections in France. Our base case is that Emmanuel Macron will win the presidency, but we have also looked at the consequences of a potential victory for François Fillon or the two populist Eurosceptic candidates Marine Le Pen and Jean-Luc Mélenchon. A victory of Fillon would probably be the best-case scenario for financial markets, as his plans are the most ambitious with regard to stimulating economic growth and also the most beneficial for government finances. That said, given the recent polls of the first and second round of voting, a victory for Macron is more likely. We think that in regard to economic reforms and consolidating government finances his plans are also favourable, albeit less ambitious than Fillon's. In the event of a Macron victory, we expect the 10-year French spread to fall back to around 50 basis points and EUR/USD to rise to 1.10. If Le Pen or Mélenchon would win, we expect a significantly less market friendly outcome; the euro would drop sharply and we expect much higher government spreads of 225 and 125bp, respectively. (Aline Schuiling, Kim Liu and Georgette Boele)

UK Politics: Election call raises political risks - Prime Minister Theresa May announced that she will propose an early election to parliament, to be held on 8 June. Parliament will very likely back the motion. The Labour party has welcomed the announcement, meaning she will get the two-thirds majority required. The UK PM is aiming to get a mandate for her stance on the Brexit negotiations, but also probably had an eye on the opinion polls, which show the Conservative party is riding high. So far in April, our moving average polls has the Conservative Party at 43%, Labour at 26% and UKIP and the Liberal Democrats each at 11%. On current polling, the Conservative party would increase its majority in parliament, while the government would also strengthen its position on its Brexit stance. However, the early election also raises political risks. In particular, a larger proportion of the 48% of the electorate that voted to remain in the EU may rally around the Liberal Democrats, that are calling for a second referendum. To the extent that these supporters are drawn from the Conservative ranks, this could eat away at the Conservative majority. The risk scenario is if the Conservatives lose their majority, plunging the UK into political chaos during the Brexit negotiations, which would then be delayed. (Nick Kounis)

Global FX: Sterling strengthens on election announcement - Despite the above, sterling reacted positively to the news. Even though the political uncertainty has increased, currency markets seemed to take the view that the Brexit would unlikely be much 'harder' given the early elections. Furthermore, financial markets may also even judge that there is now a minor probability for a Bremain. As speculative investors have been excessively short for a while, this sterling recovery has probably triggered the closing of some of these excessive speculative sterling short positions. A test and break of the 1.2775 in GBP/USD (December high) is likely in the near-term. If these speculative excessive sterling shorts are squeezed further, GBP/USD could easily reach and break 1.30 in the coming weeks. Meanwhile, EUR/GBP is on its way to reach, test and break below 0.83 as the uncertainty of the French Presidential elections weigh on the euro (Georgette Boele).

China Macro: Economic growth peaks in Q1, China's recent macro data surprised to the upside - Annual growth picked up further in Q1, reaching a six-quarter high of 6.9% yoy. This was higher than the consensus and our expectation of 6.8% yoy. Growth was supported by stronger momentum in global growth and trade and by previous stimulus, while the property sector has been quite resilient to targeted tightening measures so far. Helped by reflationary trends, nominal growth even jumped to a five-year high of almost 12%. High-frequency macro data for March (industrial production, fixed investment, retail sales) were also strong, exceeding expectations. The pick-up in growth was supported by a pick-up of industry and construction, where growth rose from 6.1% in Q4-2016 to 6.4% in Q1-2017. Whereas 'upside risks' to our 2017 annual growth forecast of 6.5% have risen, our baseline view is that growth will likely resume a gradual slowdown in the course of this year. With growth clearly 'above target', the authorities have more leeway to continue with leaning against the wind by means of a moderate, targeted tightening policy. See for more background our April China Watch published earlier today here (Arjen van Dijkhuizen).