

# ECB Succession Watch

## The European elections, Brexit and Draghi's successor: Update 3

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- Outlook:** The latest polls for the European parliament elections this week suggest a close race between the Spitzenkandidaten Frans Timmermans and the frontrunner Manfred Weber from the center-right. Hungary's decision as center-right member to vote against Weber reduces his narrow lead even more. Accordingly, uncertainty is very high with regards to the implications for the appointment of the Commission and ECB presidents. On May 28, heads of state will officially kick off the appointment process for EU institutions (including the ECB).
- Markets:** Given the changeover of the ECB's executive board, the end result should be a more hawkish ECB. But markets might test the resolve of even dovish presidential candidates, so the euro may then also appreciate, at least initially. Bond markets may show greater sensitivity to adverse macro news than in the past.
- What we are watching:** European Parliament elections of May 23-26, Brexit, Fidesz's suspension, the formation of the Finnish government, the CDU leadership meeting June 2-3 and European Council meetings on May 28 and June 20-21.



Source: iStock

### Our view

The fate of ECB President Mario Draghi's successor is closely tied to the European elections. Why? All the European presidencies up for appointment will be negotiated as one package in the coming months, and as the European Parliament votes on the Commission president, it also influences all other appointments. The informal European Council meeting on 9 May showed that the socialists and the center-right both support the Spitzenkandidat process (i.e. Frans Timmermans and Manfred Weber, respectively), while others, who have no chance of winning the elections, are against it. To this effect, Germany and Spain are in favor, France against and Italy sees it as one criterion, but not the only one. In any event, the winning Spitzenkandidat will have a role to play, because the socialists and the center-right (together) have a blocking minority in the European Council.

If Germany meets its objective of appointing the Commission president, then Erkki Liikanen (Finland) and in particular François Villeroy de Galhau (France) are likely to be in pole position for ECB presidency. Liikanen has a balanced approach and Villeroy de Galhau is more on the dovish side. If Germany doesn't get the Commission presidency, Jens Weidmann would be best positioned for the ECB presidency, which would lead to a more hawkish ECB than expected, in our view.

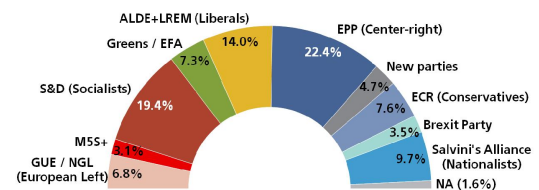
### Related Research

- The European elections, Brexit and Draghi's successor: Update 2, ECB Succession Watch, 10 May 2019
- The European elections, Brexit and Draghi's successor: Update, ECB Succession Watch, 29 April 2019
- The European elections, Brexit and Draghi's successor, ECB Succession Watch, 23 April 2019
- The future of Europe, the Eurozone and the next recession, 9 April 2019
- The ECB: A generational shift in power - Part II, 20 March 2018
- The ECB: A generational shift in power, 19 February 2018

Source: UBS

### Fig. 1: European parliament seat projection

Center-right only have a narrow lead



Sources: Politico, UBS CIO WM, as of 20 May 2019

## Questions and answers

### Who are the frontrunners for the ECB succession?

Eurozone member states are each able to put forward one candidate (through the respective head of state), though none has done it so far (and likely only a few will). The key contenders currently include:

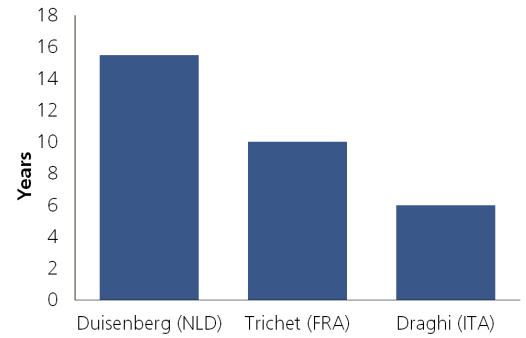
- **Jens Weidmann** (Germany): The former Angela Merkel advisor and Germany's frontrunner would probably start the rate hike process earlier than the others to create monetary policy space for a future recession. He may also seek a small balance sheet in normal times, and is critical of sovereign asset purchases. His candidacy lost momentum last year when Merkel started to focus on the European Commission presidency. French President Emmanuel Macron is said to consider Michel Barnier for European Commission president. In this case, the ECB presidency would be Germany's main target, unless Merkel grabs the European Council presidency for herself. Germany has never held the top ECB job, while France already has in Jean-Claude Trichet.
- **François Villeroy de Galhau** (France): The Banque de France governor is France's frontrunner and also enjoys some support in Germany given his German roots and language skills. Villeroy de Galhau held various posts in the French administration, including at the treasury and finance ministry. He has a dovish and pragmatic tilt and has stuck close to Draghi's line of stimulus, even if he pushes back against debt monetization ideas. However, his past position at a French bank could make the ECB more sensitive to the banking sector and move rates back to zero more swiftly, if he became president. In addition, he has argued for a large balance sheet even in normal times.
- **Benoît Coeuré** (France): Although he is very highly regarded, Coeuré's nonrenewable term as ECB executive board member runs until the end of 2019. We are skeptical that the legal hurdles to appointing him can be overcome. Although he was one of the architects of the QE program, having started his term along with Draghi in 2011, he is generally not an advocate of pre-commitments and forward guidances.
- **Erkki Liikanen** (Finland): The former Governing Council member is a seasoned veteran and was an independent thought leader within the ECB. He is a good networker with statesman qualities and his monetary approach is balanced. Some observers believe that France could also support a Finnish ECB president. Liikanen's party (Social Democrats) won the most seats in the recent elections (nine more than compatriot Olli Rehn's Center Party). This could play to his advantage against Rehn, if the Social Democrats grab the prime minister position, which is likely.
- **Olli Rehn** (Finland): The Governing Council member joined the ECB only in mid-2018. He was in charge of the euro as EU commissioner during the debt crisis, being a strong advocate of fiscal discipline. Just like Liikanen, his political past has helped him develop statesman qualities. His fiscal stance could make a difference for Germany, if France and Germany were to compromise on a non-French and non-German candidate. In addition, he is spearheading the first rethink since 2003 of the ECB's monetary strategy (subject to the Federal Reserve's own rethink in 1H20) and has argued for inflation-targeting. He is one of the few active Twitter users in the Governing Council.

Given the European elections and Brexit, uncertainty is high at this point and the frontrunners could change at a short notice. Other contenders include Klaas Knot (Netherlands), Pablo Hernandez de Cos (Spain), Klaus Regling (Germany), Ardo Hansson (Estonia), and Christine Lagarde (France).

**How do the candidates compare to prior ECB presidents?**

One thing all ECB presidents so far have in common is that they led their national central banks (for 10 years on average, see Fig. 2). In our view, the technical and management experience gained from such a position is more important than ever, because the ECB's staff, influence, and responsibilities have increased substantially since 1999. Accordingly, we think that candidates who have run a national central bank have an edge in the process. Certainly, years of experience running a central bank are a mere proxy for the skill set required of a candidate for ECB president, but they are in any case part of the debate. In Fig. 3 we go one step further and combine this proxy with our own assessment of how dovish or hawkish the candidates with central bank leadership experience are compared to the first three ECB presidents. Surprisingly, the top three candidates in most surveys (Weidmann, Villeroy, Liikanen) are fairly close in policy leanings to the prior presidents. Villeroy has similarities with Draghi, Liikanen with Duisenberg, and Weidmann with the hawkish Trichet. These profiles are far apart from each other. Draghi, for example, has not raised interest rates in his eight years as president, and even added multiple accommodative tools such as quantitative easing. Trichet raised interest rates in 2005 against the wishes of almost all member states, in 2008 during the global financial crisis, and again in 2011 just before the Eurozone entered recession. Duisenberg in turn was rather inconspicuous compared to the other two presidents. Investors are therefore well advised to closely follow the appointment process in May and June.

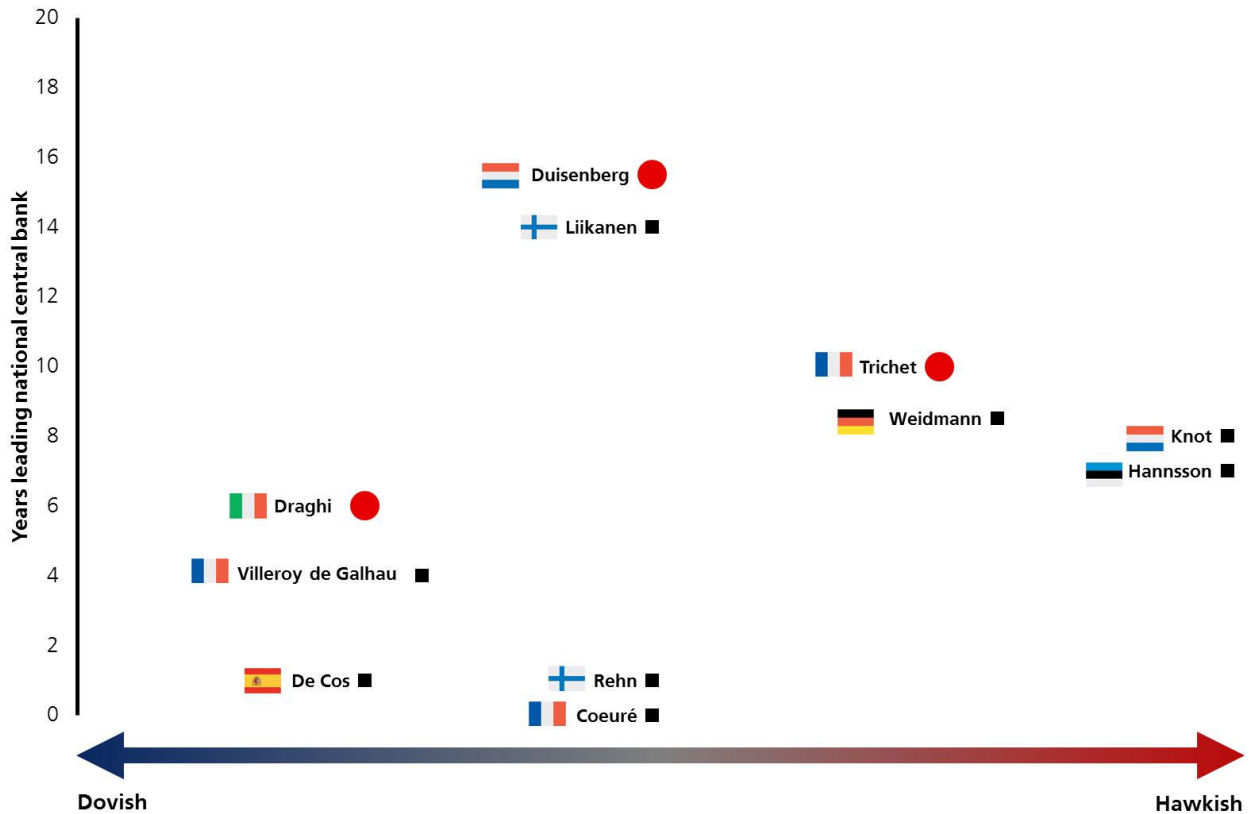
**Fig. 2: First three ECB presidents**  
Years of experience as national central bank chief



Source: UBS.

**Fig. 3: CIO ECB succession radar**

The top three candidates (Weidmann, Villeroy, Liikanen) have similarities with prior ECB presidents



Sources: UBS, Bloomberg. Note: Names can change at short notice and exclude non-central bankers such as Christine Lagarde or Klaus Regling. Note: Dovish/Hawkish assessment based on quotes from central bankers, interviews and Bloomberg ECB spectrometer.

### **How would Eurozone bonds react?**

Bond markets have responded to the ECB's more cautious stance this year with lower bond yields - in particular in medium to longer tenors - and tighter risk premiums for lower-rated countries. As a consequence, the latter (except for Italy) have markedly outperformed German Bunds recently. In contrast, last year markets anticipated the ECB's exit from active bond buying and interest rate hikes, which resulted in a steeper yield curve and rising risk premiums. We think that the choice of ECB president will trigger similar reactions. The initial response if Jens Weidmann were chosen would most likely look similar to last year, with yields and spreads shifting higher. Notably, lower-rated countries that benefited greatly from ECB bond buying could experience rising bond yields, as Weidmann has often been critical of this policy measure in the past. Risk premiums on Italian bonds, especially, would likely turn more sensitive to adverse political news if the established "Draghi backstop" is brought into question. A mere continuation of current policies under a president like France's Francois Villeroy should not result in significant changes for bond yields of most Eurozone governments, as valuations already reflect a very dovish monetary policy stance, in our view. However, investors would likely assume that even the most dovish candidate may not support Italian banks and government bonds as effectively as Draghi did, resulting in greater sensitivity to adverse economic or political news.

### **How should the currency react to a new ECB president?**

First impressions are not all. The president is the *primus inter pares* when voting on big decisions and usually leads the consensus on controversial issues. From that perspective, the majority matters more than the head. Still, the personality and the character of the president make a difference, and we should not underestimate the impact Draghi had on the euro during his term. His name will always be closely connected to the weakness of the euro triggered by quantitative easing, and the idea that the ECB will do "whatever it takes" to safeguard the Eurozone. At first, the change from Draghi to a new leader is likely to strengthen the currency almost by definition. Anyone stepping in his big shoes will find it difficult at first to convince markets that he is as strong and committed as his predecessor. We suspect that markets, when in doubt, would rather buy than sell the euro. Now, it is more difficult for the ECB to find new means to expand monetary policy than it is to tighten. Market perception of risks could therefore turn hawkish, especially as the next generation of the Executive Board will likely be more hawkish. With the new president getting settled, it seems clear that Weidmann, being more conservative, will promote policies that strengthen the euro more than it would under the other two top candidates (i.e. Villeroy or Liikanen). For this reason, we could also see a tendency that the euro reacts positively to those two candidates, at least in an initial phase.

### **What is our baseline view on the ECB succession?**

We think that politically, determining the new European Commission president will take precedence over the ECB presidency this time, especially with the ascent of protectionism (the European Commission takes the lead in trade negotiations). Accordingly, the ECB appointment will depend on the European elections, as the new European Parliament elects the European Commission president. In addition, we believe France and Germany will each aim to place a candidate of their choice (not necessarily of French or German nationality) either at the ECB or the EU Commission, with Germany in particular prioritizing the commission

presidency. In such an event, Liikanen and in particular Villeroy de Galhau would be best positioned to be ECB president, although it is still very early days and names can change at a short notice. Conversely, if Germany does not get the European Commission presidency, Weidmann may be best positioned for the role of ECB chief (unless Merkel goes herself for the European Council presidency). This is because he is the only German frontrunner, as well as the only key candidate of a country run by a head of state from the European center-right (European People's Party). Given current polling for the European elections, Manfred Weber is set to win them, giving Germany an edge on the European Commission post. Accordingly, we think that Erkki Liikanen and in particular Villeroy de Galhau are currently in the pole position for the ECB.

**When is the ECB president elected?**

We believe the ECB president will be determined after it is clear who will become the European Commission president. Following the European elections (23–26 May), the president of the European Council, Donald Tusk, will consult the European Parliament in June on the European Commission presidency. The European Council will decide on its proposal for the commission presidency on 20–21 June, while the European Parliament will elect the European Commission president in early July, most likely on 2 July. Against this backdrop, the European Council will already hold deliberations on the ECB presidency right after the European elections (May 28), as both the ECB and European Commission presidencies will likely be negotiated as a package deal between France and Germany, even if they will need the votes from their liberal and center-right peers among the heads of state.

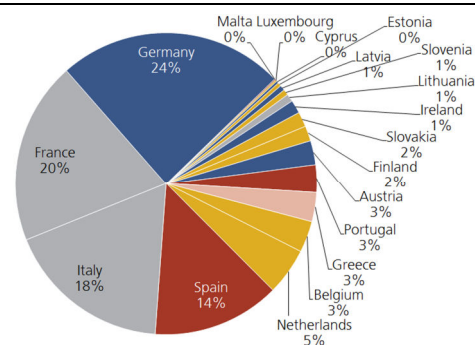
**How is the ECB president elected?**

To become ECB president, Article 283 of the Treaty of the European Union applies. Under Article 283, a candidate is appointed by the heads of the member states (for a nonrenewable eight-year term). The heads of state need to consult with the European Parliament and the ECB Governing Council before making an appointment. Nonetheless, the ultimate decision-making power lies with the Eurozone heads of state within the European Council, based on "reinforced qualified majority." This requires that at least 72% of member states (i.e., 14 out of 19 members) and member states representing at least 65% of the population of the Eurozone to approve it (see Fig. 4 for weights). As such, each member state (through its head of state) has the right to put forward one candidate. Normally, very few countries (or sometimes only one) put forward a candidate, because only a few candidates have a realistic chance of winning the race. In addition, elections in the run up to the appointments have to be watched, as they may lead to a change of the respective head of state (see Fig. 5).

**What is the link between politics and the ECB presidency?**

Typically, decision-making for European appointments revolves around the Franco-German axis as well as the affiliation of the 19 heads of state to the respective European party family. The political heat map (Fig. 6) shows all voting countries and the membership of the respective head of state in the European party families. The center-right (i.e., EPP) will mathematically not be able to push through the ECB presidency on their own. Beyond Spain (which may reciprocate for ECB Vice President Luis de Guindos), Germany will need the support from either France or Italy. France will likely only play ball if they get either the ECB presidency or European Commission presidency. Italy's prime minister Giuseppe Conte

**Fig. 4: Eurozone population weights**  
German dominance



Source: UBS, as of May 2019  
Note: blue = EPP, grey = independent, red = S&D, yellow = ALDE, light red = European Left, green = Greens. Slovakian head of state changes as of 15 June (from S&D to ALDE). Finland currently in government formation process.

**Fig. 5: Local elections**

At least four national elections due until the new European Commission take office in November 2019

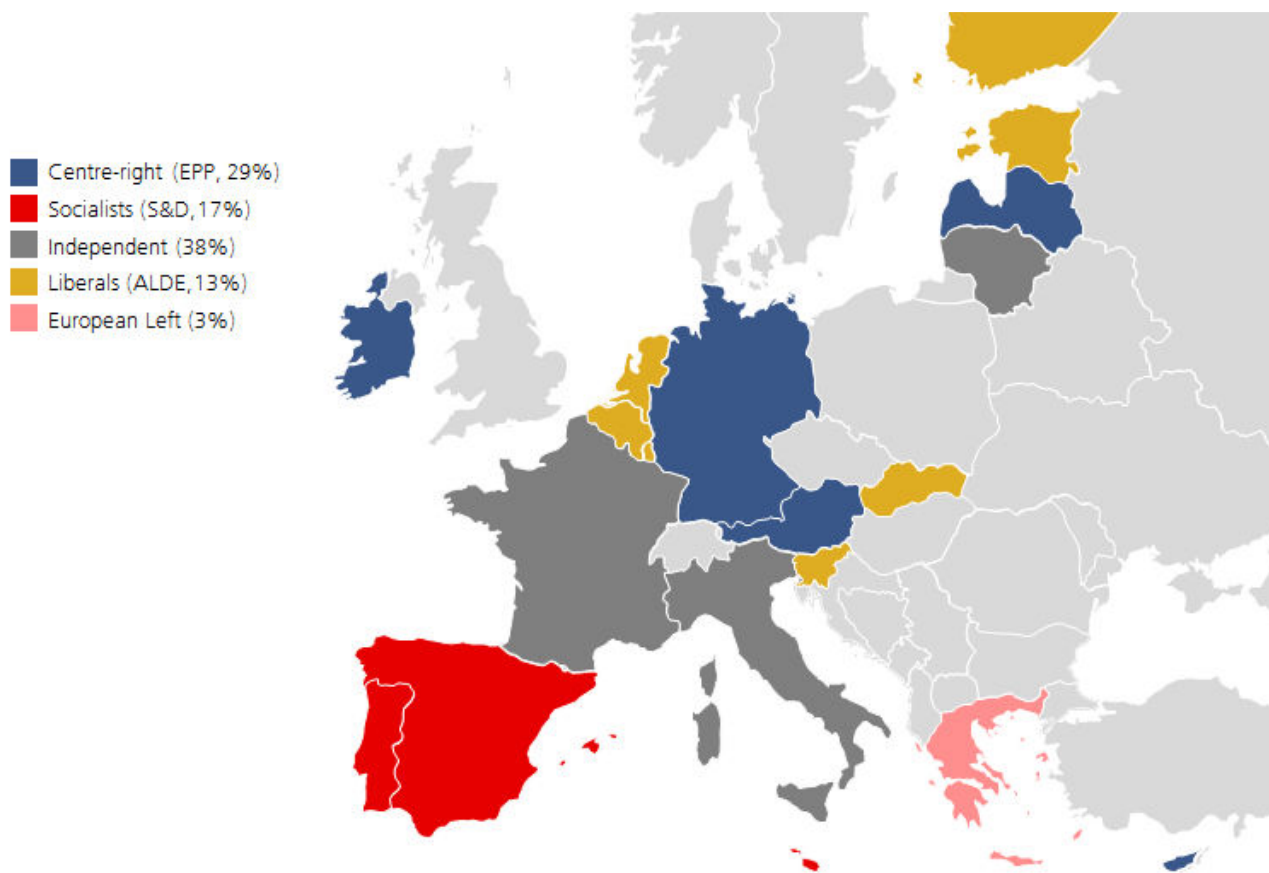
Country	Date	Election	Percentage of EZ Population
Lithuania	May	Presidential election	1%
Belgium	May	Parliamentary and regional elections	3%
Portugal	October	Parliament election	3%
Greece	October	Parliament election	3%

Source: UBS, as of 20 May 2019  
Note: Greek elections are yet to be scheduled and could take place before October 2019.

in turn commented at the informal European Council of 9 May, that Italy's priority is to be properly represented in European institutions. We believe that Antonio Tajani being re-appointed as European parliament president in July could fit that purpose.

**Fig. 6: Heads of state behind ECB presidency decision**

No qualified majority possible without cross-party deals (share of Eurozone population in brackets)



Source: UBS, as of May 2019

Note: EPP = European People's Party, S&D = The Progressive Alliance of Socialists and Democrats, ALDE = The Alliance of Liberals and Democrats for Europe. Slovakian head of state changes as of 15 June (from S&D to ALDE). Finland is currently in its government formation process and the new socialist prime minister is expected to take office by the European Council of June 20/21.

**European elections: What is the *Spitzenkandidaten*-process?**

According to the *Spitzenkandidaten*-process (used for the first time in 2014), the European Parliament has to put forward and elect the European Commission president. Usually it is the lead candidate of the winning party family, like Jean-Claude Juncker from the European People's Party in 2014. The *Spitzenkandidaten*-process is controversial because multiple heads of state see it as their responsibility to come up with the lead candidate (as per Article 17 of Treaty of the European Union). France is against the *Spitzenkandidat*-process, Germany and Spain in favor and Italy sees it as one key criterion, but not the only one. In any event, both the European Parliament and the European Council vote on the commission presidency, by a simple majority and a qualified majority (55% of member states, representing at least 65% of the EU population), respectively. Jean-Claude Juncker in turn re-confirmed his conviction at the informal European Council on 9 May, that the

Spitzenkandidat winning the European elections will become the new European Commission president. In addition, the socialists and the center right (both supporting the Spitzenkandidat process) have a blocking minority in the European Council).

### How and when is the European Commission president elected?

Following the European elections on 23–26 May, the parties within the European elections start holding coalition talks with a view to concluding them in June (Fig. 7). On May 28, the European heads of state will convene to deliberate and determine their priorities for the European Commission president. Subsequently, European Council President Donald Tusk will consult the European Parliament in June on the candidate for the European Commission presidency, taking into account the European election results. The *Spitzenkandidat* of the European Parliament will be considered, but the European Council is not bound by it. As laid out earlier, the heads of state may take the distortion of the UK participating in the elections as an excuse to ignore the *Spitzenkandidat*. Following those consultations in June, Tusk will formally propose a candidate for the commission presidency to the European Council. By 20–21 June, the European Council will formally decide on their candidate of choice based on a qualified majority vote. The qualified majority vote requires 16 of 28 countries (the UK is also allowed to vote) representing at least 65% of the EU population voting in favor of the candidate. This is then followed by the final vote in the European Parliament in July, most likely 2 July. If the European Parliament doesn't confirm the European Council's candidate, the latter has to come up with another candidate within one month's time. Furthermore, at the inaugural plenary session of the newly elected Parliament, to be held on 2 July, a new European Parliament president is set to be elected, with the current President, Antonio Tajani (EPP), being up for reelection.

### Who are the main *Spitzenkandidaten* for the EC presidency?

The center-right (EPP) and socialists (S&D) are clearly in the lead according to polls for the European elections (Fig. 1). In the meantime, their respective *Spitzenkandidaten*—Manfred Weber and Frans Timmermans—have been set.

- **Manfred Weber** (Germany, center-right): The chairman of the EPP is a member of the Bavarian party CSU, the coalition partner of the CDU. Weber's CSU is positioned to the right of the CDU, which plays in his favor to keep Hungary's Fidesz party within the centre-right party family (EPP) after the European elections. Angela Merkel has declared her clear support for Manfred Weber at the informal European Council of 9 May. In addition, she stated that all members of the European center-right (European People's Party) are in support of the Spitzenkandidat-process and thus Manfred Weber. Weber's political agenda focuses on creating more jobs, increasing border control, fostering innovation, and supporting the European youth.
- **Frans Timmermans** (Netherlands, socialist): Currently serving as first vice-president of the European Commission, the lead candidate of the socialists (PES) is a former Dutch Minister of Foreign Affairs. He gained firsthand experience next to Jean-Claude Juncker and is fluent in seven languages. Timmermans pledges that he would strengthen trade alliances, support fair taxation, and fight the shortage of affordable housing and unfair wages.

**Fig. 7: Election of the European Commission**  
A long way ahead

Date	Event
23-26 May	<b>European parliamentary election</b>
28 May	<b>European Council on presidential appointments</b>
June	<b>The president of the European Council consults with the EP</b> on the candidate for the presidency of the Commission and proposes a candidate to the European Council <b>The European Council decides on its proposal for a candidate</b> (by qualified majority)
July	<b>Election of the Commission President by the EP</b> (by majority - at least 353)
August - September	Member states propose Commissioners-designate <b>Hearings of the Commissioners-designate by the EP committees</b>
October - November	<b>Vote by the EP on the new Commission</b> (by a majority of the vote cast) <b>Inauguration of the new European Commission</b>

Sources: European Parliament, UBS, as of May 2019.



As mentioned earlier, the European Council is not bound by the *Spitzenkandidat* emerging from the European election. The council just has to take into account the result of the European election. The UK's participation in the European elections could reduce the chances of the European Council voting for the *Spitzenkandidat* due to the distorted election results. It is said that France's Macron may push for Michel Barnier as European Commission president and Germany for Peter Altmaier, especially if Weber's EPP fails to win the European elections. For what it's worth, the UK will have the right to vote on the European Commission president, as well as those of the European Council and the EU parliament. Barnier ending up as European Commission president would likely move the pole position for the ECB presidency from Erkki Liikanen and Villeroy de Galhau to Jens Weidmann, unless Angela Merkel would grab the European Council presidency for herself.

### Will populists dominate the new European Parliament?

According to polls, far-left and far-right parties could grab anywhere between 20% and 30% of the seats (depending also on definition), increasing their representation significantly. However, we don't think this will suffice to dominate the European Parliament. Populists have taken advantage of the euro debt crisis and the immigration crisis, but the immigration wave has abated and euro support is at historical highs (Fig. 9). Most votes are taken by simple majority, depending on legislation also based on an absolute majority. In addition, there are no blocking minorities when voting in the European Parliament. Accordingly, we don't think the populists are set to take control of the European Parliament. What's more, it is unlikely that the far right and far left will unite or consistently align behind legislative proposals.

### More populists in the European Parliament: Implications?

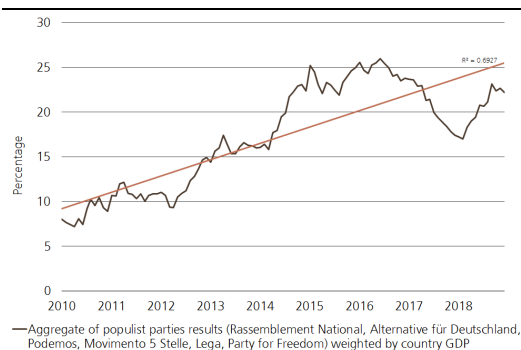
Due to the expected populist gains, it is very unlikely that the traditional coalition of the center-right (EPP) and socialists (S&D) will command a majority in the next parliament. Accordingly, we expect a majority coalition between the center-right and socialists to also include the liberals (ALDE) or the Greens. More important, though, better-than-expected performances of national parties in the European elections could trigger political consequences at the national level. In Germany, the SPD will closely follow its performance (and that of the elections in Bremen) and could withdraw from the grand coalition in Berlin, if it suffers a heavy defeat. The CDU in turn has scheduled a leadership meeting for June 2/3, which could see anything happening from moving forward the review of the grand coalition agreement, snap elections or even to Merkel resigning. Likewise in Italy, a weak performance of the Five Star Movement and strong one for the Lega could lead to a government reshuffle or even snap elections.

### What is our baseline view for the European elections?

We expect populists to grab 20–30% of the seats (also depending on definition), while their influence should be limited. The center-right (EPP) is set to win the elections (see Fig. 1), according to polls. The socialists (S&D) would challenge them, if the UK participates in the European elections (as British socialists would increase S&D's share in the European Parliament) and Hungary's Fidesz party leaves the center-right (currently Fidesz is suspended from the EPP). What's more, S&D is expected to have an easier time to convince independent parliamentarians than EPP and there is also the possibility that Syriza ends up with the socialists. In addition, there is a significant risk that the result of the European

**Fig. 8: Populist parties on the rise**

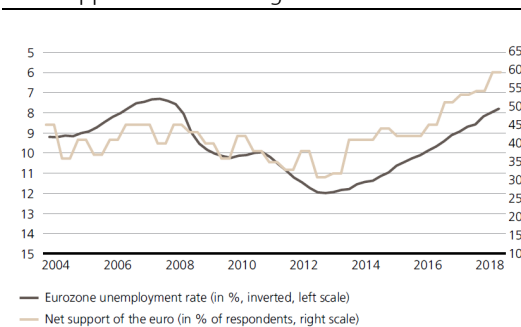
Share of above 20%



Sources: National Polls, UBS CIO WM, as of December 2018.

**Fig. 9: Euro support vs. unemployment rate**

Euro support at all-time high



Sources: Eurobarometer, Eurostat, UBS, as of December 2018.



elections may trigger consequences at the national level, such as government reshufflings and snap elections in 2019. Germany and Italy seem most exposed to spillovers given their very fragile coalition climate.

**How are seats allocated in the European Parliament?**

The criteria for the composition of the European Parliament are determined in Article 14(2) TEU, stating that at least six seats are allocated by member states. The maximum threshold is 96 and the European Council decided that the thresholds should be fully utilized in order to reflect the respective population sizes as closely as possible, a goal that is met with Germany holding 96 seats. Furthermore, the representation is degressively proportional, meaning that an MEP from a more populous member state should represent more citizens than an MEP from a less populous country. Given that the UK is now expected to participate in the European elections, the number of seats of the European Parliament will remain unchanged at 751.

**What are the powers of the European Parliament?**

The European Parliament has legislative, budgetary, and supervisory powers. Legislation voted by the European Parliament is binding on all member states. The parliament co-decides on an annual basis with the European Council on the annual budget of the EU. It also adopts the EU's seven-year budget (Multiannual Financial Framework). The European Parliament exercises democratic oversight over European institutions such as the ECB.

## Appendix

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