

# Tortoise QuickTake

## Credit Podcast



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**Welcome to the Tortoise QuickTake podcast. Thank you for joining us. Today, a senior member of Tortoise provides a timely update on trending topics in the market.**

Welcome to the weekly Tortoise credit podcast. I'm Graham Allen, Senior Portfolio Manager at Tortoise.

Today I would like to discuss why political events this weekend in Europe show that the EU is failing, despite the lack of any market reaction.

Following the election of Emmanuel Macron in the 2017 French presidential election, the establishment in Europe and more specifically Brussels, breathed a collective sigh of relief, as the specter of President Marine Le Pen had been defeated. At the time, the feeling was that Brussels' drive toward more European integration was back on track and that populism had been overcome, at least for now. Of course, the fact that Le Pen garnered 34% of the Presidential runoff votes was never really highlighted. That she even got to the runoff was also a huge improvement for her National Front party over previous elections.

Fast forward to events this last weekend when the German government finally reached an agreement to form a coalition between Angela Merkel's Christian Democratic Union (CDU/CSU) party and the Social Democratic Party (SDP), after months of wrangling following the inconclusive German general election.

The Italian general election also took place on Sunday 4th of March and resulted in no single party achieving a clear majority. The almost complete lack of any volatile market reaction to both of these events masks the fact that they clearly show that populism in Europe has not been contained but rather, is still on the rise. This indicates that Europe is inevitably heading towards a showdown that could shake the very foundation of the European Union itself.

Why were these elections indicative of future problems for Europe and the Eurozone?

Let us start in Italy. While a hung parliament was expected, the results showed a significant swing to the right. The anti-Europe Five Star Movement garnered the largest vote at 32.6%, followed by the Democratic party at only 18.7%. The other two main parties, the League and Forza, polled 17.4% and 14.0% respectively. The result means that the process of back room dealing to form a government now begins, and could last for months. More importantly, the nightmare scenario for Brussels of a coalition between the Five Star party and the anti-immigration League party now becomes a distinct possibility. In that event, Italy would continue to battle Brussels on three key issues that plague Italy today, namely the budget, immigration and banking. Italy's unemployment level at 11% is among the highest in Europe and its banking system is hampered by non-performing loans that are estimated to be above €300 billion. Sub-par economic growth for the last eight years has also exacerbated resentment of the large immigrant influx, predominately from countries like Libya.

The resolution of Germany's political dilemma is less spectacular but again, the very fact that Angela Merkel needed to form a coalition is indicative of her weakened position and an indication that her pro-Europe policies are becoming less popular. Between the two parties, they hold 47% of the vote (significantly down from 67% in the 2013 elections), so the new coalition has a clear mandate to govern. However, less covered in the media is the fact that now the conservative anti-Euro Alternative for Germany AFD party now becomes the 'official' parliamentary opposition party with only 13% of the vote. This role comes with a certain level of prestige and allows the party to "punch above its weight" in the parliamentary process, achieving a wider audience for their extreme anti-Europe views.

On the face of it, the Italian election was inconclusive and the SDP vote solved the German political conundrum for now, likely explaining the lack of any market or political angst. However, in the context of the rest of Europe, both of these events clearly show that populism did not end with the French Presidential election. Add to this the likelihood that BREXIT, when completed, may offer a blueprint for another exit, as well as put more pressure to reduce sovereign contributions to Brussels. Of course, when the UK does finally leave, its lack of net contribution to the EU budget will also cause tension among remaining members to cover the shortfall.

For the time being, a recovering Eurozone economy is having the effect of masking the building tensions within the Union, although uneven recovery rates has caused resentment amongst the core countries. With GDP expected to average between 2.5% - 3.0% for 2018 across the Eurozone, with significantly higher levels being forecast in Eastern Europe, political differences are likely to be deferred for now. But further integration within the EU could also be hampered by the trends being seen in these and other elections which seem to show that anti-Europe sentiment is still rising. Brussels has openly said that the answer to Europe's problems is more Europe, but these results seem to indicate building opposition to those policies. At some juncture, something has to give. What is clear is that Europe needs new policies to achieve more integration in order to stem the tide of populism. The increasing tension between populism and statism increasingly highlight the fundamental flaws of the European project that have existed from Day One. If these policies are not forthcoming then European unity will likely not survive the next big downturn.

Thank you for joining us.

**Thank you for joining us. And stay tuned for our next cast. Have topics you want covered or other feedback to share? Write us at [info@tortoiseadvisors.com](mailto:info@tortoiseadvisors.com).**

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