

Will Belgium Avoid Post-Election Deadlock?

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In a few weeks, Belgian voters will elect a new parliament. Due to deep divisions within society, we expect it to take several months to form a new government. The ensuing uncertainty is likely to result in some widening of bond spreads. However, we expect a worst-case scenario like 2010-2011 to be avoided.

Belgium will hold an important triple election on May 25 as citizens cast votes for their representatives in the federal, regional and European parliaments. Any party that does poorly will probably remain in the opposition at all policy levels for the following five years.

Previous elections have put pressure on the Belgian bond market. Due to the deeply fragmented political landscape and historical divisions between the Flemish and francophone communities, new governments have only been formed with great difficulty. After the 2007 election, it took 284 days to create a new permanent government. And following the 2010 election it took 541 days—a world record. Political uncertainty and separation fears around the time of past elections led to a significant widening of Belgian bond spreads versus German Bunds (**Display 1**). Is this likely to happen again?

Fragmented Political Landscape

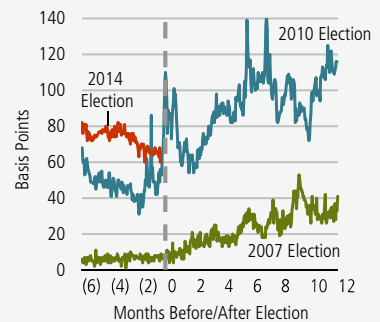
Belgium's political difficulties are mainly

the result of historical divisions between its Flemish and French-speaking communities. The complex federalist structure was created to enhance the autonomy of its regions and protect the rights of their distinct linguistic groups. Elections are segmented, with political parties split on language grounds—elections are a contest between Flemish parties in Dutch-speaking Flanders, and between francophone parties in Wallonia. So even though these elections lead to the formation of a federal parliament, there is no true “national” election. In recent years, a difficult situation has been made worse by the rise of nationalist, pro-secession parties like the New Flemish Alliance (N-VA).

The current government was formed at the end of the 2010-2011 negotiations. It is a diverse coalition of six parties—the center-left francophone and Flemish Socialist parties, the center-right francophone and Flemish Liberals, the center-right Flemish Christian Democrats and the center-left francophone Christian Democrats.

Display 1
Spread Widening After Elections

Belgium 10-Year Government Bond Spread*



*Belgian bond spread to German Bunds before and after federal elections
Through May 8, 2014
Source: Haver Analytics

Election Outlook

The latest opinion polls show a slight drop in support for several parties of the current coalition, and an increase in support for the N-VA and smaller parties on the far left and far right (**Display 2, next page**), when compared with the 2010 results.

N-VA's national support has increased to about 21% from 17% in 2010 (based on surveys showing it would win about 33% of the Flemish vote, up five points from the 2010 result). So it is on track to remain the largest party in the Belgian parliament after this month's elections.* If this happens, the N-VA would probably be given the first

*While N-VA won the most seats in the 2010 federal election, it decided to move into opposition.

chance to form a new government. Just as in 2010, however, this would create tensions with the francophone parties and could lead to protracted discussions.

Flemish Nationalists: In or Out?

Currently, there are two coalition outcomes that appear most plausible—one that includes the N-VA, and one that does not. The N-VA would likely work to form a center-right government with the Flemish and francophone Liberals and Christian Democrats in a four- or five-party coalition that would give it a majority. To make this work, N-VA has already indicated its intention to find common ground on issues like tax policy and welfare reform, whilst relegating its longer-term confederalist and/or secessionist aims to the background—at least for now.

However, there are several complications to this scenario. First, the francophone Liberals and Christian Democrats have publicly pledged not to join a coalition that includes the N-VA; it is not yet clear how this position would evolve in negotiations. Second, much federal legislation in Belgium (such as on so-called “community laws”) requires not only a majority of parliament, but also a majority of both language groups. Such a majority within the francophone group appears unlikely in a coalition that includes the N-VA.

In the alternative scenario, the Flemish Nationalists would fail to form a government. This would leave the task to either the francophone Socialists (as in 2010-2011) or the francophone/Flemish Liberals. In this case, a continuation of the current six-party centrist coalition would be the most likely outcome. The N-VA would be relegated once more to the opposition at the federal level, though it would likely lead the regional Flemish parliament.

Avoiding Deadlock This Time

Given the likelihood for divisive negotiations, our base case anticipates some delays in the talks, but with a new government in place by year-end.

At present, we do not expect an absolute deadlock scenario, as in 2010-2011 or 2007-2008. In those episodes, failure to reach a deal was mainly due to a push from Flemish parties for major state reform (to devolve more powers to the regions, change the federalist structure and reform a contested electoral constituency). This required a demanding two-thirds majority, and was opposed by the pro-state French Walloon parties. In 2010-2011, the sixth state reform was ultimately agreed upon after 485 days, with the new government sworn in two months later.

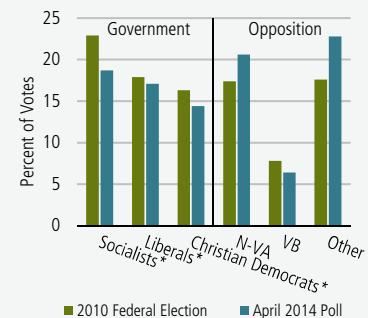
Today, there is little appetite for—and possible legal restrictions against—a seventh state reform, at least in the short term. Voters are more concerned about the economy and the improvement of living standards. Most citizens and politicians are keen to avoid a repeat of 2010-2011.

So far, the campaign has mirrored these interests. Parties have focused on a more traditional left versus right debate about socioeconomic reforms, dealing with high unemployment and key structural issues—like the tax burden on households and corporations. This may make it easier to find common ground in coalition talks than after previous elections, when the pro-Belgium versus pro-separatist rift took center stage. A temporary shift in focus away from major constitutional/state reform may help shorten coalition talks.

That said, the political landscape is certain to remain highly fragmented—as indicated

Display 2
Flemish Nationalists in the Lead

Shares of Votes, 2010 Election and Recent Opinion Poll



The Belgian political landscape is highly fragmented.

*In the chart, “Socialists”, “Liberals” and “Christian Democrats” each show cumulative support for the Flemish and francophone formations of these parties. As such, each bar represents total support for two parties.

The Socialists are the traditional center-left. The Liberals and Christian Democrats form the traditional center-right. New Flemish Alliance (N-VA) is the center-right, pro-confederalist party. Vlaams Belang (VB) is a far-right, pro-independence party. “Other” includes the Flemish and francophone Greens, and smaller parties.

Source: Belgium Federal Public Service, La Libre Belgique and AllianceBernstein

by recent opinion polls. Even in a favorable scenario, negotiations will still take some time, and with the nationalist N-VA set for a repeat victory, the future governments composition is an open question.

Until the new coalition is formed, we expect bond spreads to widen somewhat, driven by the uncertain post-election environment. It’s plausible that markets would react like they did in the six months after the 2007 election, when spreads widened 20 basis points. However, a major sell-off as in 2010-2011, which was caused in part by the simultaneous breakout of the European debt crisis, looks unlikely this time around.

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