

ECONOMICS: EUROPEAN PERSPECTIVES—MAY 23, 2014

EU Elections: Radical Parties to Make Loud Headlines, Limited Impact

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Protest voting and low voter turnout are likely to fuel support for extremist/anti-European parties in this week’s elections. The results could temporarily weigh on peripheral euro-area bond markets. However, we don’t expect a major impact either on the functioning of the EU or on national politics in most countries.

This week, voters across the European Union’s (EU) 28 member states cast their ballots for a new European Parliament. Voting for the directly elected representative body of the EU started on Thursday in the UK and the Netherlands and will end on Sunday.

Opinion polls point to a sharp rise in support for extremist/Eurosceptic parties (**Display 1**). These parties (mostly on the political right) are on track to win about 25% of the seats in the new parliament—in Display 1, a total of “Non-Attached”, or NA, Europe of Freedom and Democracy (EFD) and the United Left (GUE/NGL)—double their current 13%. In France, Italy and the United Kingdom (UK), the Eurosceptic parties could cause major upsets; with France’s National Front, Italy’s Five Star Movement and the UK’s Independence Party (UKIP) all in with a

good chance of becoming the largest delegations from their respective countries in the next European Parliament.

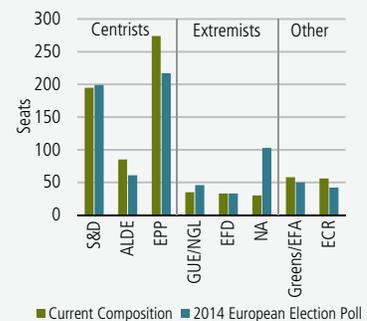
Pyrrhic Victory for Eurosceptics

As was highlighted during the sovereign-debt crisis, the European Parliament is much less influential than the Council of Ministers (i.e., national governments) in the formulation of regional policy. But the parliament does play an important (and expanding) role in the legislative process—as was evident in the banking union negotiations. So could the success of extremist parties threaten future legislation needed to improve the institutional setting of the EU and euro area? In our view, the answer is no.

Why? Despite their success, extremist parties are only likely to attain about 25% of the seats. So even if some of these

Display 1
Rise in Votes for the Extremists

Projected Seat Allocation for New European Parliament vs. Current



Descriptions of the European party groups included in the footnote below*
 As of May 19, 2014
 Source: European Parliament, TNS Opinion

parties could form a parliamentary bloc—which is still questionable—they would represent only a vocal opposition. Moreover, the diverse nature of the parties involved and their very different viewpoints on key policy issues would call into question the cohesion of any such grouping.

The biggest parties in the new parliament, with around 25%–30% of the seats

*Descriptions of European party groups: “S&D” is the center-left social democrats, and includes Germany’s SPD, UK’s Labour and France’s Socialist party. “ALDE” is the centrist liberals. “EPP” is the center-right European People’s Party, and includes Germany’s CDU, France’s UMP, and Italy’s Forza Italia.

“GUE/NGL” is the radical left, and includes parties like Greece’s Syriza. “EFD” is a far-right group, and includes UK’s Independence Party. “NA” is the non-attached parties, mostly far-right, and includes France’s National Front and Italy’s Five Star Movement.

“Greens/EFA” are the European Greens and the European Free Alliance. “ECR” is a conservative, Eurosceptic coalition—the largest party is the UK’s Conservatives.

projected for each, are likely to remain the main center-left (Social Democrats, S&D) and center-right (European People's Party, EPP) parties who are still very pro-European (and generally much more so than national governments). In the past, these parties have tended to cooperate on key legislation, and the growing threat from extremist parties may force them to join forces even more in the future. Indeed, the reduction in seats for the political center could lead to a "Grand Coalition" between these two main party groups and the centrist liberals (ALDE) in order to pass legislation requiring a two-thirds majority. So the rise in support at the fringes could, unintentionally, make the European Parliament even more centrist/pro-integration.

Impact on National Politics

In most countries, the European election results are likely to have only a limited impact on national politics. But there are some exceptions:

Greece: Threats to Coalition

Greece is the most important exception to this rule. The main reason is the weak state of Greece's current governing coalition—particularly the junior coalition partner, the Panhellenic Socialist Movement (PASOK). Due to the economic crisis, unpopular austerity reforms and high unemployment, the government's majority in the national parliament has been reduced by internal conflict and now stands at just two seats. This weakness raises the risk that a poor performance at the European elections could call into question the government's political legitimacy.

The main opposition party, the far-left Syriza, is expected to do well in this week's European vote (alongside several other fringe parties), with PASOK likely to do poorly (**Display 2**) (but better at the local elections that take place simultaneously). After this weekend's vote, some political instability is likely in Greece, which could include negotiations for a broader "unity

government" and/or the government having to survive a no confidence vote. However, in our view, more adverse scenarios like immediate early legislative elections are unlikely in the short-term.

Italy: A Blow to Renzi?

Matteo Renzi, the new Italian Prime Minister, could face a big test after the European elections. Because he took power as the result of an internal party coup and has never been elected to national office, the performance of his Democratic Party will face scrutiny. In particular, failure to top the popular vote would deal a blow to Renzi—and recent opinion polls suggest that it could be a close race with Beppe Grillo's radical Five Star Movement. A weak showing would raise questions over Renzi's democratic legitimacy, weaken his position within his own party and pose a threat to his whole reform program.

UK and France: Few Implications

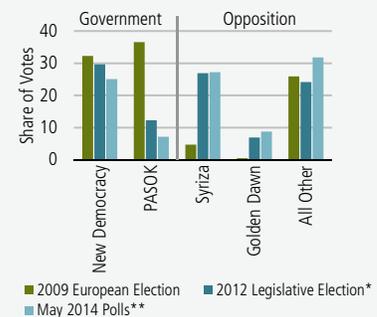
In Britain, UKIP—an anti-EU, right-wing party—is on track to come out on top with about 30% of the vote in recent opinion polls. However, this strong showing is unlikely to be repeated in a general election (national opinion polls put UKIP's support at 10%–15%), so it is not clear what impact this week's European vote will have on economic policy in the UK or on the results of next year's general election. Should UKIP do well, though, investors might become more concerned about the outcome of a possible 2017 referendum on the UK's membership of the EU (which will only take place if the Conservative party wins the May 2015 general election).

In France, the far-right National Front looks set to gain the largest share of the vote, making this the biggest shock to the political psyche since the same party contested the final round of the 2002 presidential election. However, with the next national elections still three years away, and with President Hollande having recently reshuffled his government (with the appointment of a new prime minister),

Display 2

A Weakened Greek Government

Greek 2009/2012 Elections and May 2014 Opinion Polls



*Results from the June 2012 legislative election

**A simple average of five recent polls conducted in May for the European Parliament elections

Source: European Parliament, Greek Ministry of the Interior and various Greek polling companies

the fallout is likely to be limited. But it may slow the reform process which, in any case, is still painfully slow.

Market Reaction to Be Muted

The strong showing of extremist/anti-European parties at the European parliamentary elections is expected to make loud headlines over the next few days. For governments, the message is that, after the trials and tribulations of recent years, much work still needs to be done if they are to address the concerns of many disillusioned voters.

For investors, the elections will serve as a reminder that, even though the worst of the sovereign-debt crisis may be behind us, economic conditions in many countries remain challenging and the wounds of the last few years will take a long time to heal. Beyond this, however, the results of this week's elections are unlikely to have a material impact on either the direction of the EU or, with a few notable exceptions, on national politics. As a result, we expect the impact on financial market behavior to be limited and temporary. ■

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