EURO THEMES

Ramifications of Finland's general election

Outcome is too close to call, and investors should pay close attention

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Context

As we highlighted in our comment on the outcome of the 24-25 March EU summit, no major surprises arose from that meeting. The modified proposal of the pact for competitiveness was widely accepted and renamed "Euro Plus Pact", and an agreement on the upsize and the scope of the devices safeguarding financial stability of the euro area (EFSF and ESM) was struck. However, details on the mode of financing of the modified EFSF and ESM have yet to be provided and agreed by end-June, as European politicians wanted to avoid further contagion of already-heated Finnish politics with issues related to financing rescue packages for euro area member states in the periphery in light of the upcoming general election on 17 April. Importantly, in this context, AAA-rated countries such as Finland most likely need to carry the bulk of the financial burden of an increase in the EFSF and ESM, if the AAA rating of these facilities is to be kept. Hence, support from the governments of AAA-rated euro area sovereigns – notably Germany, France, Luxembourg, Netherlands, Finland and Austria – will be key in this context.

Finland is going to hold general elections on 17 April. Given the heightened concerns at the time of the EU summit that the euro critical party "True Finns" and other euro-sceptical parties that had recorded substantial improvements in recent polls could benefit further from any decision on the financing details for the EFSF and ESM, and given that Germany was not keen on a swift solution for this topic in light of the pending constitutional court ruling on the bailout packages for Greece and Ireland and the EFSF more generally, the decision on the funding details has been delayed until end-June.

What is at stake?

Given this context, should anti-European parties gain the majority in this weekend's election in Finland and eventually form a new government, it would potentially exert unusually large (Finnish) influence on the final outcome of the EU deliberations regarding the funding for the planned increase in the EFSF and the setup of the (even larger) ESM. It could even affect the negotiations between Portugal and the EU/IMF on a multi-year adjustment and emergency financial support programme funded in part through the EFSF, as EFSF decisions must be taken unanimously by all stakeholders (ie, including Finland).

Should Finland decide to abstain from participating in a further upsizing of the EFSF/ESM and or vote against an EFSF loan to Portugal, this would cause serious political ramifications in the euro area. It would set a precedent in that the principle of solidarity would have failed and the overall financial support regime of the EU, which is based on unanimous voting, would probably need to be revamped, which could have severe legal implications. At a minimum, and abstracting from all the political noise and volatility this would create, the whole framework agreement of the EFSF would possibly be up for change because the principle of unanimous voting would need to be changed towards qualified majority voting principles, and/or Finland would need to be excluded as a stakeholder and, thus, as a creditor country to the periphery. Both scenarios are highly unlikely at the moment, as the principle of unanimous voting is enshrined not only in the EFSF framework agreement but also in the EU Treaty. Hypothetically, should Finland abstain from supporting Portugal and should the EFSF framework agreement be changed to allow for non-unanimous voting, the remaining five AAA-rated euro area countries would need to take on Finland's share in any such rescue package. Various press reports in Bloomberg and Reuters argue that this would account for up to EUR1.4bn (1.8% of an envisaged EUR80bn rescue package for Portugal), which we believe is incorrect because the EFSF share in the overall rescue package for Portugal would be lower than 100% due to the fact the IMF would at least partially co-finance such a programme. Finally, it could also be considered that, should Finland veto an EFSF programme for Portugal, the first disbursements of the programme would be financed through the EFSM with a view to gain time to address the procedural and legal problems created by a Finnish objection.

Any such political outcome in Finland would possibly sow doubts in other politicians' and investors' minds, as well as among the broad public, as to whether the overall political commitment of Europeans to provide financing for the ailing periphery is at stake. Such a scenario would thus throw a spanner in the works of the relatively freshly common political will shown earlier this year on account of the various EU summits. It should not come as a surprise in this context that the public opinion in Germany, Slovakia and the Netherlands is growing increasingly opposed to further financial support.

Current political environment

On the morning of 13 April, the latest poll conducted by TNS Gallup was released in the Helsingin Sanomat (a Finnish daily), which indicated that next Sunday's general election will be a very close run. Indeed, the newspaper reports that the figures suggest support for three of the four largest parties in the country falls within the statistical margin of error of 2 percentage points.

Regarding our main concern stated above, it is worth noting that the True Finns (a decisively anti-European conservative party) earned 16.9% support (a historic high level), yet notably 1.5pp points lower than in last month's poll. Hence, the True Finns have slipped to fourth place. Meanwhile, the National Coalition Party (pro-European) is still polling clearly ahead of the others with 20.2% support (but down from 20.7%), followed by the Social Democrats (anti-European) with 18% (from 17.4%) and the Centre Party (pro-European) with 17.9% (from 18.3%).

In sum, with respect to the political stance on European matters, this means:

- Pro-European parties of the governing coalition (Centre Party, National Coalition Party, Green League and the Swedish People's Party) are currently polling first and third, with an overall cumulative vote share of about 52%;
- Anti-European opposition parties – ie, opposed to the Portuguese bailout and upsize of the EFSF – (True Finns, Social Democrats, Left Alliance, Christian Democrats) are polling second and fourth, with an overall cumulative vote share of about 47%.

Therefore, despite the recent slippage of the True Finns party, it is important to note that the support for the parties in the current coalition government seems to be slightly on the wane, while backing for the leftist opposition parties has turned upwards in recent polls, thus strengthening the position of the anti-European political camp.

However, we believe one should differentiate between the parties that run a campaign on anti-European topics. As a matter of fact, we consider the social democratic party as a fundamentally pro-European one (as it was the party that brought Finland into the euro), that has recently adopted a more anti-European stance to exploit the mood in the electorate (similarly to the strategy of the liberal party, FDP, in Germany recently). Therefore, the social democrats are likely to eventually be less euro-sceptic than many might think at present. Thus, in our view, it is by no means certain that this party would join a coalition with the True Finns if this were a feasible option after the election.

Our assessment

From the latest polls and their recent evolution, it is impossible to say what the outcome of the elections will be. In fact, recent polls suggest that the group of anti-European parties is still trailing those parties composing the current government, but the margin of error is high and, thus, results could turn around quite easily.

Against this backdrop, Martti Salmi (deputy head of the Finance Ministry's division for European Union and international affairs who is without party affiliation and thus has no stake in the outcome of the election), is reported by Bloomberg as saying after his cross-country tour that compared with a 2006 tour (before the 2007 elections), during which he spoke in 18 cities, that he detected "a shift in the general mood". Compared with the previous tour, "now people were dismayed about what was happening in the EU". On the other hand, "many people seem to understand the need to act (in support of EU matters) in order to avoid an even bigger crisis". According to polls released on Tuesday, "those who are against any aid to Portugal or any increase of guarantees for the EFSF get 48 percent and the others 52 percent, so it is too close to call," Salmi said to Reuters.

It will thus be crucial for investors and analysts alike to not only monitor the election outcome on 17 April but also the succeeding coalition negotiations, which we believe might take at least one week before a new government can take the office formally. Party leaders are likely to be divided between reiterating their political stance on the EU even more strongly, while at the same time trying to form a sustainable coalition government and deal with concerns among the political partners in Europe.

On this last point, one would have also to see the reaction of politicians in other euro area member countries should the anti-European parties gain the upper hand in Finland. We would expect the political pressure on the new Finnish government to increase substantially to comply with what the previous government had negotiated at the EU level, notably the rise in the funding for the EFSF and ESM. We would also expect tremendous peer pressure from the EU on Finland to not veto an EFSF programme for Portugal. Let us recall the significant delays that occurred in the context of the agreement for financial support for Greece, notably in relation to Germany's position, but that an accord was eventually reached. Along the same lines, more recently, for the most recent elections in Ireland, one must recall that the initial stance of the Labour party (albeit eventually being in the position of a minority party in the governing coalition with Fine Gael) was moderated significantly once elected (notably on the extended period allowed for fiscal adjustment), and did not try to bargain it with Fine Gael. Hence, recent events could repeat themselves, as the social democratic party would support a more pro-European stance, in our opinion, once elected, which would make three out of the four main parties elected as pro-European. However, should the True Finns' support bounce back in Sunday's election results, it would render the formation of a government more difficult and could jeopardise a pro-European parliament.

All in all, should an anti-European government coalition be elected and formed in Finland in the aftermath of the 17 April election result, in our opinion, this would seriously undermine the European political commitment for unanimous solidarity and financial support. It would complicate the resolution of financial stability woes within the euro area, trigger increased uncertainty among investors and, thus, possibly translate into renewed stress in European government bond markets. It could also lead to (at least) a temporary weakening of the euro.

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