

EURO THEMES

Ramifications of Finland's general election

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

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.

Francois Cabau
+44 (0)20 3134 3592
francois.cabau@barcap.com

Frank Engels
+49 (0)69 7161 1832
frank.engels@barcap.com

www.barcap.com

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.

Analyst Certification(s)

We, Francois Cabau and Frank Engels, hereby certify (1) that the views expressed in this research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

Important Disclosures

For current important disclosures regarding companies that are the subject of this research report, please send a written request to: Barclays Capital Research Compliance, 745 Seventh Avenue, 17th Floor, New York, NY 10019 or refer to <https://ecommerce.barcap.com/research/cgi-bin/all/disclosuresSearch.pl> or call 212-526-1072.

Barclays Capital does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that Barclays Capital may have a conflict of interest that could affect the objectivity of this report. Any reference to Barclays Capital includes its affiliates. Barclays Capital and/or an affiliate thereof (the "firm") regularly trades, generally deals as principal and generally provides liquidity (as market maker or otherwise) in the debt securities that are the subject of this research report (and related derivatives thereof). The firm's proprietary trading accounts may have either a long and / or short position in such securities and / or derivative instruments, which may pose a conflict with the interests of investing customers. Where permitted and subject to appropriate information barrier restrictions, the firm's fixed income research analysts regularly interact with its trading desk personnel to determine current prices of fixed income securities. The firm's fixed income research analyst(s) receive compensation based on various factors including, but not limited to, the quality of their work, the overall performance of the firm (including the profitability of the investment banking department), the profitability and revenues of the Fixed Income Division and the outstanding principal amount and trading value of, the profitability of, and the potential interest of the firms investing clients in research with respect to, the asset class covered by the analyst. To the extent that any historical pricing information was obtained from Barclays Capital trading desks, the firm makes no representation that it is accurate or complete. All levels, prices and spreads are historical and do not represent current market levels, prices or spreads, some or all of which may have changed since the publication of this document. Barclays Capital produces a variety of research products including, but not limited to, fundamental analysis, equity-linked analysis, quantitative analysis, and trade ideas. Recommendations contained in one type of research product may differ from recommendations contained in other types of research products, whether as a result of differing time horizons, methodologies, or otherwise.

This publication has been prepared by Barclays Capital, the investment banking division of Barclays Bank PLC, and/or one or more of its affiliates as provided below. It is provided to our clients for information purposes only, and Barclays Capital makes no express or implied warranties, and expressly disclaims all warranties of merchantability or fitness for a particular purpose or use with respect to any data included in this publication. Barclays Capital will not treat unauthorized recipients of this report as its clients. Prices shown are indicative and Barclays Capital is not offering to buy or sell or soliciting offers to buy or sell any financial instrument.

Without limiting any of the foregoing and to the extent permitted by law, in no event shall Barclays Capital, nor any affiliate, nor any of their respective officers, directors, partners, or employees have any liability for (a) any special, punitive, indirect, or consequential damages; or (b) any lost profits, lost revenue, loss of anticipated savings or loss of opportunity or other financial loss, even if notified of the possibility of such damages, arising from any use of this publication or its contents.

Other than disclosures relating to Barclays Capital, the information contained in this publication has been obtained from sources that Barclays Capital believes to be reliable, but Barclays Capital does not represent or warrant that it is accurate or complete. The views in this publication are those of Barclays Capital and are subject to change, and Barclays Capital has no obligation to update its opinions or the information in this publication.

The analyst recommendations in this publication reflect solely and exclusively those of the author(s), and such opinions were prepared independently of any other interests, including those of Barclays Capital and/or its affiliates. This publication does not constitute personal investment advice or take into account the individual financial circumstances or objectives of the clients who receive it. The securities discussed herein may not be suitable for all investors. Barclays Capital recommends that investors independently evaluate each issuer, security or instrument discussed herein and consult any independent advisors they believe necessary. The value of and income from any investment may fluctuate from day to day as a result of changes in relevant economic markets (including changes in market liquidity). The information herein is not intended to predict actual results, which may differ substantially from those reflected. Past performance is not necessarily indicative of future results.

This communication is being made available in the UK and Europe primarily to persons who are investment professionals as that term is defined in Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion Order) 2005. It is directed at, and therefore should only be relied upon by, persons who have professional experience in matters relating to investments. The investments to which it relates are available only to such persons and will be entered into only with such persons. Barclays Capital is authorized and regulated by the Financial Services Authority ('FSA') and member of the London Stock Exchange.

Barclays Capital Inc., U.S. registered broker/dealer and member of FINRA (www.finra.org), is distributing this material in the United States and, in connection therewith accepts responsibility for its contents. Any U.S. person wishing to effect a transaction in any security discussed herein should do so only by contacting a representative of Barclays Capital Inc. in the U.S. at 745 Seventh Avenue, New York, New York 10019.

Non-U.S. persons should contact and execute transactions through a Barclays Bank PLC branch or affiliate in their home jurisdiction unless local regulations permit otherwise.

This material is distributed in Canada by Barclays Capital Canada Inc., a registered investment dealer and member of IIROC (www.iiroc.ca).

Subject to the conditions of this publication as set out above, Absa Capital, the Investment Banking Division of Absa Bank Limited, an authorised financial services provider (Registration No.: 1986/004794/06), is distributing this material in South Africa. Absa Bank Limited is regulated by the South African Reserve Bank. This publication is not, nor is it intended to be, advice as defined and/or contemplated in the (South African) Financial Advisory and Intermediary Services Act, 37 of 2002, or any other financial, investment, trading, tax, legal, accounting, retirement, actuarial or other professional advice or service whatsoever. Any South African person or entity wishing to effect a transaction in any security discussed herein should do so only by contacting a representative of Absa Capital in South Africa, 15 Alice Lane, Sandton, Johannesburg, Gauteng 2196. Absa Capital is an affiliate of Barclays Capital.

In Japan, foreign exchange research reports are prepared and distributed by Barclays Bank PLC Tokyo Branch. Other research reports are distributed to institutional investors in Japan by Barclays Capital Japan Limited. Barclays Capital Japan Limited is a joint-stock company incorporated in Japan with registered office of 6-10-1 Roppongi, Minato-ku, Tokyo 106-6131, Japan. It is a subsidiary of Barclays Bank PLC and a registered financial instruments firm regulated by the Financial Services Agency of Japan. Registered Number: Kanto Zaimukyokuchō (kinsho) No. 143.

Barclays Bank PLC, Hong Kong Branch is distributing this material in Hong Kong as an authorised institution regulated by the Hong Kong Monetary Authority. Registered Office: 41/F, Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

Barclays Bank PLC Frankfurt Branch distributes this material in Germany under the supervision of Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

This material is distributed in Malaysia by Barclays Capital Markets Malaysia Sdn Bhd.

This material is distributed in Brazil by Banco Barclays S.A.

Barclays Bank PLC in the Dubai International Financial Centre (Registered No. 0060) is regulated by the Dubai Financial Services Authority (DFSA). Barclays Bank PLC-DIFC Branch, may only undertake the financial services activities that fall within the scope of its existing DFSA licence.

Barclays Bank PLC in the UAE is regulated by the Central Bank of the UAE and is licensed to conduct business activities as a branch of a commercial bank incorporated outside the UAE in Dubai (Licence No.: 13/1844/2008, Registered Office: Building No. 6, Burj Dubai Business Hub, Sheikh Zayed Road, Dubai City) and Abu Dhabi (Licence No.: 13/952/2008, Registered Office: Al Jazira Towers, Hamdan Street, PO Box 2734, Abu Dhabi).

Barclays Bank PLC in the Qatar Financial Centre (Registered No. 00018) is authorised by the Qatar Financial Centre Regulatory Authority (QFCRA). Barclays Bank PLC-QFC Branch may only undertake the regulated activities that fall within the scope of its existing QFCRA licence. Principal place of business in Qatar: Qatar Financial Centre, Office 1002, 10th Floor, QFC Tower, Diplomatic Area, West Bay, PO Box 15891, Doha, Qatar.

This material is distributed in Dubai, the UAE and Qatar by Barclays Bank PLC. Related financial products or services are only available to Professional Clients as defined by the DFSA, and Business Customers as defined by the QFCRA.

This material is distributed in Saudi Arabia by Barclays Saudi Arabia ('BSA'). It is not the intention of the Publication to be used or deemed as recommendation, option or advice for any action (s) that may take place in future. Barclays Saudi Arabia is a Closed Joint Stock Company, (CMA License No. 09141-37). Registered office Al Faisaliah Tower | Level 18 | Riyadh 11311 | Kingdom of Saudi Arabia. Authorised and regulated by the Capital Market Authority, Commercial Registration Number: 1010283024.

This material is distributed in Russia by Barclays Capital, affiliated company of Barclays Bank PLC, registered and regulated in Russia by the FSFM. Broker License #177-11850-100000; Dealer License #177-11855-010000. Registered address in Russia: 125047 Moscow, 1st Tverskaya-Yamskaya str. 21.

This material is distributed in India by Barclays Bank PLC, India Branch.

This material is distributed in Singapore by the Singapore branch of Barclays Bank PLC, a bank licensed in Singapore by the Monetary Authority of Singapore. For matters in connection with this report, recipients in Singapore may contact the Singapore branch of Barclays Bank PLC, whose registered address is One Raffles Quay Level 28, South Tower, Singapore 048583.

Barclays Bank PLC, Australia Branch (ARBN 062 449 585, AFSL 246617) is distributing this material in Australia. It is directed at 'wholesale clients' as defined by Australian Corporations Act 2001.

IRS Circular 230 Prepared Materials Disclaimer: Barclays Capital and its affiliates do not provide tax advice and nothing contained herein should be construed to be tax advice. Please be advised that any discussion of U.S. tax matters contained herein (including any attachments) (i) is not intended or written to be used, and cannot be used, by you for the purpose of avoiding U.S. tax-related penalties; and (ii) was written to support the promotion or marketing of the transactions or other matters addressed herein. Accordingly, you should seek advice based on your particular circumstances from an independent tax advisor.

Barclays Capital is not responsible for, and makes no warranties whatsoever as to, the content of any third-party web site accessed via a hyperlink in this publication and such information is not incorporated by reference.

© Copyright Barclays Bank PLC (2011). All rights reserved. No part of this publication may be reproduced in any manner without the prior written permission of Barclays Capital or any of its affiliates. Barclays Bank PLC is registered in England No. 1026167. Registered office 1 Churchill Place, London, E14 5HP. Additional information regarding this publication will be furnished upon request.