

## Focus on the Firebreaks

### How European Elections Affect Asia

Mar 10, 2017

- The Dutch are holding it next week. The French are starting next month, while the Germans are doing it in September. We are not referring to some art festivals here, but rounds and rounds of elections that could determine the future of Europe – and thus, the mental health of global investors.
- Forces of xenophobic populism appear to be on the rise on the continent. In the Netherlands and France, we might even see far-right political parties win the highest number of votes by promising to break free from the EU.
- Still, quirks in the electoral systems in both countries should present enough firebreaks. And, the less colourful politicians would likely still rule the day. In other words, Asia can take heart that it probably has just Trump to fret about.

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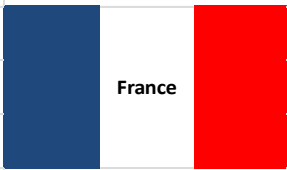

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Date	Country	Type of Elections
15 March		Parliamentary Elections
	Netherlands	
23 April		Presidential Election (1st Round)
7 May		Presidential Election (2nd Round)
11 & 18 June		Parliamentary Elections
24 September		Federal Parliamentary Elections
	Germany	

Source: OCBC.

To discuss the intricacies of different European political systems, and how the outcomes could impact Asia, we bring back our hypothetical client, Mr. Q, as the voice behind some real and vexing questions on the issue. This first instalment focuses on the imminent elections in the Netherlands.

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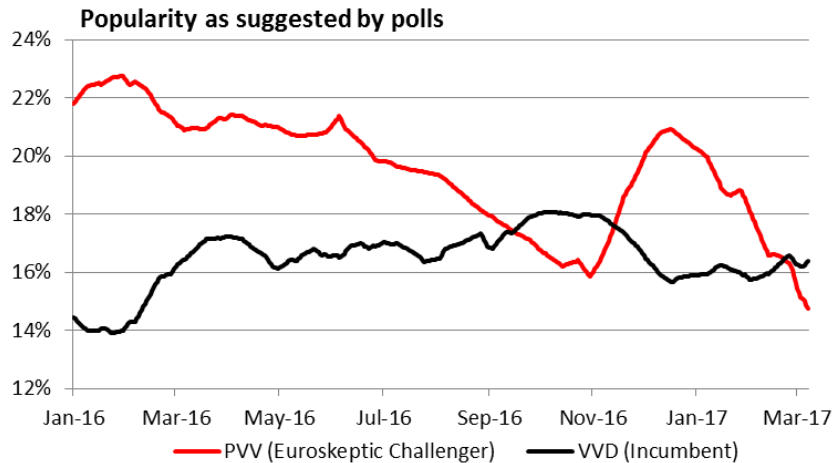
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**I was just in Amsterdam. Lots of election posters and campaign fares. And I kept seeing pictures of this guy with too slick a hairstyle. He doesn't exactly look like Trump but apparently wants to be like him? What's the deal with that?**

Well, hope you enjoyed your trip. You are probably referring to Geert Wilders, who is one of the leading candidates in the upcoming parliamentary elections on March 15<sup>th</sup>.

He has said some controversial things, not least against immigration and what he sees as rising Islamic influences in his country, hence the similarity. Like the US President, Wilders is also banking on a groundswell of populist sentiment. He said he would close the nation's borders and even withdraw from the European Union, to boot.



Source: Peilingwijzer, OCBC. Note: Latest numbers dated as of March 7<sup>th</sup>.

***Like another Brexit? Wouldn't that be damaging for market sentiment?***

Yes, that is apparently his intention. But, let's not get too carried away yet at this point. First, he has to win the election. Then, he has to form a government and become the Prime Minister, before holding a referendum, winning that vote and going through the process of breaking away from EU. Given how unpredictable referendum or elections have been recently, there are obvious risks of conflagration. Still, it's only fair to note that there are firebreaks too.

***So, don't get all panicky is what you are saying. Are you going to show me some jolly poll numbers? Only to then say take them with a pinch of salt again?***

Sometimes I wish you don't remember what I had said so well, Mr. Q. Anyway, to begin with, latest polls are indeed suggesting that Wilders' political vehicle, Party for Freedom (aka PVV in Dutch) has lost its lead in recent weeks. It used to command more than 20% of popular support, but that has apparently dipped to below 15%.

In contrast, the incumbent party – staffed with politicians that are more staid looking but also with markedly less controversial socioeconomic stance – called VVD, has seen its support level stabilizing at above 16%.

***Wait a second. The gap is too narrow for you to be this comfortable, especially because I know you have always been sceptical about polls. Also, both numbers look awfully low. You are telling me that even the most popular parties command less than one-fifth support each?***

Bingo. You have just hit on one of the most important points here. One big firebreak that makes me relatively comfortable about the Dutch election is that there is no dominant party there. I don't want to go into the intricacies of how the Dutch electoral system is one of the most proportional in the world here. Just take it from me that the system inherently favours small parties, because the parliamentary seats are allocated based on votes gained at the aggregate national level rather than per district.

To get any one seat out of a total of 150 available in the lower house, *Tweede Kamer*, parties need just 0.67% of the total national votes. This works out to be just around 85,000 votes, assuming every eligible Dutch voter bothers to cast their votes. The low bar of entry has seen some quixotic political parties with rather specialized political platforms. In the current parliament, for instance, a party called PvdD, which puts animal welfare as its main goal about has as many as two seats.

***Hey, what's wrong with protecting animals? I love dogs!***

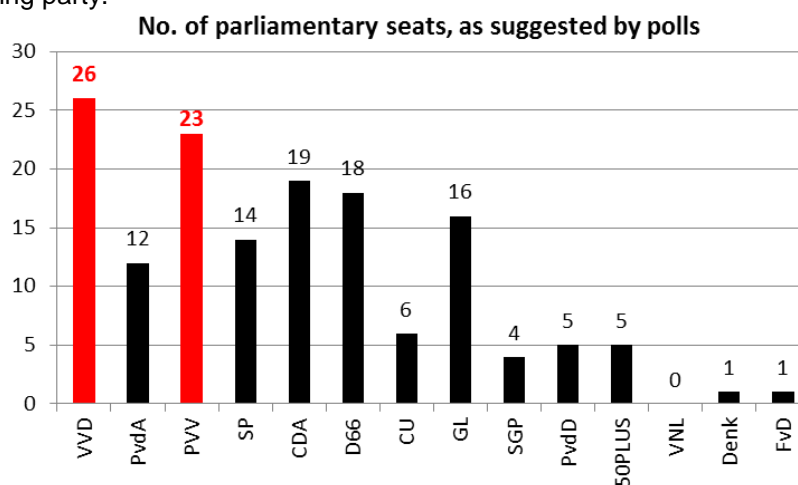
Me too, until the one at home makes me think otherwise every now and then. But, imagine, of all the tough real-life issues and intricate policy trade-offs affecting millions of human beings out there, this party just focuses on animals and it gets seats in the parliament!

**Okay, fair enough. Let's move on. Before we got distracted, we were saying...?**

Right, we were talking about how fragmented the Dutch parliament tends to be, with many different parties, due to the proportional electoral system – and that might be what will save the day.

Here is how it works. Precisely because even the leading party is likely to garner just around 20% of the parliamentary seats, it will have to find other parties to get a simple majority of more than 75 seats to form a government and rule the country.

Now, the firebreak that I was talking about comes in now, because every major political party has stated that it will not be entering coalition talks with Wilders' party. So even if the PVV defies expectations and gets the largest share of seats, it is unlikely to be able to get enough support to clear this hurdle. Indeed, in modern Dutch history, there have been at least three cases in which the party that has won plurality (i.e. most seats) ends up being in the opposition camp, essentially because the rest ganged up against the leading party.



Source: Peilingwijzer, OCBC. Note: Latest numbers dated as of March 7<sup>th</sup>.

**I see what you mean, but I doubt we should take what these parties say at pure face value.**

Of course, if the PVV wins by a much wider margin than expected – again, not an entirely implausible scenario at this day and age – other parties might be tempted by what it has to offer during the negotiations, and just pretend they never said what they did say.

To be sure, they are aware of the potential backlash from their voters next time round, but the dangling of ministerial posts and such might prove too much. Indeed, I will be particularly interested to see if the animal rights party joins in the horse-trading fun fair, since it may well win as many as 5 seats now!

**Let it go, please. Now, let's assume somehow the PVV does manage to form a government. Will they really call for a referendum and win it?**

Let's unpack that a bit. On whether a referendum will indeed be called, my guess is at some point of a Wilders government, it will be, since the issue seems to be a core tenet of the party's platform. Also, even without Wilders, a law was passed recently that compels the government to hold a referendum on any law if 300,000 citizens request it. That is a relatively low threshold, and the law has indeed been used to reject a proposed trade pact with Ukraine.

Next, would a referendum result in a 'Leave' vote? Polls out there still suggest a majority of people in the Netherlands want to remain in the EU. Indeed, according to a survey done by the current government in September last year, the percentage of people who support a pull-out from the EU actually dropped from 24% to 20% after the UK's Brexit vote. A separate poll by Peil.nl did show a drop

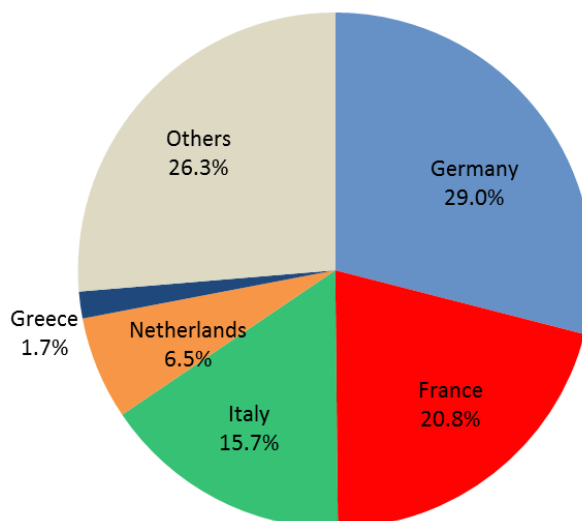
in support for 'Leave' as well, but nonetheless at a relatively high level of 40% in October. So, it is not exactly an all-clear.

**Actually, if I squint hard enough, I can see how we can get to that stage. Brexit vote was a long shot until it wasn't. Still, it didn't turn out to be all that bad. Does it all really matter then?**

It is really tempting to say no, a 'Nexit' would not matter to global market, just because Brexit turned out to have no perceptible impact in the end. However, one key difference here is the fact that UK was not in Eurozone but the Netherlands is very much part of that currency union. I have yet to come across anything that suggests that if a country which is a Eurozone member can stay in the currency union if it chooses to leave the European Union, despite the fact that Article 140(3) of the Lisbon Treaty suggests that joining the currency union is an irrevocable act.

Netherlands may not be a big country and its economy makes up just 6.5% of the total Eurozone GDP. However, unlike peripheral countries which have been hit by sovereign debt crisis and have had to wrangle with the existential questions of whether they would have to exit the Eurozone, it is a "core" economy that is an integral part of the group. Thus, not only would its exit be more shocking, it could also threaten the integrity of the Eurozone currency union more than, say, a pull-out by Greece.

**Make-up of Eurozone GDP, % of Total**



Source: Bloomberg, OCBC.

Now, from the perspective of global markets, anything that suggests a breakup of Eurozone, which is fundamentally an economic construct, matters a lot more than the disintegration of European Union, a political body. This is not to say that the breakup of EU would not impact the European economies and hence the global one, just that if Eurozone as a currency union disintegrates, the volatility that this event would bring to the global currency markets makes it an exponentially trickier outcome. After all, Euro is the world's second-most traded currency. If it convulses, the ripple effect can be significant, especially for emerging markets which been hit with bouts of currency volatility in recent years.

**That's a sobering prospect. I just hope the various firebreaks that you mentioned would indeed work and we do not get to that stage after all.**

Yes, I hope so too. To recap, these are why we remain relatively comfortable that the Dutch election outcome will not shake up global sentiment:

1. Polls suggest that the anti-EU PVV party has lost out to establishment incumbent VVD party.
2. Even if PVV wins the highest number of seats, the fragmented Dutch electoral system means that it still needs the support of a number of other parties to clear the majority threshold to form

a government. This looks unlikely given that the other parties have stated they will not join any PVV-led coalition government.

3. If PVV somehow manages to still form a government, there is a chance that it may renege on its campaign promises to hold a referendum on EU membership.
4. If it holds the referendum, it is not certain that it will win. Polls still suggest a majority of Dutch citizens prefer to remain in the EU.

***Okay. Thanks for that list. I think that's enough European politics for today. Let's see how next week pans out. But I want to find out more about Marine Le Pen and the French elections when we speak again. I heard it's a close one there too.***

Yes, let's touch base on France again soon. It's another can of worms, potentially.

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