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IMMEDIATE INSIGHT

EUROPE'S DISCONTENTS GAIN SWAY

The rise of populist parties of the left and right in Europe is emerging as a threat to the eurozone that is potentially just as profound as the sovereign bond crisis of 2011, argues Gareth Colesmith, senior portfolio manager at Insight Investment.

The general election in Greece this month will have repercussions well beyond its borders. If opinion polls are right, Syriza, a relatively new, leftist political party will gain power. This would break the Pasok/New Democracy duopoly that existed since Greece returned to democracy in 1974 and signal to Europe's political establishment that nothing can be taken for granted.

While mainstream political parties have seen a slow but relentless decline in support for decades, there are two developments in particular that are worrying for the medium- to long-term. Firstly, even in countries that have seen a return to growth, falling unemployment and improving consumer confidence, support for non-traditional political parties continues to accelerate. This defies expectations that countries which successfully enacted reforms would see a gradual return to the political status quo.

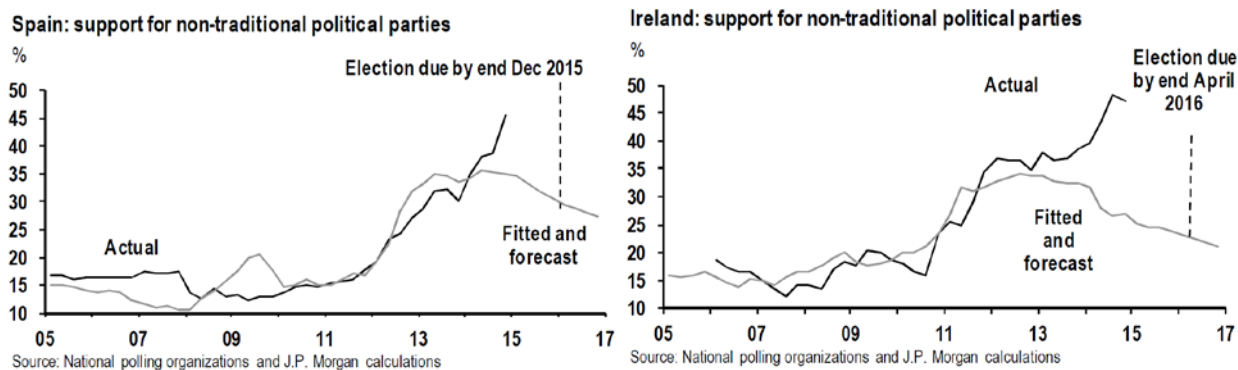
Secondly, peripheral countries are splintering from the rest of Europe as they are generally seeing more protest votes go toward broadly left-wing, soft eurosceptic parties, while the electorate in other countries are largely casting protest votes for right-wing, harder eurosceptic parties. Even if these parties do not come to power, the concern is that their influence on more traditional parties will drag the politics of the periphery and the core in opposite directions, hindering economic and fiscal progress both at the eurozone and EU level.

So far, recent developments in Greece have largely only unsettled the domestic stock and bond markets. But with parliamentary elections in Denmark, Estonia, Sweden, Finland, Poland, Portugal, Spain and the UK slated for 2015, it may pay investors to read political commentary as closely as the data on Bloomberg screens in the months ahead.

A wind of change

It is not surprising that countries which are suffering from weak economies are seeing an increased support for protest parties. This is the case in Italy (the Five Star Movement), France (Front National), Finland (True Finns) and most notably in Greece (Syriza, Golden Dawn, Anel and Potami). What is more concerning is the recent trend for this support to continue gaining ground even after the economy starts to recover.

Yet this is what seems to be unfolding in countries such as the UK (UK Independence Party), Spain (Podemos) and Ireland (Sinn Fein and various independent MPs), challenging models based on variables such as budget tightening, unemployment and consumer confidence, as these charts from JP Morgan show:



Recent opinion polls in Spain and Ireland indicate left-wing protest parties are the most popular, although in both cases they lack sufficient support to be able to govern alone. There may be idiosyncratic factors driving some of these results, such as corruption scandals in Spain, or this could be the first sign of a more general and long-lasting secular trend against the established socio-economic consensus.

The rise of the radical left in the periphery

In the peripheral countries, the reaction against EU-imposed austerity has typically led to the rise of left-wing protest parties. Although not the only recipients of protest votes, new parties such as Syriza in Greece, Podemos in Spain, and the Five Star Movement in Italy have made the most gains. In Ireland, Sinn Fein has a long history but has never been part of the establishment.

The emergence and increased prominence of fledgling protest parties can be seen even at the local level. In Catalonia, left-wing Esquerra Republicana de Catalunya is outpolling the centre-right Convergència i Unió. The exception so far has been Portugal, which has not yet seen a significant rise in new political parties gaining sway.

Most of these recently formed parties offer a platform that combines relatively radical left-wing economic policies with a moderate eurosceptic stance. They are generally committed to European integration but are against the current institutional structures. The exception is the Five Star Movement in Italy, which has an eclectic policy platform, mixing left-leaning economics and environmental issues.

Syriza has moderated its policy agenda as the prospect of forming a government nears and seems almost certain to need to form a coalition with less radical left-wing parties, such as the centre-left Pasok and newly-established Potami. Such a coalition would seek to remain in the single currency, but would likely reverse austerity efforts and seek a renegotiation of Greece's bailout terms with international creditors. Greece has also seen an increase in support for right-wing eurosceptic parties such as Anel and Golden Dawn, but they have largely been eclipsed by the left.

A more positive outcome has been seen in Italy, where the threat posed by the Five Star Movement has pushed the centre-left Democratic party into adopting a serious reformist stance under new prime minister Matteo Renzi. The strong showing of Renzi's party in the European elections demonstrates the extent to which voters in Italy are keen to see structural reforms.

Core Europe marches right

In contrast, most non-peripheral EU countries have seen a rise in support for right-wing protest parties. At one end of the spectrum are right-wing eurosceptic parties such as Alternative für Deutschland (AfD) in Germany, True Finns in Finland and Prawo i Sprawiedliwość in Poland.

But there are also a number of more nationalist anti-EU parties such as UKIP, the Danish People's Party and the Sweden Democrats. On the far right, there are some xenophobic and quasi-fascist parties such as the Front National (FN) in France, the Partij voor de Vrijheid (PVV) in the Netherlands, the Freiheitliche Partei Österreichs (FPÖ) in Austria, and Jobbik in Hungary. While this is a diverse group, hard stances against the eurozone, the EU and immigration are common themes.

With a few exceptions in central Europe, most of these parties are not yet close to being able to form viable governments. Although some, such as the FN in France and the PVV in the Netherlands have topped opinion polls, the political systems in these countries make it difficult for them to govern.

While parties like these are unlikely to sweep into power, the influence they could have on other mainstream parties is a concern. In contrast to the positive catalyst for reform seen in Italy, rising support for nationalist parties tends to pull traditional centre-right parties further to the right, particularly in regard to issues concerning EU membership and immigration. In the UK, UKIP has emboldened the eurosceptic faction of the Conservative party and in Germany, Angela Merkel's Christian Democratic Union has become more cautious toward euro integration since the rise of the AfD.

This march to the right has perhaps gone furthest in Hungary, where the ruling party Fidesz, originally a liberal party in the 1990s, has gradually transformed into an authoritarian nationalist party, due in some part to the rise of the far-right Jobbik party. Nationalist parties have also entered government in Poland and Austria, leading to temporary diplomatic sanctions being imposed on Austria by other EU countries.

The disappearing centre ground

These trends could fuel political crises should individual countries elect governments with radical policies. The real and present danger is Greece, where the prospect of a Syriza-led government looks highly probable in early 2015. This could ensnare the eurozone in a renewed economic crisis as austerity efforts unwind and as other EU countries potentially seek to renegotiate bailout terms with their international creditors. Other countries which could see radical or eurosceptic parties gain a foothold in governing coalitions over the next few years include Denmark, Spain and Ireland. General elections on the horizon in the UK, Netherlands, France and Germany also have the potential to further upset the political status quo.

The cumulative effect of this bifurcation of European politics could make reaching agreements over economic reforms at an EU or eurozone level increasingly difficult. As a result, policy response to crises looks set to become even slower in Europe and less effective.

However, recent political developments need not sour the outlook for peripheral government debt. The European Central Bank is widely expected to announce a plan to buy eurozone government bonds at its January meeting, a move which would likely anchor bond yields in Europe in the short term. But, with numerous new protest parties gaining sway in Europe and a slew of elections slated for 2015 and beyond, it remains prudent to monitor political dynamics closely.

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