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SPOTLIGHT – EUROPEAN ELECTIONS

6 March 2017

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UNION BANCAIRE PRIVÉE

Overview

- ◆ Elections in the Netherlands, France and Germany look highly uncertain and could interfere with the ongoing recovery scenario in place.
- ◆ The future of the Eurozone is heavily dependent on the results of these elections, particularly from the outcome of the election in France.
- ◆ European markets have not priced the extreme scenario of a “Frexit” – France leaving the Eurozone.
- ◆ Impacts from politics on European assets could be asymmetrical: potential heavy losses in case of extreme political scenario versus a modest rebound in case of a “pro-European” outcome from the elections.

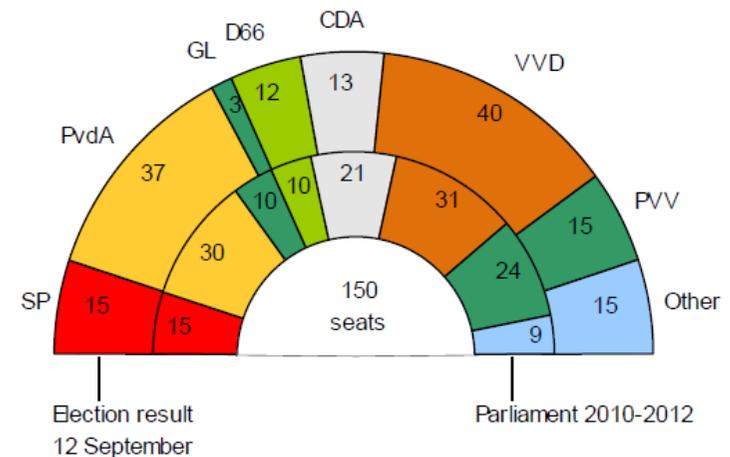
Dutch elections

Political landscape looks more complex

- ◆ 150 seats in Lower House; Senate elections to be held in 2019.
- ◆ 28 parties will participate in these elections; proportional voting system favours a fragmented outcome and coalition formation.
- ◆ Polls show a split electorate with votes widely divided between parties and a rising climate of uncertainty.
- ◆ 40% of voters remain undecided.
- ◆ Post elections, it is likely to take several weeks to form a coalition (in the past negotiations haven taken from three months to a full year); if no deal possible, new elections will take place.

Netherlands: Lower House

Distribution of seats in the parliament 2010-2012 following the election results of 12 September; Socialist Party (SP), Labour Party (PvdA), GreenLeft (GL), Democrats 66 (D66), Christian Democratic Appeal (CDA), People's Party for Freedom and Democracy (VVD), Party for Freedom (PVV)

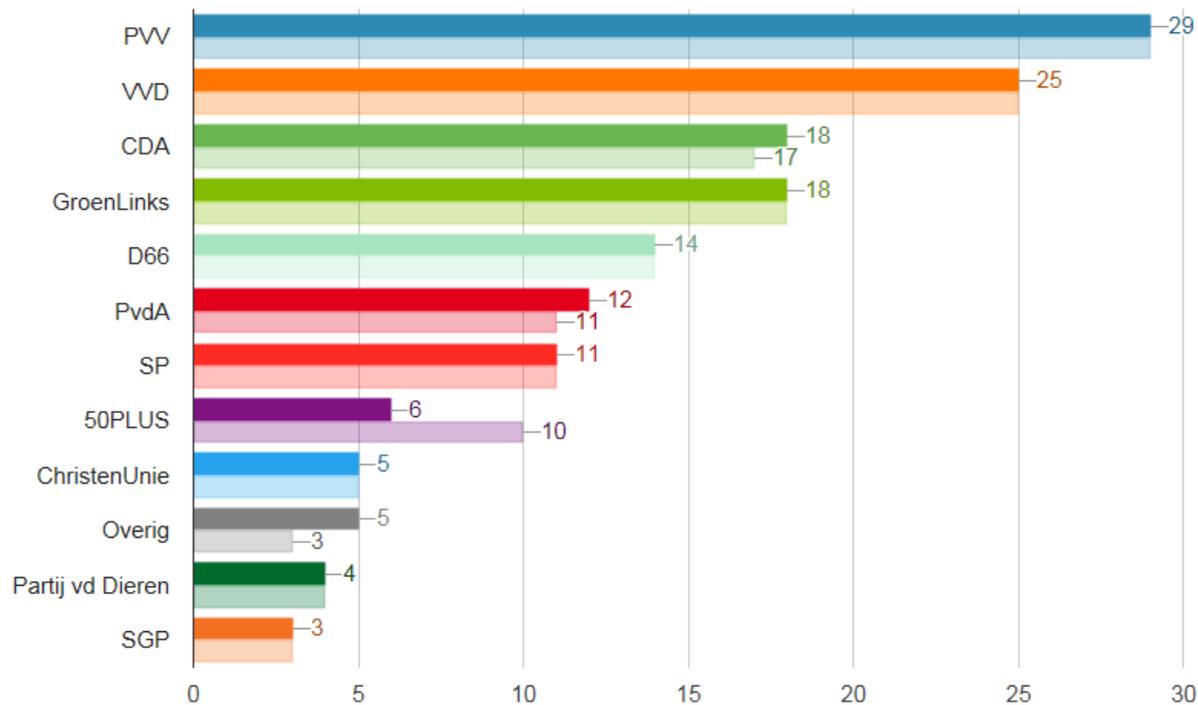


Sources: Dutch Parliament, De Telegraaf, Commerzbank Research

Dutch elections

Latest poll: anti-EU party leads

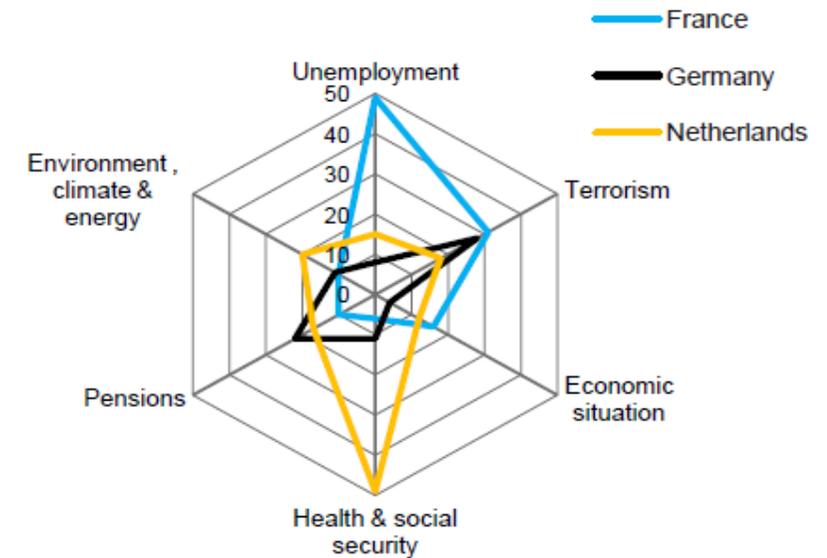
Peil.nl – Allocation of seats according to the polls of 26-02 vs. 19-02



Source: PEIL

- ◆ PVV (Party for Freedom) is ahead in the polls, but its advance has recently weakened; a narrow coalition looks possible if PVV stays above 30%.
- ◆ 12 parties expected to have seats in the next Lower House.
- ◆ Six major parties have ruled out working with PVV; it would take five or six parties to form a coalition out of PVV (a mix of the conservative centre right and centre left).

What are the two most important issues facing (our country) at the moment?



Focus on Netherlands

Strong, competitive and accessible economy

- ◆ Strong, and competitive economy, with high quality infrastructure and administration.
- ◆ Friendly tax regime, particularly for multi-nationals.
- ◆ Low fiscal deficit (1% of GDP) and public debt ratio (65% of GDP) on a medium-term decreasing trajectory; an easing of fiscal policy expected post elections.
- ◆ High current account surplus (8% of GDP); hub for goods, services and finance; active re-export sector to other countries (higher value added); large savings from corporate.
- ◆ Low inflation (1% y/y), low unemployment rate (5%), but still slack in labour market.
- ◆ Housing and lending recovering, but slow deleveraging of household debt; recent rises in minimum wage, pensions and child benefit.

Netherlands GDP & Business sentiment Annual percentage change, including forecasts



Source: Thompson Reuters Datastream, 21.02.2017

Domestic matters at the centre of political debate:

1. **Immigration and integration**
2. **Pensions and retirement**
3. **Healthcare and social security**
4. **Employment**

Is “Nexit” in sight ?

After Brexit, Nexit...

◆ **PVV’s manifesto to leave the EU:**

- ▶ 79% of voters are in favour of staying in the EU

◆ **Possible political outcomes:**

- ▶ PVV above 30%; coalition around the PVV
- ▶ PVV below 20%; VVD to lead a new coalition

◆ **Referendum on EU membership:**

- ▶ Dutch have previously made only a limited use of referendums: only possible for laws and treaties approved by Parliament, but not yet implemented; exception for “temporary” laws); just two referendums ever held in the past (2005 & 2016).
- ▶ Binding referendum requires a change in Constitutional laws (2/3 rd majority in Congress on a 2nd reading)

- ◆ **Government** could theoretically leave the EU (not written into Constitution), but **Congress** has to validate such a decision.

Key points on the Netherlands

Three concerns for the markets

◆ **Will an anti-EU party win the election?**

- ▶ Yes, probably; but unlikely to be able to form a coalition and a government

◆ **Will a referendum on EU membership take place?**

- ▶ Difficult to organize, but non binding consultation possible
- ▶ A coalition could organize referendums on specific EU projects

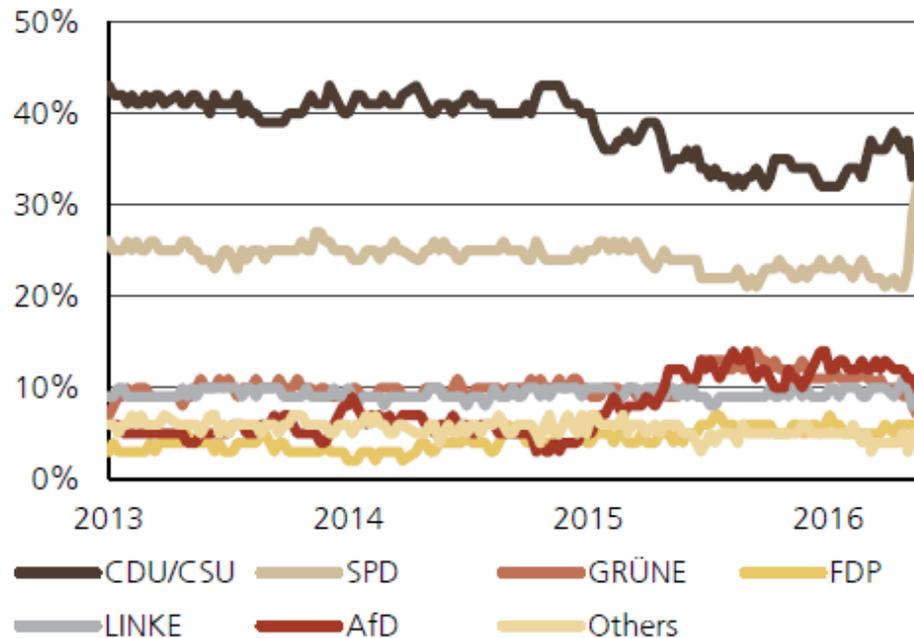
◆ **Will the Netherlands leave the EU/Eurozone?**

- ▶ Probably not; lack of public support for such a move.
- ▶ *Leaving the EUR:*
 - Higher costs than for UK
 - Intra euro trade dominates the export sector
 - Hub for goods, services and finance
 - Criticism still exists on the way that the EU functions

German elections

Polls: Schultz ahead of Merkel

German elections: latest polls



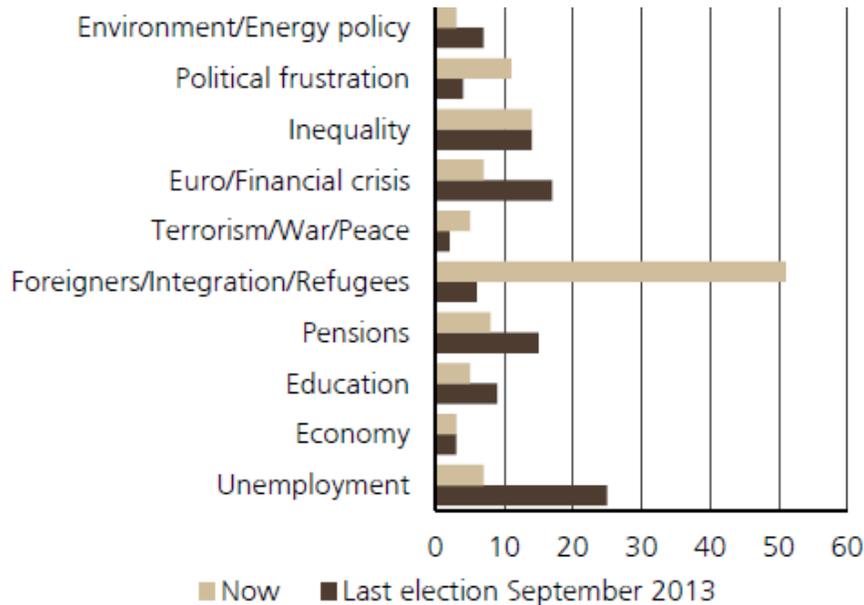
Source: Emnid

- ◆ Appointment of Schultz as leader of the SPD has boosted SPD in the polls, while support for Merkel has decreased.
- ◆ Elections for the next Chancellor are more open than previously thought (09-24).
- ◆ Three local elections to keep a close eye on: Saarland (05-07), Schleswig Holstein (05-07), North Rhine-Westphalia (05-14)

German elections

Debate and concerns

German elections: most important issues for German voters



Sources: Forschungsgruppe Wahlen, Politbarometer February 2017

- ◆ Election manifestos to be presented in May/June

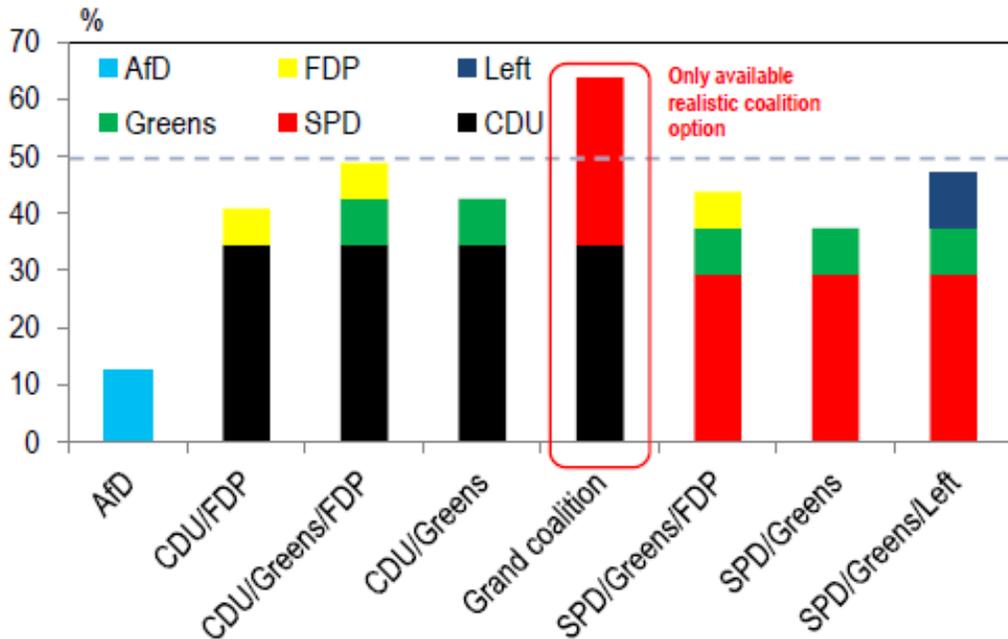
Main themes:

- ◆ Merkel (CDU-CSU): economic competence, tax reliefs but critics focus on migrant policy.
- ◆ Schultz: pro EU (federalism), social justice (lower tax on low incomes), pensions; relaxed views on immigration, and fiscal discipline.
- ◆ Limited fiscal easing expected (less than 1% of GDP), due to rules on debt.

German elections

Bumpy road for Merkel

Polling projections for seat numbers (%) in next Parliament

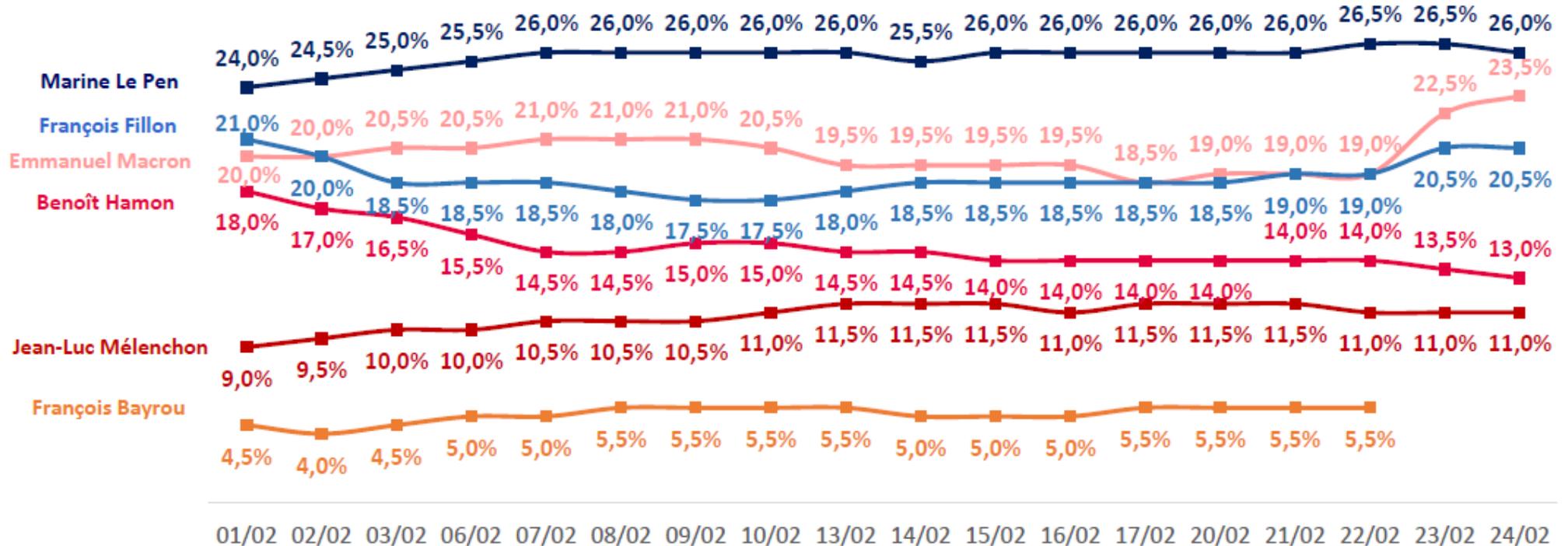


Sources: Infrates, Emnid, Allensbach, Forsa, GMS, INSA, FGW, Citigroup

- ◆ Possible rise of AfD in Parliament (recent weakness in polls).
- ◆ Grand coalition seen as the most probable scenario based on polls:
 - ▶ CDU-CSU-SPD: who will lead the coalition?
 - ▶ An alternative grand coalition possible: SPD-Greens-Left

French elections

Polls: Le Pen winning the 1st round, but losing on the 2nd



Source: Ifop

- ◆ **Presidential Elections:** 1st round by 23rd Apr.; 2nd round 7th May
- ◆ **Parliament elections:** 11th & 18th June
- ◆ Le Pen ahead in the polls for the 1st round
- ◆ 2nd round: Macron/Fillon winning vs Le Pen

French elections

Key points from candidates' manifestos

	Fillon	Macron	Hamon	Le Pen
Fiscal	Lower tax rate on corporates	End of health and employment tax on wages	Higher taxes on top earners	Universal income tax
	Higher VAT (+3.5%)	Higher and larger CSG tax	EU fiscal harmonization	Three tax levels for corporates (SME)
	No wealth tax	Wealth tax based on real estate	Tax on robots	Tax/ban on imports
	Harmonize EU corporate tax	Lower tax rate on corporates	Reduced taxes for low paid	Cut taxes on low incomes
Labour	Corporates to limit workers' weekly hours	Permanent Tax credit (CICE)	32 hours per week	Favour 'French' employers
	Negotiations at corporate level	Flexible hours worked around 35 h	Raise minimum wage (10%)	Retirement age at 60
	Cap and then lower unemployment benefit	Higher unemployment benefits	Repeal employment law	Lower gas/oil prices
	Permanent tax credit (CICE)	UNEDIC (benefit fund) to be nationalized	Welfare benefit increased by 10%	
	Retirement age at 65	Raise retirement age from 60-65	Universal Income (€ 750) in 2022	
	Boost low pensions			
Public spending	€ 100 bn lower spending	€ 60 EUR lower spending	Add 5k police officers	Lower public spending (€ 60 bn)
	Social security	Add 10 k police officers	Add 40k professors	Banque de France to finance debt
	Civil service	Higher spending on schools and teachers	€ 35 bn Stimulus package	
	Cut of 500k in civil servants	Cut of 120k in civil servants	Defence spending up to 3% GDP	
	Defence spending up to 2% of GDP	50 bn EUR global public investment		

Source: Candidates electoral programmes

 To favour the supply side

 To favour the demand side

French elections

Key points from candidates' manifestos

	Fillon	Macron	Hamon	Le Pen
Europe	Reduce power of the European Commission	Pro EU reform and stronger integration	Minimum wage	Leave the EU
	Better integration of Eurozone	Pro trade agreements	Scrap debt of most indebted countries	Restore 'France'
	New Schengen Treaty		Suspend Stability Pact	
	European debt and EU Treasury		Reject trade agreement (CETA/TTTP)	
	EU energy and defence policy		Harmonize taxation	
	Harmonize EU corporate tax		European Investment Plan	
Immigration	Control via quotas	Strengthen police at external frontiers	Better integration	Limit legal immigration
	End of nationality via birth		Reinforce rules on asylum	Return to border controls
	European Security Council created			No automatic immigration rights
Others	Favours housing market		Legalize cannabis	Leave NATO
	Nuclear power to continue		Limit political mandates	Pro Russia
	Not against Russia		Citizen college created	Nuclear power to continue
			Outlaw presidential re-election	Reduce number of MPs; use of referendums

Source: Candidates electoral programmes

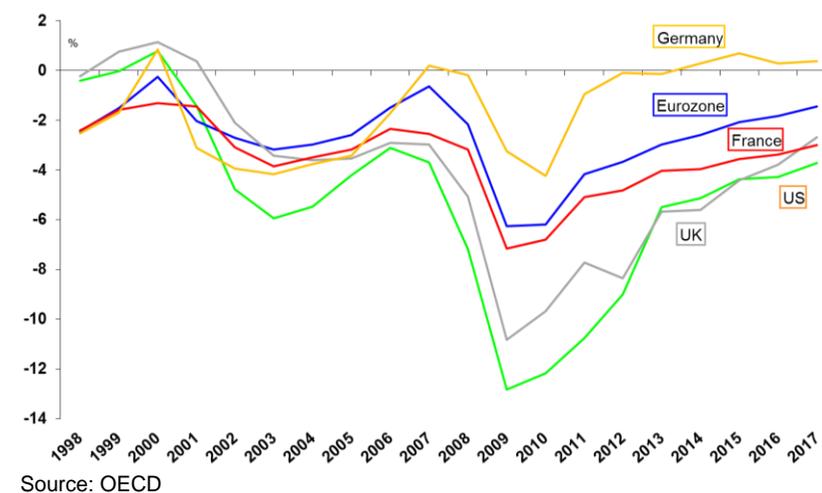
 Main topics/political party platform

French elections

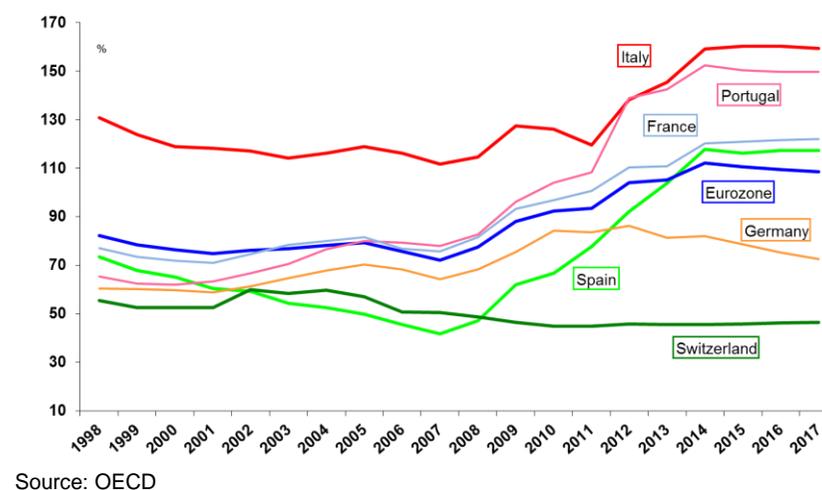
Budgetary policy outlook

- ◆ Economic outlook has improved, but growth trend remains uncertain in the coming years (1%-2% range).
- ◆ Fiscal deficit (3% of GDP; primary deficit at 1%) and public debt at 96% of GDP: public debt remains on a rising trend.
- ◆ Ambitious programmes, but sometimes based on unrealistic assumptions or on inflated fiscal receipts or lower spending:
 - ▶ Fillon: fiscal deficit at 4/5% in 2018, 0% in 2022; public debt at 49% in 2022.
 - ▶ Le Pen: fiscal deficit at 1.3% of GDP in 2022; net impact of measures: - EUR 34.5 bn (- EUR 130/150 bn according to independent studies).
 - ▶ Hamon: no complete data available; a net impact estimated by various studies in a range of EUR 80 bn to 300 bn.
 - ▶ Macron: fiscal deficit to stay below 3% of GDP; moderate GDP growth assumptions.
- ◆ France is still subject to excessive deficit procedure at EU; need to save 0.5% of GDP to fulfil the medium-term deficit reduction.
- ◆ Debt servicing could increase further (1.8% of GDP).
- ◆ France has no cushion in the face of external shocks.

Fiscal deficit as % of GDP



Gross public debt as % of GDP



French elections

Political issues related to Parliamentary elections

What if...

◆ **Le Pen wins:**

- ▶ Larger number of Front National's seats in Parliament, but risks of not having a majority.
- ▶ Fragmented Parliament or some form of coalition; Constitutional changes needed.
- ▶ Long process to exit the Eurozone (EU to vote on 'Frexit').

◆ **Macron wins:**

- ▶ To build a new party and to establish a majority in Parliament.
- ▶ Composite majority of centre, moderate Left parties and former members of Hollande's team.
- ▶ Soft reforms proposed. Ad hoc majority to be found.

◆ **Hamon wins:**

- ▶ Support from Left-extreme Left parties and Greens.
- ▶ Unstable majority over five years.

◆ **Fillon wins:**

- ▶ Large majority and support from right and also extreme right parties.

Key points on France

Three concerns for the markets

- ◆ **Will an anti-EU party win the election?**
 - ▶ No, still low probability.
 - ▶ Anti-EU party may have a larger role in Parliament (blocking minority)

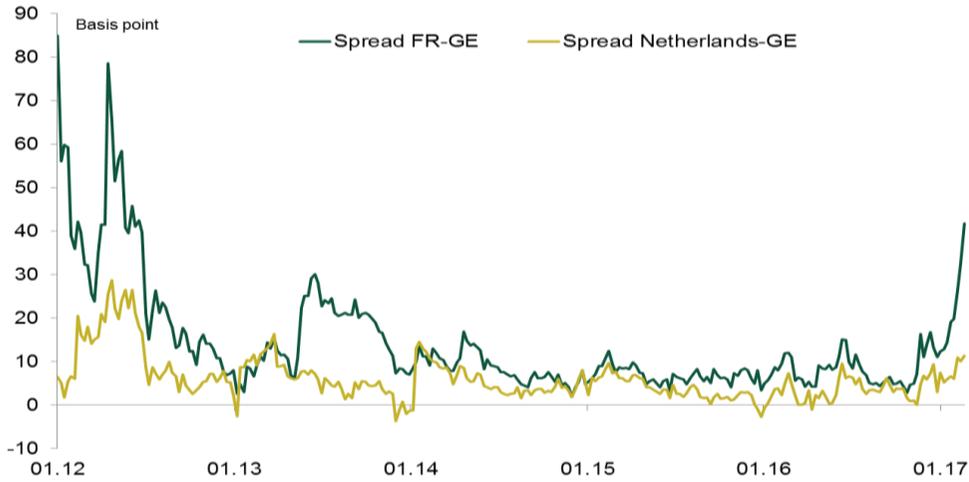
- ◆ **Will a referendum on EU take place?**
 - ▶ No, unless Le Pen wins.
 - ▶ Difficult to organize an international Treaty and Constitution.
 - ▶ Non binding consultation possible.

- ◆ **Will France leave the EU/Eurozone?**
 - ▶ No, but rising criticism and disappointment regarding the EUR/Eurozone.
 - ▶ EUR has lost support and popularity.

French elections

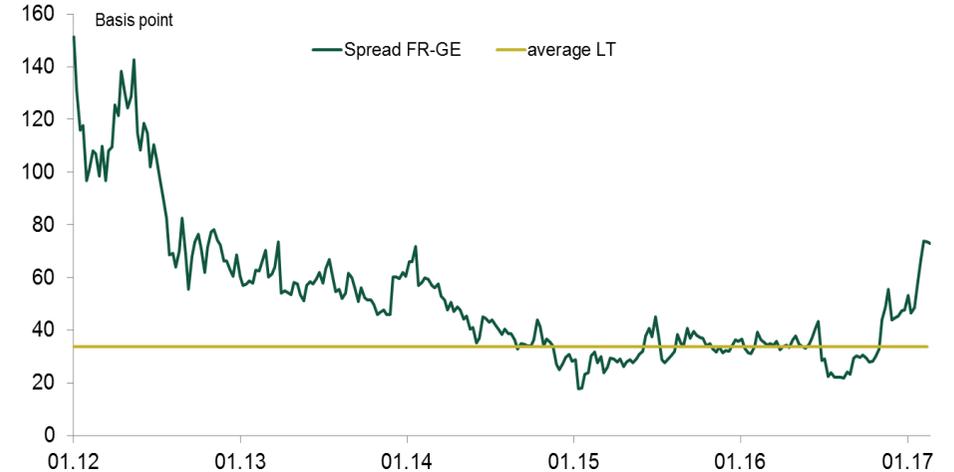
Market reactions

2-year government bonds spread



Sources: Bloomberg, UBP ETR

France-Germany 10-year spread



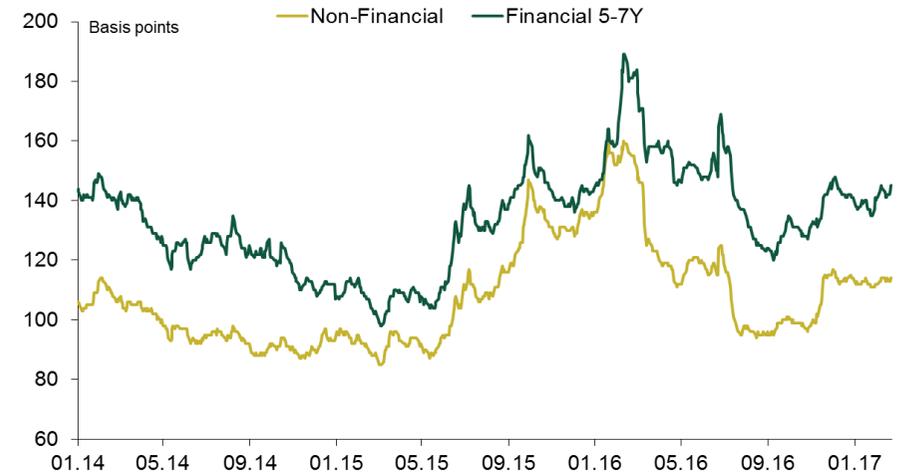
Sources: Bloomberg, UBP ETR

Credit default swap 5-year BNP



Sources: Bloomberg, UBP ETR

EUR IG spreads (5-7 years)



Sources: BoA ML; UBP ETR

French elections

Market reactions

French sovereign risk and French equity market relative to Euro Stoxx 50



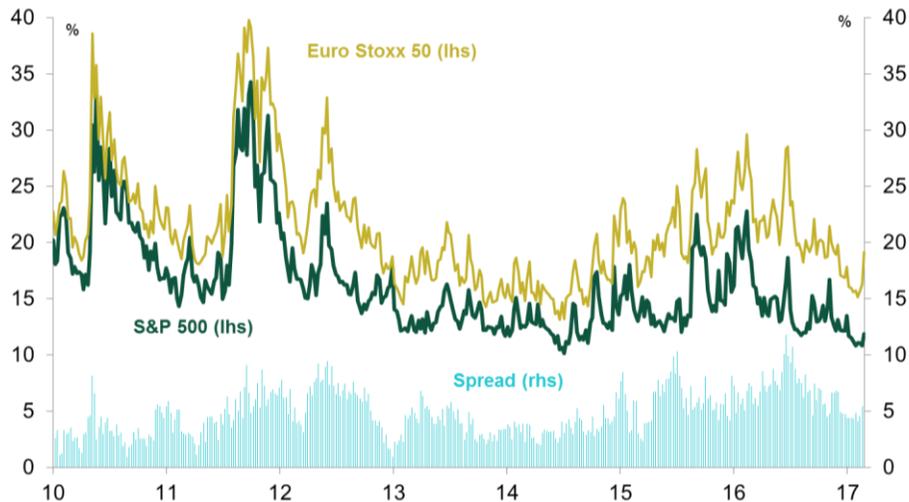
Sources: Thompson Financial, UBP ETR

French sovereign risk and Euro Stoxx 50 relative to S&P 500



Sources: Thompson Financial, UBP ETR

Euro Stoxx 50 and S&P 500 3-month ATM implied volatility



Sources: Thompson Financial, UBP ETR

Euro Stoxx 50 and EUR/USD 3-month ATM implied volatility



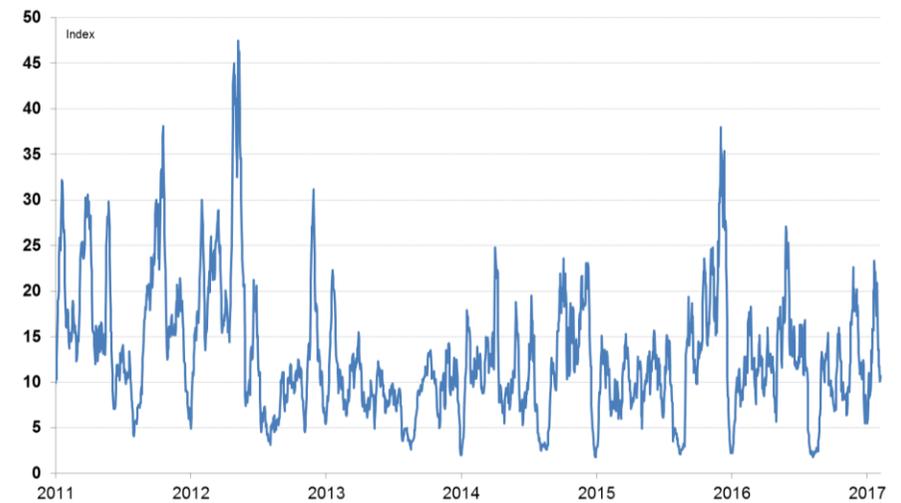
Sources: Thompson Financial, UBP ETR

European politics

Fragmentation risks to stay alive post elections?

- ◆ Expect quiet markets if **populist parties** are excluded from any coalition governments.
- ◆ Eroding power and **lack of initiatives** from EU; no majority to reform and more difficult to find new agreements.
- ◆ **Trust of EU, traditional parties** and governments could remain low.
- ◆ **Rise of Populism/anti EU parties** remains a medium-term risk.
- ◆ Eurosceptic parties might have a **blocking minority** in several Parliaments.
- ◆ Contagion effect: if Brexit is possible...
- ◆ EU/Eurozone **fragmentation** risks could stay in place, even after the elections:
 - ▶ Fragmented Parliaments
 - ▶ Weak and volatile coalitions

France: geopolitical volatility index



Source: Predata

Authors



Michaël Lok

Group Chief Investment Officer (CIO) and
Co-CEO Asset Management

michael.lok@ubp.ch



Norman Villamin

Chief Investment Officer (CIO) Private Banking

norman.villamin@ubp.ch



Patrice Gautry

Chief Economist

patrice.gautry@ubp.ch

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Rue du Rhône 96-98 | CP 1320 | Genève 1, Suisse

T +41 58 819 21 11 | T +41 22 819 22 00 | E ubp@ubp.ch | www.ubp.com

