

Research Finland

Government crisis: don't panic yet, but risks are rising

- A government crisis - what happened? The Finns Party had a party assemble during the weekend where they elected a new leader for the party, member of European Parliament Jussi Halla-aho. Halla-aho is known for his strong anti-immigration attitude and has even been convicted for hate crime. The National Coalition Party (NCP) immediately announced that they need to seriously consider whether the party can stay in a government with a Finns Party led by Halla-aho. On Monday, the two governing coalition partners of the Finns Party, the Centre Party and the NCP, together announced that there is no common ground for cooperation effectively leading to a government collapse.
- At the time of writing, it is too early to say whether the government collapse will lead to a snap election. Another option would be to form a new government – possibly including Centre Party, NCP, the Swedish People's Party and Christian Democrats. The four-party coalition would have a slim majority, with 101 seats in a 200-seat parliament. Finland has been run by majority coalition governments for decades, which would make the new government fairly weak and dependent on individual MPs. However, the Swedish Party and Christian Democrats have confirmed that they are willing to negotiate.
- A snap election is very unusual in Finland. It would require a proposal from the prime minister and a decision by the president. During the time of independence, the president has decided to dissolve parliament only seven times – most recently in 1975. Thus, in the case of government collapse, there has been a tradition of forming a new government. Moreover, in most recent cases where the government has been dissolved, the reason has often been prime minister's resignation which has only implied marginal changes in the government. A total collapse leading to a new round of negotiations is just as unusual a procedure as a snap election.
- Currently, NCP (20.6%) is leading in polls. The Social democrats, currently in opposition, are runners-up with 18.7% share of the vote whereas the Centre Party (17.5%) has fallen to third place. The Greens (14.3%) have gained significantly after the 2015 election whereas the support for the Finns Party has plummeted to 9.4% from 17.7% in the 2015 election. An early election would lead to a government formed by the likely winner, the NCP. They could try to form a government closely resembling the centre-right coalition (with the Centre Party, Swedish People's Party and Christian Democrats) or an 'urban-green coalition' with Social Democrats and Greens.
- Some major structural reforms could be at stake. A social and healthcare reform (SOTE) has been central to the government's plan to balance public finances going forward. The Finnish population is ageing fast and the demographic shift burdens the public sector in the coming decades. The reform is also much awaited by the rating agencies. The reform planning has proceeded slowly and many details are unsolved. A weak centre-right coalition could push the reforms ahead, but the pace may slow down. With snap elections and a completely new government the whole reform could return to the drawing board. All parties realise that a reform is needed but they disagree a lot on the form.

Key points

- Finnish three-party coalition government collapsed on Monday after the Finns Party elected a new anti-immigration, euro-sceptic leader, Jussi Halla-aho, over the weekend.
- For now, it is too early to say whether the government collapse will lead to a snap election. Another option would be to form a new government.
- Currently, the NCP (20.6%) is leading in the polls. The Social democrats (18.7%) are running behind. The Centre Party (17.5%) has fallen to third place.
- Some structural reforms could be at stake. A social and healthcare reform (SOTE) has been central to the government's plan to balance public finances going forward. Another area of reforms is the labour market.
- Fortunately, the Finnish economy is growing again - we forecast 2.8% GDP growth in 2017, which gives some buffer against political gridlock.
- Against the positive macro-economic backdrop, we still recommend our clients to be long RFBGs and suggest using the current widening to add exposure.

Chief Economist

Pasi Kuoppamäki
+358 50 424 00 25
paku@danskebank.com

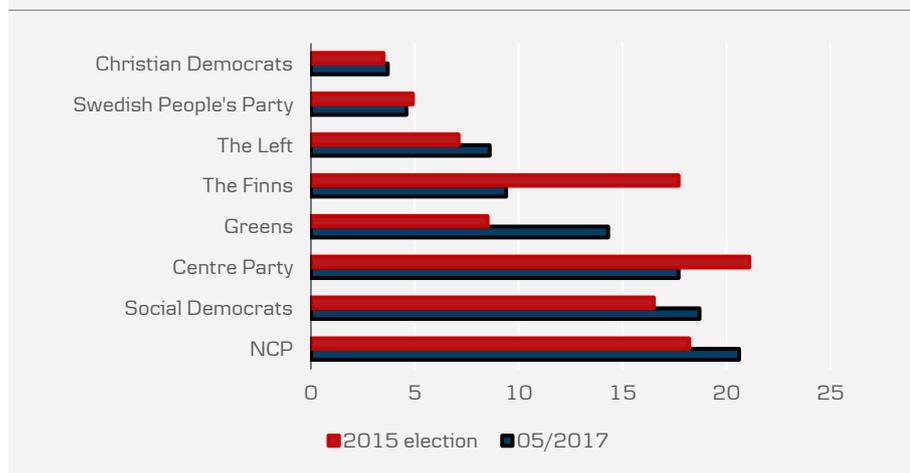
Senior Analyst

Minna Kuusisto
+358 10 546 79 55
mkuu@danskebank.com

- Another area of reforms is the labour market. Finnish labour market participation is low compared to other Nordic countries. Reforms in this area have also been slow and a lot has been left to collective agreements between labour market institutions. A weak centre-right coalition could make some reforms, while a government including Social Democrats (in case of a snap election) would probably not achieve much in this area.
- Fortunately, the Finnish economy is growing again. We forecast 2.8% GDP growth in 2017, which gives some buffer against political gridlock. The Debt-to-GDP ratio could stabilise in the medium run, but reforms are needed to keep it low in the longer run with the ageing population.
- We have witnessed a 1.0-2.5bp spread widening in the RFGB market versus Germany on Monday as the market has priced in a political uncertainty premium. However, considering the positive macroeconomic background and the fact that even in case of a snap election, the government may be able to proceed with the much-needed reform agenda, we still recommend our clients to be long RFGBs and we actually think that the current widening could be an opportunity to add exposure.
- In our bond portfolio in *Government Bonds Weekly* we have since the spring recommended buying the 5Y RFGB against 5Y NETHER. We see no reason to close this recommendation.
- However, we highlight the risk of increasing political risk premium, especially if uncertainty over the reform agenda prevails for an extended period of time and/or the rating agencies react to increased political uncertainty. At the current juncture, we expect no immediate reaction from the rating agencies.

See our published research: *Finland Research - Economy at full speed towards potential*, 7 June 2017

NCP is leading in polls, SDP is a runner-up



Source: Helsingin Sanomat, Danske Bank Markets

Disclosure

This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The authors of the research report are Pasi Kuoppamäki, Chief Economist and Minna Kuusisto, Senior Analyst.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

The research reports of Danske Bank are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from and do not report to other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including a sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

None.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank Markets (a division of Danske Bank A/S). It is provided for informational purposes only. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ('Relevant Financial Instruments').

The research report has been prepared independently and solely on the basis of publicly available information that Danske Bank considers to be reliable. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and Danske Bank, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts responsible for the research report and reflect their judgement as of the date hereof. These opinions are subject to change, and Danske Bank does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom or the United States.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank's prior written consent.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank who have prepared this research report are not registered or qualified as research analysts with the NYSE or FINRA but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Report completed: 12 June 2017, 16:45 GMT

Report first disseminated: 12 June 2017, 19:05 GMT