

ÖVP wins October 15th Austrian snap election; far-right FPÖ likely to enter government

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- October 15th Austrian snap election outcome.** According to the results available so far, the centre-right Austrian People's Party (ÖVP) was a clear winner at the October 15th snap general election with 31.4%, increasing its popularity rate by 7.4ppts compared to the last National Council elections in 2013 (*Figure 1*). In terms of seats, ÖVP secured 61, short of an absolute majority required in the 183-seat parliament. The far-right Freedom Party of Austria (FPÖ) trailed behind with 27.4%, its highest rate ever suggesting a good chance of entering government for the first time in more than a decade. The centre-left Social Democratic Party of Austria (SPÖ) which was the largest party in the 2013 elections followed suit with 26.7%, the worst recorded result, purportedly hurt over the last few weeks by charges of dirty campaigning. Out of the three smaller parties, the Greens were the biggest losers negatively affected by the resignation of a couple of key party figures. The party gained 3.3%, well below the 12.4% of the 2013 election and short of the 4% threshold of valid votes needed to make it into parliament. The other two small parties, the liberal NEOS and the newly established Peter Pilz's List party headed by Peter Pilz, a former parliamentarian from the Green Party, scored 5.0% and 4.1% respectively, enough to ensure parliament entry.

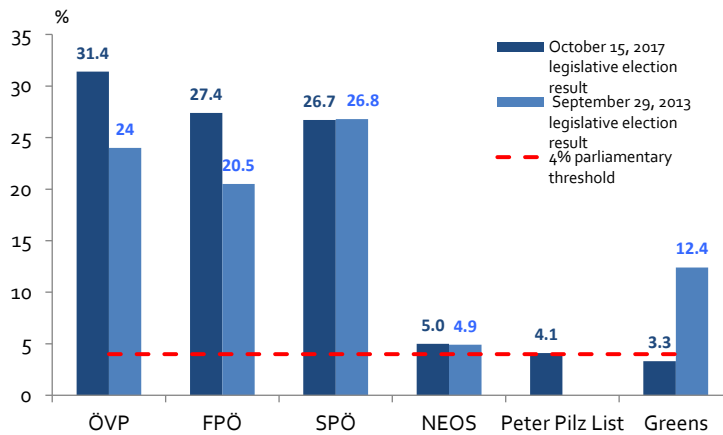
Undoubtedly, much of the ÖVP's appeal has been credited to the 31-year old party leader Sebastian Kurz who shifted the party more to the right making immigration the focus of his election campaign. Upon being appointed as party leader in May 2017 after months of infighting between the two governing coalition partners (SPÖ and ÖVP), ÖVP soared in opinion polls jumping from third to first. He had run the inter-party elections on the promise of terminating the coalition agreement with SPÖ and had pledged for a snap election (the legislative term was scheduled to end in Q3 2018). Speaking to reporters late on Sunday soon after preliminary election results were published, the ÖVP leader declined to say which coalition options he favoured. Instead, he said that he intends to talk to all parties in parliament and did not rule out forming a minority government. Austria's parliamentary elections are held under a proportional system, encouraging coalition governments. As such, collaboration between at least two of the three major parties SPÖ, ÖVP and FPÖ will likely be unavoidable.

The final election result including all postal votes is expected to be presented on Thursday, October 19. According to the Austrian Constitution, the newly elected parliament will have to come together within 30 days of the election. However, coalition talks are likely to last much longer. Over the last three decades, the average time required for coalition talks to bear fruits has been around 80 days.

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Figure 1 - October 15, 2017 & September 29, 2013 legislative election results

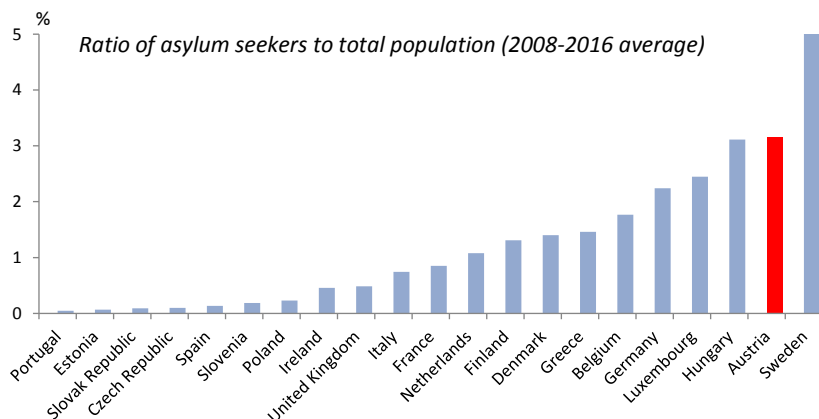


Source: Wiki, Bloomberg, Eurobank Economic Research

- Coalition options.** The grand coalition between ÖVP and SPÖ that has governed Austria for 23 of the last 30 years is unlikely to be continued, especially as the recent scandal of dirty campaigning that shook the SPÖ over the last few weeks has intensified the confrontation between the two former coalition partners. More likely is that the ÖVP will join forces with FPÖ, targeting a more liberal economic policy with substantial tax cuts as well as a more restrictive policy on the issue of refugees and migration. The two parties have kept the door open for a possible alliance and undoubtedly have plenty of common ground.

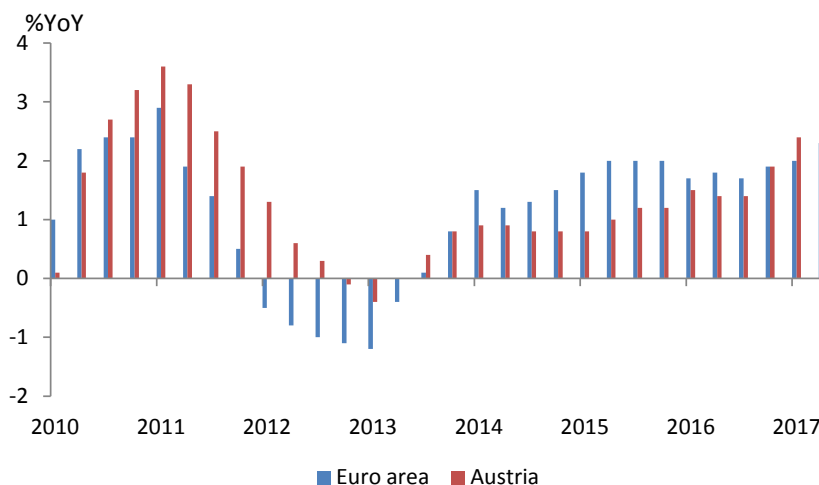
Both parties have pledged to reduce taxes and have campaigned on the need for tougher immigration controls, quickly deporting asylum-seekers whose requests are denied and cracking down on radical Islam. It is worth noting that Austria has been impacted not only by a large influx of refugees during the migration crisis that began in 2015 but also by a large number of persons seeking asylum in the country (*Figure 2*). The ÖVP plans to reduce the tax rate for the three lowest tax brackets, increase the minimum wage and abolish the corporation tax on retained earnings. On its part, the FPÖ has pledged to abolish the minimum corporation tax rate and free businesses from compulsory levies. Both parties intend part of these proposed tax cuts to be financed by denying migrants access to social benefits for the first five years they enter in Austria. With a general government budget deficit slightly above 1% of GDP in 2016, there seems some scope for tax cuts, supporting domestic demand and posing upside risks to the Austrian economy. After lagging behind in 2014 and 2015, Austria has been among the main outperformers in the euro area over the last couple of quarters recording growth rates above the euro zone average in the first half of this year (*Figure 3*). If coalition talks between ÖVP and FPÖ fail, the prospect of an alliance between SPÖ and FPÖ cannot be ruled out completely.

Figure 2- Austria has experienced a high ratio of asylum seekers relative to its population



Source: OECD, AMECO, Eurobank Economic Research

Figure 3- Austrian GDP growth back above euro area average



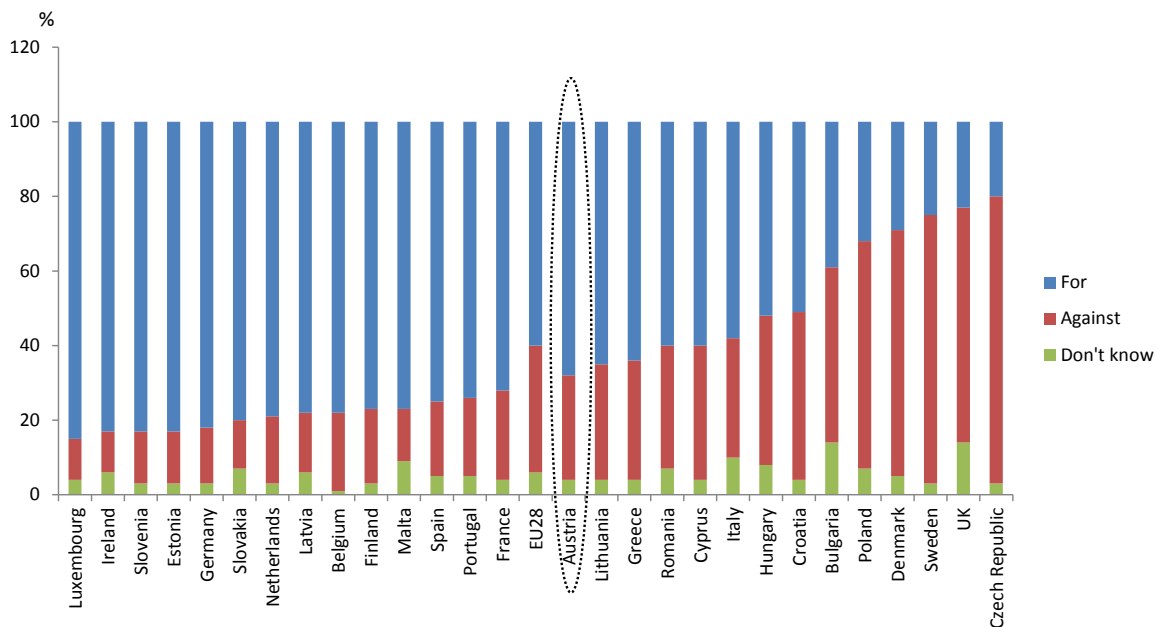
Source: Eurostat, Bloomberg, Eurobank Economic Research

For the financial markets, the most important issue is that euro-sceptic FPÖ is poised to enter government for the first time since early 2000s when other EU member states imposed joint diplomatic sanctions on Austria in an attempt to force the party out of power. Note that 68% of Austrians have a positive opinion on “A European economic and monetary union with one single currency, the euro”, above the EU-28 average (Figure 4). Admittedly, unlike the 2016 presidential campaign when it was calling for a referendum on EU and euro area membership, euro-skeptical FPÖ has toned down its anti-EU and anti-euro rhetoric. However, it demanded EU competences to be transferred back to a national level, proposal that stands in direct contradiction with French President Macron’s initiatives for a deeper integration of EMU. In all, if FPÖ joins a coalition government, headwinds to greater EU fiscal integration in the coming years are likely to be stronger. This is especially the case should the FPÖ secure the post of foreign minister, a post they asked for during the election campaign. On its side, the ÖVP has been strongly opposed to an exit from the EU and the

euro while party leader Sebastian Kurz has adopted a more pro-European stance favoring joint control of the external border and further EMU integration in common foreign and security policy. However, like the Free Democratic Party (FDP) in Germany, he rules out state debt mutualisation and opposes Macron’s proposals for a common European finance minister and a euro area budget.

- Knee-jerk market reaction.** The Austrian election outcome along with increased market skepticism over whether the Fed will actually increase the key interest rates three times next year following last week’s weaker than expected US September inflation data, favored German Bunds. Adding to the above, the situation in Catalonia remains fluid after Catalan President Carles Puigdemont missed this morning’s deadline to give a clear answer to Spain’s Prime Minister Mariano Rajoy whether or not he declared unilateral independence, paving the way for the central government to invoke Article 155 and take control of the region. Against this background, the 10-yr Bund yield hit a fresh two-week session trough of 0.3985% in European trade on Monday, some 13.5bps lower from a two-month high marked in late September. In FX markets, the EUR/USD lost some ground hovering around 1.1800, having retreated from last week’s three-week peak of 1.1880. However, in spite of today’s down move, the pair remained above a string of technically important support levels as the latest developments in Spain and Austria are purportedly seen by market participants as imposing no serious threats to the euro area as a whole, at least for the time being. Looking further ahead, much will depend on the outcome of the October 26th ECB monetary policy meeting and upcoming US inflation data as investors continue to question the room for higher Fed interest rates next year amid persistently subdued US inflation pressures.

Figure 4 - European Commission: What is your opinion on "A European economic and monetary union with one single currency, the euro"



Source: EU Commission, Standard Eurobarometer 87, September 2017

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