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## CZECH ELECTIONS 2017: AT THE CROSSROADS?

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**The upcoming elections will very likely see the strong showing of anti-establishment parties...**

**...raising possibility of some unsavory government coalitions and...**

**...of Czech Republic taking the Hungarian / Polish route.**

Next Parliamentary elections are going to be held in few days, precisely on October 20-October 21, 2017. In what follows, I will look at what the potential outcome of the elections is, what coalitions are possible and likely, and what it means for the economic policy of the Czech Republic in next (maximum of) four years.

Let us begin with the overview of the main contestants, ranked by the predicted electoral outcomes as forecast by the Czech version of the models of Nate Silver (fivethirtyeight.com) and David Rothschild (predictwise.com). This model<sup>1</sup> aggregates the data from polls and from bookmakers while at the same time taking into account the date when the polls were produced and other factors.

**Uncontested leader** in all of the polls incl. the one mentioned in previous paragraph is the movement ANO (Czech abbreviation for Alliance of Dissatisfied Citizens) of the former minister of finance and billionaire of Slovak origin, Andrej Babis, regularly polling between 25% and 30%. This is a populist “big-tent” party opposed to be labelled on the classical right-left axis, describing itself as a movement still standing outside the “traditional” politics (the fact that it was part of the coalition government with Social Democrats and

Christian Democrats since 2013 nonetheless...). Echoing Trump, it (cl-) aims to (want to) “cleanse” the country of allegedly pervasive corruption and mismanagement and battle the allegedly people-remote, self-serving establishment in Prague. In its practical views – insofar as they can be ascertained – it is a centrist party with strong populist and some leftist leanings. It won 18.7% votes (47 seats) in the 2013 elections, making it second strongest party only behind Social Democrats with whom ANO formed the government thereafter. The above-mentioned model from early October puts ANO at 65 seats in the future Parliament (of 200), making it the biggest Parliamentary party. The fact that **ANO’s leader, Babis, together with his Deputy Jaroslav Faltýnek, were recently stripped of MP immunity and released for prosecution in the case of subsidy granted previously to farm called Stork Nest did not dent its support.** Both are being accused of masterminding the EU subsidy fraud and harming the financial interests of EU.<sup>2</sup>

Second party according to the seats predicted to be won (31) by the model are **Czech Social Democrats** (known by their Czech acronym “CSSD”), the winner of the 2013 elections (20.45%, 50 seats). This is a typical social-democratic party, dating back

<sup>1</sup> Data are from early October run of the model. Subsequent runs might change the numbers.

<sup>2</sup> Until 2007, Stork's Nest (a farm) belonged to Babis's Agrofert Holding. Afterwards, its ownership was transferred - via bearer shares - to Babis' children and brother of his wife so as to enable the farm to apply for CZK 50 mn. (EUR 1.9 mn.) EU subsidy, which it wouldn't be able to do if it were part of the massive Agrofert Holding. The subsidy was granted and after few years, the farm was transferred back to Agrofert.

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to 1870 (though it split and merged with Communists after the Communists takeover in 1948 and was not re-established as a standalone party until after 1989) and standing on the platform of welfare state and of mixed economy. It is a leading member of the current coalition government (with ANO and Christian Democrats) – the current Prime Minister Bohuslav Sobotka hails from CSSD. The slide of support of Social Democrats in last 9 months (they were tied with ANO in most of the polls as recently as the end of 2016), which followed Sobotka's campaign against and ultimate ouster of Babis from Ministry of Finance and other missteps (ill-advised proposal to raise taxes on salaries higher than CZK 40 ths. back in February), led recently to the change of the campaign leader from Sobotka to the Foreign Minister Lubomir Zaoralek.

The third place according to the model (26 seats) is occupied by **Communists** (Czech abbreviation of "KSCM" standing for Communist Party of Bohemia and Moravia), an unapologetically far-left communist party, majority of which is Stalinist in nature and still in favor of the "leading role" of the Communists in the society. Communist won 14.91% of votes (33 seats) in 2013. The party, led by Vojtěch Filip, **stresses primacy of common ownership and vehemently criticizes the post-1989 developments**. In my personal view, it should have been outlawed long time ago. It isn't and regularly pulls between 10% and 15% of votes in elections. It has never been part of the central government since 1989 but it has been part of the regional governments.

The fourth according to the model are **Civic Democrats**, known by their Czech abbreviation of ODS, a liberal-conservative right-wing, Eurosceptic party modelled after Tories in the United Kingdom. ODS was the winner of 2010 elections, having won 20.22 % (53 seats) and having nominated Petr Nečas as Prime Minister. The Party was greatly harmed by the fall of

government in 2013 and the early elections the fall triggered in October 2013 when it won merely 7.72% (16 seats). The current models predicts it wins 24 seats and the party is led by Petr Fiala.

The fifth party, with predicted 16 seats won, is **TOP 09**, a name derived from first letters of Czech words Tradition, Responsibility, Prosperity. TOP09 is Christian-democratic liberal conservative party but, unlike ODS, one of distinctly pro-EU orientation. In 2013 elections it won 12% of votes which translated into 26 seats. The current leader is Miroslav Kalousek, former chairman of KDU-CSL, described in the following paragraph.

Following closely with the predicted gain of 15 seats is **Christian Democratic party**<sup>3</sup> by the name of Christian and Democratic Union – Czechoslovak People's Party (Czech acronym "**KDU-CSL**"), a junior member of the current coalition (it won 6.78% and 14 seats in previous elections in 2013). KDU-CSL is one of the oldest Czech political parties, having initially be formed in 1919. It is a centrist, pro-EU Christian Democratic and socially Conservative party, led by Pavel Bělobrádek.

Two other parties that stand a chance of making it into the Parliament are **Freedom and Direct Democracy** (known by Czech abbreviation of SPD), led by Tomio Okamura, and **Czech Pirate Party**, led by Ivan Bartoš, predicted to win 13 and 10 seats, respectively. The former is populist, (ostentatiously) direct-democracy, anti-immigration nationalistic outfit aiming at radical, dissatisfied and marginalized voters and offering supposedly quick and easy solutions to many of their problems. The latter is modelled on Swedish Piratpartiet with emphasis on open and freely available

<sup>3</sup> All of the parties described from this point below may or may not make it into Parliament as they are close to 5% threshold needed. Czech electoral system means that the votes of those parties that didn't cross the 5% threshold would be allocated among parties that did.

information, Internet neutrality, direct democracy and free speech. Neither of these parties won any seats in 2013, though SPD formed by splitting from Dawn of Direct Democracy which won 14 seats in 2013 elections.

The number of parties with a chance of making it into the Parliament and the fact that a lot can happen in next two weeks may make it look like it is not easy to predict the post-election composition of the coalition government. But closer look reveals only few options are likely.

**Let us start with what is not:** the government without ANO. Yes, purely mathematically it is possible to have coalition government without ANO, but practically it is anything but: since Communists (KSCM) are even more unacceptable as government coalition partner to Civic Democrats or TOP09 than ANO, excluding ANO and KSCM from any participation in the future government means coalition government of remaining 6 parties incl. populists from SPD and left-wing Social Democrats. This is extremely unlikely and would be very fragile even if it ever came into existence.

Hence, under the projected results – and even if ANO gets 5 pp less than what is projected (as was the case in 2013) – **ANO participation in the future government is almost inevitable.** Here it gets interesting: the ideological shallowness, so to speak, and the one-man nature of the movement means that there are almost no things that the movement would hold so sacred that failing to get its way on them would be an insurmountable barrier to coalition formation. In other words, ANO can govern with anybody.

**Let us digress a bit here and have a look at ANO's program.** Recall that I did the survey of individual parties' economic programs at the end of July and that at that time it was impossible to go through ANO's program because ANO didn't have any program to speak of, so I had to glean the information from press releases, interviews etc. My conclusion back then was that ANO had no "coherent economic program **but a rabble of tax cuts besprinkled with promise of infrastructure**

**spending that is vaguer and more uncertain even than Trump's fiscal policy dreams."**

Although ANO finally released its program (with the fateful title of "Now or Never"), this conclusion still holds. It is still nothing more than the slick populist politics, with promises like cutting the number of ministries (via merging them), cutting number of some central government workers (as if ANO wasn't part of the government that increased the # of public sector workers by most in recent memory) and cutting budgets of some institutions (Parliament etc.) aiming to persuade voters that ANO is "draining the swamp". There is also the promise to fight against corruption, a platform ANO ran on 4 years back (shouldn't corruption have been eradicated by now?). There are of course long-term visions (e-government, broadband internet everywhere etc.) and some things that shouldn't be part of the program (broadband coverage of Prague metro...really?).

**Economic program consists primarily of promises to not raise or to outright lower the taxes, coupled with promise not to adopt euro "under current conditions" and to invest at all costs.** Budget is to be "balanced" over long-term (read: never), personal income tax should fall for almost all workers and not rise for any worker, loopholes and tax exceptions will be "reviewed". Good third of the "economic program" is about which goods will be taxed at lower VAT rate, a measures enabled, supposedly, by "very successful" EET program: beer in restaurants will be taxed at 10%, as will be such diverse goods and services like bike repairs, hairdressers, window cleaning, cut flowers, butter etc. This doesn't rhyme with the "review" of tax exceptions that ANO promises elsewhere in the program, but as said before, **consistency isn't the strongest part of ANO...**

**...but it is exactly what is its biggest asset when it comes to coalition formation. ANO has by far the biggest coalition potential of all parties simply because it is not a party built around common ideas and principles but a political arm of Agrofert, operated and owned by Andrej Babis.** See, EET is done deal, up and running, and euro adoption isn't imminent, so these issues won't be deal-breakers for any coalition formation. There is

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something for every potential partner. Higher pensions and keeping the PAYG pension system essentially intact will appease Social Democrats, while ANO's insistence that the decision to accept migrants remain with national governments will please SPD (for which keeping out immigrants is *raison d'être*). E-government and other wild Internet future dreams could rhyme with Pirates while keeping social system intact may find resonance even with Communists. After the stillborn February plan of Social Democrats to raise taxes on higher salaries, and likely also because of strong economic growth, nobody is now talking about higher taxes anymore – au contraire, the new common denominator of all parties is lower or at least not higher taxes for everyone. Hence, pretty much everyone can strike a deal with ANO and ANO can strike a deal with anyone, at least as far as economic policy is concerned.

**And parties are aware of all this – save for TOP09 and ODS, nobody is ruling out the coalition in unambiguous terms.** KDU-CSL says it won't work with someone formally accused of crime (read: Babis) but can work with ANO as such, and the same thing holds for CSSD. Considering that KDU-CSL and CSSD "slept together" for last 4 years, knowing well what kind of person Babis is, means even Babis' persona will probably not be a deal-breaker if ANO offers them to be the part of the coalition.

Under the forecast results, **the most likely future coalition in my eyes is thus the current one (ANO + CSSD + KDU-CSL)**, more so now that current PM Sobotka, who clashed with Babis in the Spring and led the campaign for his resignation from Ministry of Finance, was relegated to second or third place in CSSD's hierarchy. For all the pre-election rhetoric, current campaign leader of CSSD, Foreign Minister Zaoralek, has better relations with Babis than Sobotka. KDU-CSL is a party that has historically proven be in coalition with anybody, really, so that wouldn't be an obstacle.

**Second most-likely possibility is also one that is much worse – and I would dare to call it a nightmare of Czech democracy, a scenario which could see Czech Republic going down to same road Hungary or Poland took, i.e. towards illiberal democracy.** This would be the government led by

ANO with support, open (i.e., coalition) or silent, of fringe parties: **Communists and SPD**. Although each of these parties accentuates different things (and economic policies of ANO and KSCM do differ markedly on paper), each of these parties is populist in nature, is anti-immigration, lambasts the post-November developments and the establishment, and appeals to the same group of voters – disgruntled, less educated, with anti-democratic leanings, with a feeling of having been left behind by events of last 28 years. That makes these parties natural allies at the deepest level possible. Babis, Okamura and KSCM's leadership haven't excluded the mutual post-election cooperation and ANO already cooperates with KSCM at lower levels of government. ANO's open collaboration with Communists would also rehabilitate them for the future as it would break another post-November taboo: that Communists are no-touch.

What to expect from these two election outcomes? **The first alternative – the continuation of the current government – is lesser of two evils.** We wouldn't see much of a change as far as the economic policy is concerned. There is an agreement on taxes (lower or at worst not higher than what they are now) and the plans to lower VAT on certain goods / services will certainly have broad support with both ANO and Social Democrats. Strong economic growth translating into growth of budget revenues will enable the government to raise wages in public sector again (and potentially, via lower social security contributions, to increase take-home pay of workers in the private sector), also an area where ANO and CSSD and KDU-CSL are pretty close to each other. Some sticking points (pension system, special corporate income tax on selected big businesses etc.) will be glossed over. The budget will worsen cyclically but it will not be exposed in full until economy slows down. There will be no reform of pension system (though ANO has some elements of merit-based pensions in the program). Economy won't be affected much in the long-run and **so long-term trends** (convergence, stronger CZK, tight risk premium over German bunds) **would not be affected.**

**But they would be in the second scenario described above.** The sell-off in bonds and,

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especially, currency may not be immediate (like after most recent Polish elections) but it would happen eventually and relatively fast as markets become aware that Czech Republic is at risk of taking the Polish route. Although the real convergence wouldn't be affected, the risk premium over Germany would rise. Concessions made to Communists would have to be large and would take us a bit further from European Union and NATO (though obviously not out of these), and would lead to higher cyclically-adjusted (and also

headline) budget deficit. CNB would have to counter this with higher interest rates. The biggest threat would, however, be to Czech democracy: it is impossible to now forecast which particular forms the dismantling of Czech democratic foundations would take, but the anti-establishment nature of all parties that would form this government is such that attempts at that would be certain.

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