

# FUNDAMENTALS

## EU migration, populism and investment risks

Investors need to factor in how immigration concerns in the European Union could fuel the rise of populist parties, potentially increasing the political risk premium.



Chris Jeffery works as a strategist within LGIM's asset allocation team, focussing on discretionary fixed income and systematic risk premia strategies.



Every six months the European Union (EU) asks its citizens about their worries, hopes, fears and dreams in the 'Eurobarometer' survey. Citizens of every single member state now identify tackling immigration as one of their top two concerns for the EU. Respondents in 20 out of 28 countries see immigration as "more of a problem than an opportunity". We try to unpick why this is the case, why anxiety over immigration is likely to continue and how it will affect investors.

The consequences for financial markets are tied up in the potential political fractures associated with

immigration. Populist movements across the continent have exploited the perceived economic, social and cultural threats posed by immigration to win votes and influence. They typically combine worries about immigration with antipathy (or outright opposition) towards the institutions of the EU, often pushing moderate parties in a similar direction. Eastern Europe contains a number of examples where such movements have been successful in gaining power.

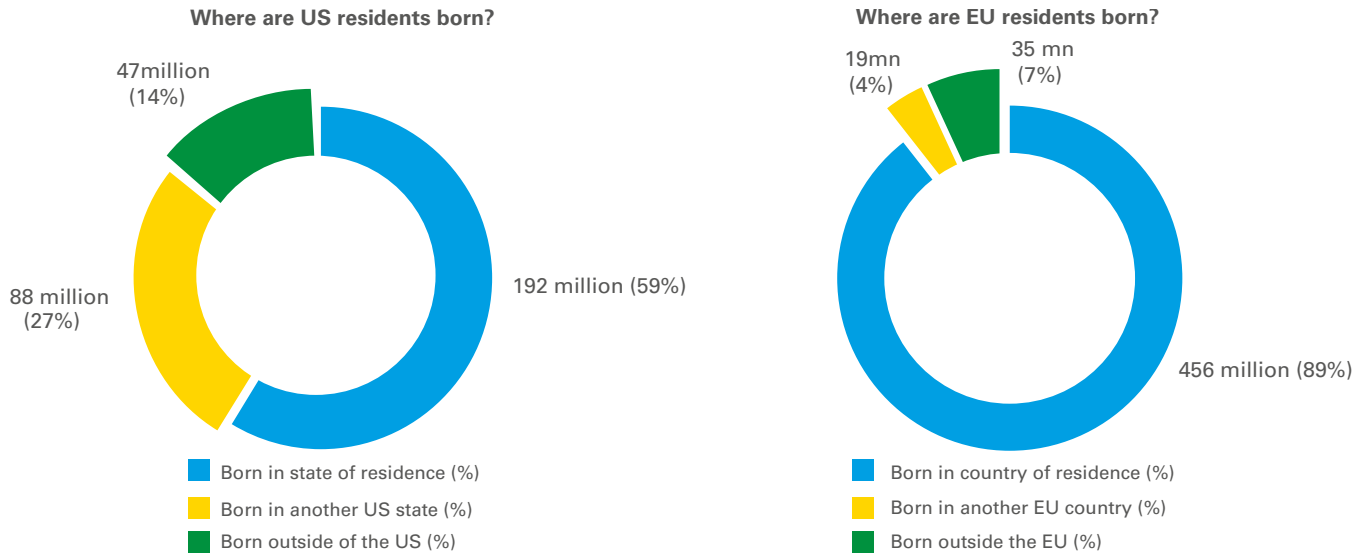
A similar tipping point has now been reached in Italy where the new government has placed tackling

immigration at the heart of an anti-European agenda. Repricing the political risk premium in the EU could have a profound impact on financial markets as they factor in a fundamental challenge to the prevailing institutional architecture.

### DOES THE EU HAVE AN IMMIGRATION 'PROBLEM'?

Despite immigration's prevalence as a political issue, the proportion of the population born overseas (i.e. first generation migrants) is actually quite low in Europe relative to other parts of the world.

Figure 1: Share of international migrants



Source: United States Census Bureau, State of residence by place of birth, 2016 Washington DC And Puerto Rico treated as US States.

Source: Eurostat, Migration and Migration Population statistics, Foreign-born population by country of birth, 1 Jan 2016.

For example, international migrants make up 14% of the US population compared to just 7-11% in Europe (depending on how you consider intra-EU migrants).

Service, jobs and pensions – and leave Britain economically worse off with less influence in the world. That

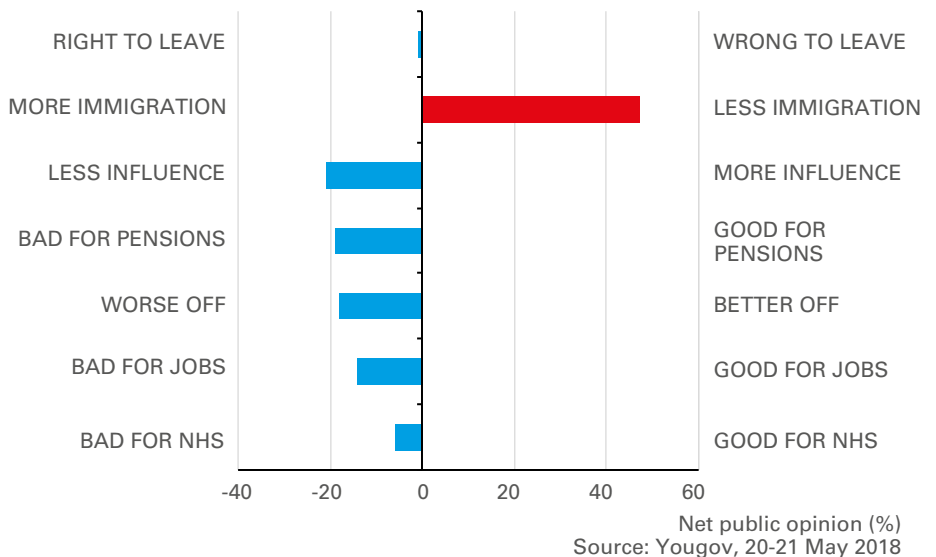
is all offset by the overwhelming belief that Brexit will lead to less immigration.

However, Europeans consistently report higher concerns about immigration than Americans. In a recent international survey, 35% of Americans described immigration as having a “very or fairly positive” impact on their country. Just 16% of European had a similarly positive attitude.<sup>1</sup> Both numerically, and culturally, Europe therefore looks like a relatively closed society.

Immigration concerns were a significant contributing factor in the UK’s vote to leave the European Union in June 2016. This is clear from recent surveys which show limited regret over the vote to leave the EU despite popular belief that it will be bad for the National Health

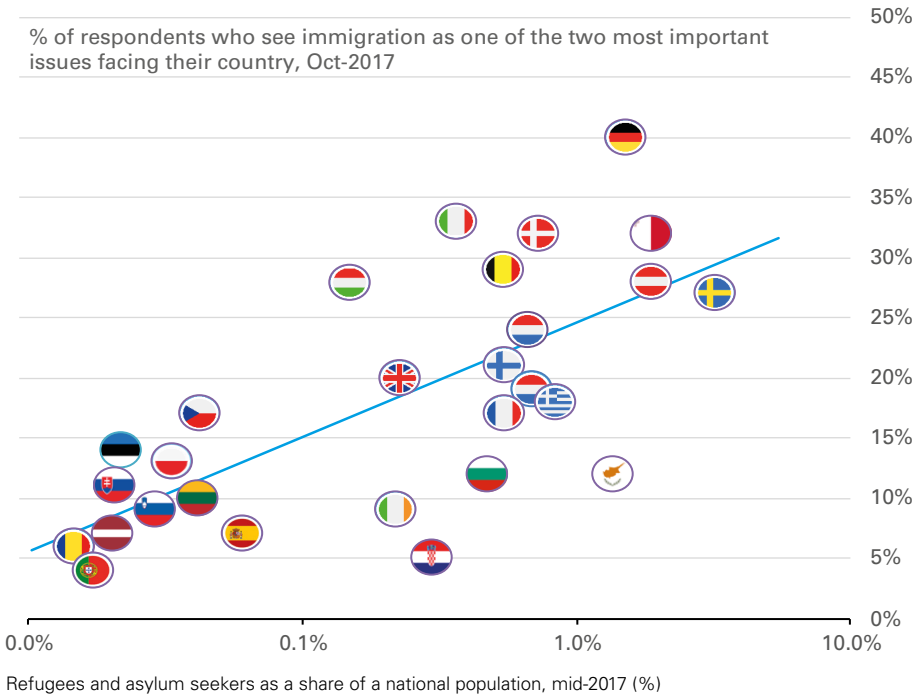
Figure 2: British public opinion on the EU referendum

1. In hindsight, do you think Britain was right or wrong to vote to leave the EU?
2. Do you think there will be more or less immigration into Britain after we leave the EU?
3. Do you think Britain will have more or less influence in the world after we leave the EU?
4. Do you think leaving the EU will have a good or bad effect on people’s pensions?
5. Do you think Britain will be economically better off or worse off after we leave the EU?
6. Do you think leaving the EU will have a good or bad effect on British jobs?
7. Do you think leaving the EU will have a good or bad effect on the NHS?



1. “Global Views on Immigration and the Refugee Crisis” Ipsos, Sep 2017. EU data are an unweighted average of Hungary, Italy, Belgium, France, Poland, Germany, Sweden, Spain and the United Kingdom.

Figure 3: EU attitudes to immigration



In those countries untouched by the refugee crisis (the Baltics, Spain & Portugal), few people see immigration as a particular concern for their country. In those countries at the centre of the crisis (Germany, Italy, Hungary, Austria), it is seen as an important public priority.

**WHAT IS DRIVING THE REFUGEE FLOWS?**

The clearest immediate cause of the refugee flow into Europe is the Syrian civil war. The United Nations High Commissioner for Refugees estimates that over five million people have fled the country since the war began in 2011. Most of those are in neighbouring countries (Turkey, Lebanon, Jordan and Iraq), but around one million have sought asylum in the EU.

However, Syrians account for less than 25% of EU asylum-seekers over the last five years with an equal number coming from across Africa. A further 25% come from elsewhere in the Middle East, Afghanistan or Pakistan. Many are fleeing conflict and persecution at home while some are economic migrants seeking better employment and income prospects overseas.

**WHAT'S THE SOURCE OF THE EUROPEAN ANGST?**

Across the EU, the data suggest that concern is focused on the influx of asylum-seekers and refugees, rather than the growth of international immigration itself.

Yet, asylum-seekers and refugees make up a small fraction of the number of immigrants. In 2017, there were an estimated 56 million international migrants in the EU, including 35 million

from outside of the Union. In contrast, there were just under three million asylum-seekers and refugees.

The number of refugees and asylum-seekers as a share of the national population is a statistically significant driver of the anti-immigrant sentiment across the EU. This is contrast to the share of migrants within the population which has no such explanatory power.

Figure 4: Where are European asylum-seekers coming from?

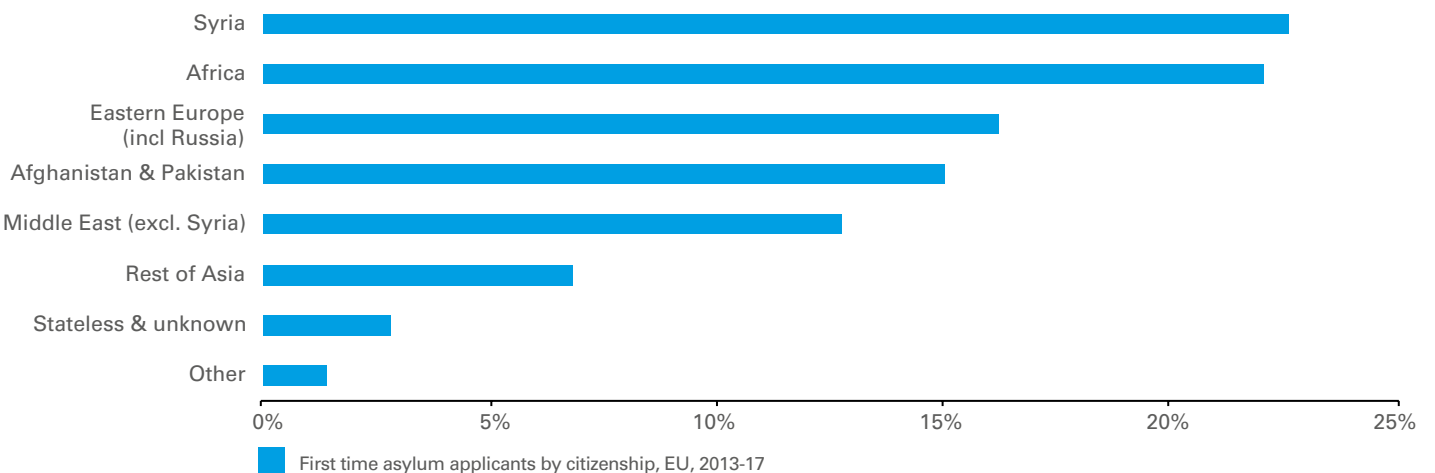
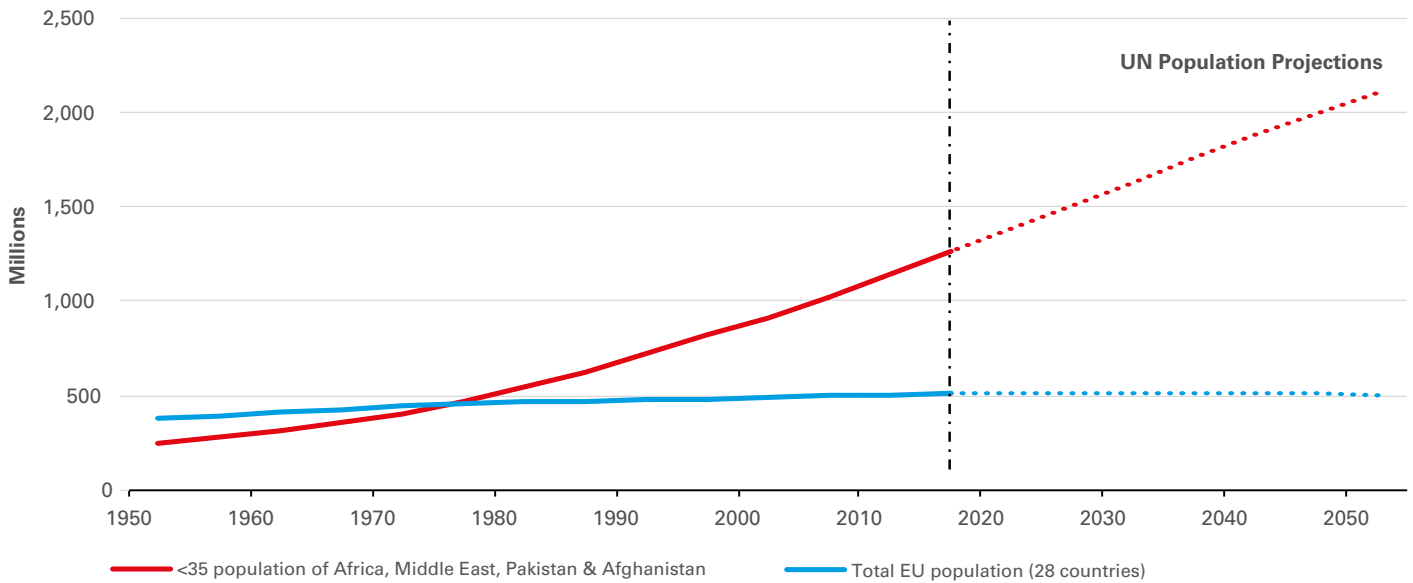


Figure 5: Demographic pressures on immigration to Europe will intensify



Source: United Nations World Population Prospects, 2017

**WHAT ARE THE PROSPECTS FOR FUTURE FLOWS?**

Models of migration flows tend to focus on ‘push’ and ‘pull’ factors: the prospect of higher real incomes, better social protection and political rights in Europe are the clearest pull factors. Conflict and lack of opportunity are the biggest push factors.

Efforts to control the flow of migrants in recent years have focused on building literal and administrative walls around Europe. The media focus on the migration routes through Greece and Italy, but hundreds of thousands of people are also denied entry every year on the border between Morocco and the Spanish territories of Ceuta and Melilla.

The efforts to battle the impact of demographic pressures are likely to intensify over the years ahead. Over the next thirty years,

the population of the EU is set to stagnate at around 500 million. In contrast, the under-35 population of Africa, the Middle East, Afghanistan & Pakistan is likely to grow by over 60%.<sup>2</sup>

As such, we don’t need a fully articulated gravity model of bilateral population flows to realise that migration flows into Europe are likely to be on a structurally rising trend over the next couple of decades.

The refugee crisis has accelerated the drift towards populist politics in large parts of Europe, in our view. Populists can be found anywhere on the traditional left-right spectrum but are united in their claim to represent the true will of the people against a perceived enemy or threat; immigrants are a principal target alongside domestic ‘elites’, ethnic minorities and institutions. Populist parties across Europe

now attract almost a quarter of the overall vote, up from less than 10% in 2000. National Front in France and Alternative für Deutschland in Germany have risen from relative electoral obscurity using the lightning rod of immigration to rally supporters to their cause.

In Eastern Europe, such political organisations have been elected to lead:

- Poland’s Law and Justice (PiS) party and Hungary’s Fidesz party share a conservative-nationalist world view and have arguably taken steps to undermine the free press, independent civil society and the constitutional courts since taking office.
- They share an anti-immigration platform with the Czech Republic’s ANO party which rose to power in December 2017 and Slovenia’s SDS party which was the largest party at the June 2018 elections.

2. United Nations, Department of Economic and Social Affairs, Population Division (2017). World Population Prospects: The 2017 Revision

These parties draw strength and legitimacy from one another. Their world view (and the interdependence of these parties) was clearly articulated during the Slovenian election campaign. The Hungarian prime minister, Viktor Orbán, took to the stump arguing:

“If Europe surrenders to mass population movement and immigration, our own continent will be lost...Tens of millions aim to travel from Africa to Europe... The aim is to settle among us people who do not belong to our culture and who will want to live here according to their own religions and customs.”

The governments of Hungary, Poland and the Czech Republic now stand accused by the European Commission of “non-compliance with their legal obligations on relocation” of refugees within the

Schengen common travel area. Tensions over refugees are feeding the broader political rifts across Europe.

In Italy, the recently formed government coalition between the Northern League and the Five Star Movement has used fears about 500,000 “irregular” immigrants at the centrepiece of a campaign to challenge EU norms on policy across almost all fronts. In Germany, the seventy-year-old alliance between the Christian Democratic Union and the Christian Social Union is under considerable stress due to differences of opinion over how to handle the flow of refugees.

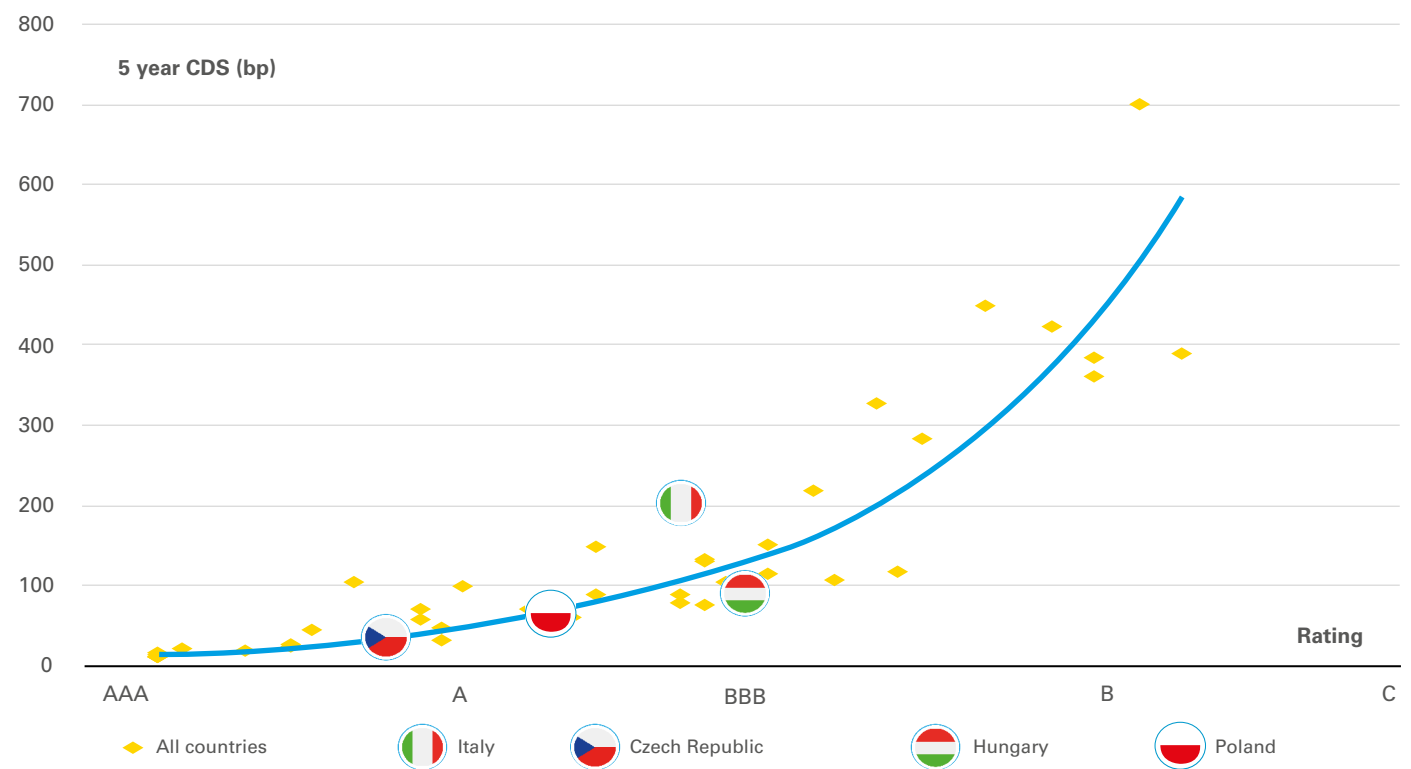
**THE INVESTMENT RISK**

Europe’s native-born population is steadily shrinking. If governments wish to maintain their economic clout, immigration is likely to be part of the solution. Without

it, public spending will have to shrink as the tax base contracts over time and servicing previously accumulated debt will become increasingly difficult.

However, immigration is politically fraught. It is unpopular across most of the continent and a source of growing friction between countries within the common travel area. Over the decades ahead, the population explosion on Europe’s borders implies the flow of economic migrants is unlikely to slow down. Investors need to be aware that the countries at the centre of the refugee crisis and that receive the greatest number of international migrants are most at risk from populist leadership. As we have recently seen in Italy, market complacency to political risk can have drastic consequences for investors’ capital.

**Figure 6: Market consequences of increased political risk**



Source: LGIM

That risk has now been crystallised in the price of Italian assets. Italian equities have fallen by around 10% since the formation of the new populist government, by the time of writing Italian government bonds are trading at a significant discount to any other investment grade-rated sovereign.

The same cannot be said of other populist-led countries in Eastern Europe. There is no evidence yet of a political risk premium in Czech, Polish or Hungarian assets despite the confrontational approach

adopted towards European institutions and norms. Assets in those countries look vulnerable to any further escalation in tensions exacerbated by the almost inevitable fights over immigration in the years ahead.

Market focus can rapidly snap back to underlying political risks after long periods of calm. If refugee flows stay high (or even intensify), the prospect of disruptive political clashes between member states and the EU remains ever-present.

**August Comte (1798-1857), argued that “demographics is destiny”. Arguments over immigration look destined to dominate European politics for years to come.**

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