



MACROECONOMIC *view*

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Where is France heading?



KEY HIGHLIGHTS:

- The snap parliamentary elections create unprecedented political uncertainty
- There are three possible outcomes: victory for Macron, division into three blocs, victory for the Rassemblement National (RN)
- The latter is the most likely scenario and would lead to a “cohabitation” between Macron et the RN
- The risk of Frexit has disappeared, but the RN’s economic policy could raise concerns among investors
- The risk premium on French debt is likely to rise further



In France, the recent elections for the European Parliament ended in a rout for the presidential party. It garnered half the votes of Marine Le Pen’s *Rassemblement National* (RN), at 14.6% and 31.3% respectively. Although this outcome had been predicted by polling institutes, the defeat remains a hard pill to swallow for Emmanuel Macron. On the one hand, he had invested a great deal of energy in the campaign, delivering numerous speeches in favour of European integration. On the other hand, the RN continued to gain ground among various population groups that had previously been quite hostile to it (women, executives, pensioners). **In response, Emmanuel Macron dissolved the National Assembly (*Assemblée Nationale*) and called a snap parliamentary election on June 30 and July 7.** This extremely rare decision took everyone by surprise, including within the presidential camp. **It creates a situation of political uncertainty rarely seen before.** So, where is France heading?

First, let’s look at the political aspect. The French constitution allows the president to dissolve the National Assembly, but only once per year. In the sixty-six years since the Fifth Republic was founded, this right has only been used five times, the last instance being nearly thirty years ago. The most famous example is the dissolution by General De

Gaulle in May 1968, in response to the deep social crisis that had been plaguing the country for weeks.

By dissolving the Assembly, Emmanuel Macron acknowledges he is no longer able to continue his work. He holds only a relative majority in the Assembly, and his government is under the constant threat of being brought down by a coalition of all the opposition parties. Although this has not happened in two years, it remains a sword of Damocles hanging over his administration. The President’s decision is no less risky because it could benefit the opposition parties. Moreover, it comes just a few weeks before a major global sporting event, the Paris 2024 Olympic Games, which will require enormous resources to ensure security and hospitality for visitors.

The knock-on effects of Macron’s gamble are uncertain. The ideal scenario for the President would be to pull off a De Gaulle-style manoeuvre with the message: “me or chaos.” This would force some voters on the left and right to join his centrist alliance out of a rejection of the radical parties: La France Insoumise on the far left and the RN on the far right. However, the current situation lacks the insurrectionary character that marked the year 1968.



What scenarios can be derived from this election?

Given the current alliances between political parties, there could be three blocs: one uniting the left and far left, another comprising Macron and his allies, and a third made up of the RN and defectors from the Conservative party. Naturally, each bloc claims it can win.

The first available polls all agree that a Macron victory is highly unlikely and predict an RN victory, with uncertainty about its magnitude. The specificities of the French voting system (two rounds, 577 constituencies) add a fairly wide error margin to these projections. **It is possible that the elections will result in no side gaining an absolute majority in the new Assembly, leading to a deadlock situation.** In such a scenario, the government, whoever it might be, would be limited to handling current affairs, and any reform proposals would be ruled out. **It is also quite possible that the new Assembly could be dominated by the RN.**

In this case, the President would have to ask the leader of the RN, Jordan Bardella, to form a government, in the secret hope that this party proves incapable of effectively running the country. Some suggest that this is the President's real objective, aiming to discredit his opponent Marine Le Pen ahead of the 2027 presidential election. It should be noted that Macron cannot stand for a third consecutive term. If we take the political fiction game very far, we could even envisage a final hypothesis: the resignation of the President, leading to early presidential elections (a unique case in French history, with De Gaulle in 1969).

A "cohabitation" (or sharing of power) between a president from one party and a government from the opposition occurred three times in the past, in the 1980s and 1990s. In such cases, the President typically retreats into his reserved domain of foreign affairs while the government handles domestic affairs. This can generate friction between the Head of State and the Head of Government. **In any case, the conduct of economic and fiscal policy would become less predictable in the short term.**

What is France's economic situation? In recent years, the French economy has faced the same shocks as its neighbours. Business conditions have been disrupted like never before. First, there was a collapse in activity during the pandemic, followed by a strong recovery; inflation soared during the energy crisis, followed by rapid disinflation; credit dried up following the tightening of monetary policy; and public finances deteriorated.

Based on the results for 2023 and forecasts for 2024, French economic growth is slightly higher than the European average while inflation is a bit lower. The labour market is fairly solid, but bankruptcies are on the rise. Business sentiment has been relatively stable for several months, at a level compatible with sluggish growth. Household morale remains low due to the shock to purchasing power. **All in all, this paints the picture of a recovering economy that has not yet fully overcome past shocks. In these conditions, political uncertainty is likely to create a wait-and-see climate that could have damaging consequences for companies' investment and hiring plans.**

What are the implications for public finances? This touches on France's traditional weak point. In the two years before the pandemic (2018 and 2019), France's budget deficit had been brought below the critical threshold of 3% of GDP, and debt had stabilized at 98% of GDP. Over the last four years, the situation has massively deteriorated. Last year, the budget deficit rose to 5.5% of GDP, and the debt was close to 110% of GDP. In 2007, before the financial crisis, the ratio of public debt to the French population was €20,000 per inhabitant. By 2023, it had risen to €45,000, and in two years' time, it will reach €50,000.

The country's sovereign rating was downgraded by Fitch last year and by S&P last month. In a few days, France will be placed under the excessive deficit procedure by the European Commission, along with around ten other EU countries. France's fiscal position has deteriorated not only in relation to Germany but also to other neighbouring countries. All this reduces the fiscal headroom for the next government, whoever it may be.

In France, political risk is usually perceived as low. Before the 2017 presidential election, investors were concerned about "Frexit" (France leaving the eurozone) because it was part of Marine Le Pen's programme at the time. As soon as she was defeated, she rejected the idea once and for all. The RN continues to criticise the EU, but it no longer seeks to leave it. **The risk of a "Frexit" can now be considered as nil. The political risk now lies more in the financial cost of the economic measures proposed by the RN.**

During the 2022 presidential election, the Concorde Foundation estimated that Marine Le Pen's economic programme would increase the structural budget deficit by 3.3% of GDP per year.



Today, the RN remains somewhat vague about its economic policy should it lead the next government. Its primary focus is on national security and immigration issues. **Some of its spending pledges are not compatible with controlling deficits and debt. An overly lax fiscal policy could be sanctioned by a rise in interest rates on the markets.** This is what happened to Liz Truss's government in the UK in 2022 and to Italy's M5S-Lega government in 2018, both of which faced adverse consequences. This is surely a lesson to ponder.

It should be reminded that around half of French debt is held by foreign investors (see chart). This share has decreased since 2010, but it remains significant enough that fiscal adventurism would not be tolerated. Over the past two years, the yield spread between French and German government bond has hovered around 50 basis points. In the current circumstances, the risk is that this premium will increase before the political situation stabilises.

What are the implications for Europe? It is difficult to say to what extent Emmanuel Macron's defeat in the recent European elections is due to his persona (his approval rating never recovered from the "gilets jaunes" crisis in 2018) or to his ideas in favour of further European integration, in a world inclined to turn inward. What's certain, is that the French President's proposals to develop Europe's strategic autonomy, strengthen its defence, and increase its budget have not been reinforced.

In Germany, the ruling three-party coalition also suffered a setback in the European elections, particularly Chancellor Scholz's party. Five years ago, the allocation of key EU posts was negotiated between France and Germany, two countries that seemed strong enough to impose their views on the rest of the EU. This time around, both countries are weakened, as are their leaders. This makes the European situation more complex and therefore, more uncertain.

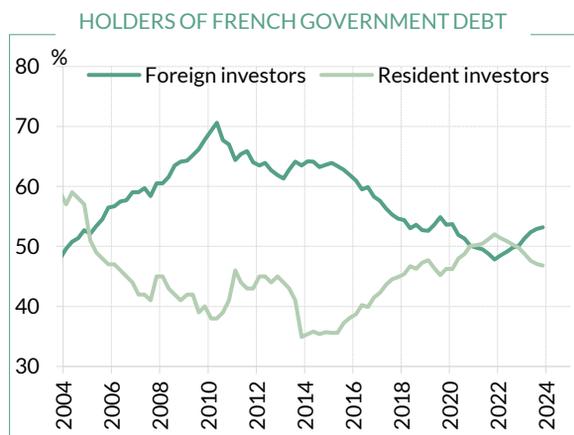


Chart source : Agence France Trésor, ODDO BHF

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