



Global Macro Research

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#France

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#Politics

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#Fiscal Policy

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What's next in French politics after the election result?

The French legislative elections delivered a parliament split three ways, with the left-wing New Popular Front the surprise victor. Markets were initially modestly encouraged by the prospect of policy stasis preventing a large fiscal expansion. But France will struggle to form a stable government.

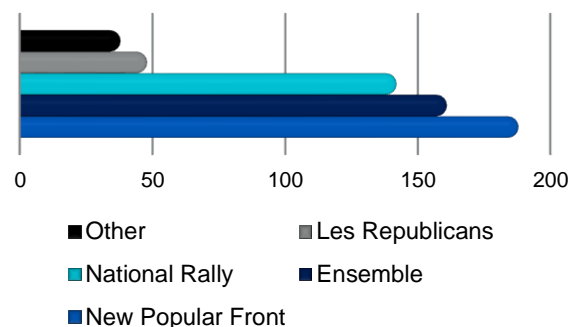
Key Takeaways

- The French legislative election delivered a surprise victory for the left-wing New Popular Front (NFP). But it has fallen well short of a majority, and the parliament is roughly evenly split between the left, the far-right, and Macron's centrists.
- The three most likely options for a new government are: an NFP-dominated minority; a 'rainbow' coalition covering the centre and parts of the left; and a technocratic caretaker government in the event other options fail. France may see a few of these options over coming months given the hung parliament.
- In particular, the NFP probably isn't a durable base for government, given its internal divides. The bloc hasn't put forward a candidate for prime minister, and there is a high probability the alliance fractures.
- Any coalition or minority administration involving even the moderate left is likely to seek increased public spending and taxation, even if the highly expansive fiscal platform put forward during the campaign isn't enacted. Certainly, a divided parliament won't be able to deliver the fiscal consolidation required by the EU Excessive Deficit Procedure.
- Financial markets initially took the news of a hung parliament and prospect of policy stasis as good news, however most recently equity prices have been a bit weaker. And we continue to think the headwinds to the French economy and fiscal position are structural, going beyond the event risk associated with this election.

A surprise result, driven by tactical voting

France's legislative elections delivered a surprise victory for the left-wing New Popular Front (NFP) coalition, which has secured roughly 188 seats, ahead of Macron's Ensemble on around 161 and Marine Le Pen's National Rally (RN) on 142.

Figure 1: New Popular Front came a surprise first in second round voting



Source: Ministry of Interior, abrdrn, July 2024

The result, which was not anticipated by polls, was driven by a successful tactical voting campaign in which candidates standing against RN were able to consolidate votes. RN secured nearly 40% of the vote but this failed to translate this into seats (see Figure 2).



Figure 2: NFP lead in terms of total seats, but not votes cast

Group	Seats	Seat change	Vote share
NFP	188	+57	26.3%
Ensemble	161	-76	24.7%
RN	142	+53	37.1%
Les Republicans	48	-13	6.2%
Other	38	-21	5.6%

Source: Ministry of Interior, abrdn, July 2024

Market reaction has been muted, which probably reflects a “least bad” take on the outcome. Initially, OAT spreads tightened a touch and equities moved slightly higher, but the market has been weaker most recently. And while the door has closed to a populist-right majority, much uncertainty still exists around France’s political and economic future.

The three most probable scenarios for a new government are a leftist minority government, centre and centre left majority coalition, and a technocratic caretaker government. It is possible France moves through several of these scenarios as different coalition possibilities are explored before collapsing under the weight of their internal contradictions.

Government formation may well take some time, and is not guaranteed

The formation of the next government is likely to take several weeks. A caretaker government led by Macronist Prime Minister Gabriel Attal will be in place until at least the end of the Paris Olympics on 11 August.

In the first instance, the NFP may attempt to form a minority government if it can agree on a prime ministerial candidate and find enough votes for a supply and confidence agreement.

However, the NFP is an untested political alliance of the four main parties on the French left (the hard-left France Unbowed, the centre-left Socialist Party, the Greens, and the Communist Party) which may struggle to remain united now the election has passed.

Indeed, the NFP was unable to name a candidate for prime minister during the election campaign and it is divided on practical and policy questions.

There is already evidence of division within the group. Following Sunday’s result, Jean-Luc Mélenchon, leader of France Unbowed, said the NFP would apply “our manifesto, nothing but our manifesto”.

The group ran on a platform of significant fiscal expansion including disavowal of EU fiscal rules, repeal of Macron’s pension reform, price caps on essential foods and fuel, and raising the monthly after-tax minimum wage from €1,398 to €1,600. It estimated this will cost between €125 billion and €187 billion annually. It also proposed €150 billion of tax increases, predominantly targeting the wealthy and businesses.

This platform does not have support outside the NFP so is not a viable basis for the kind of confidence and supply arrangement that would be required to keep a minority government in power.

France Unbowed will almost certainly remain opposed to any coalition agreement that involves working with Macron’s Ensemble. But other parties, particularly the Socialists and the Greens, are likely to be more open to a coalition arrangement with Ensemble in exchange for policy concessions and supplying the prime minister.

But while there is likely a viable path to a majority government between Macron’s party and some members of the left group, this may require the NFP to first try and fail to form a lasting minority government.

It is possible that it takes much longer to form a government depending on how willing parties are to work with Macron, the extent to which Macron is willing to concede power to a parliament in which Ensemble is a minority, and the ability of any potential coalition to find a compromise on fiscal policy.

If no government can be formed, it is possible that a caretaker government takes power until elections can be held again in a year. In any case, it seems unlikely that this parliament is able to serve out its full term.

Budget process will be difficult

In any scenario, fiscal consolidation is likely to be slower than Macron and the EU would have preferred, while structural reforms are set to be delayed or even rolled back.

Most contentious will be the future of Macron’s signature pension reform, given the almost universal opposition to its continuation outside his own electoral grouping. It remains to be seen whether Macron can stomach significant changes to pensions policy given the extent of the political capital he spent to pass the policy, and its importance in his broader reform agenda.

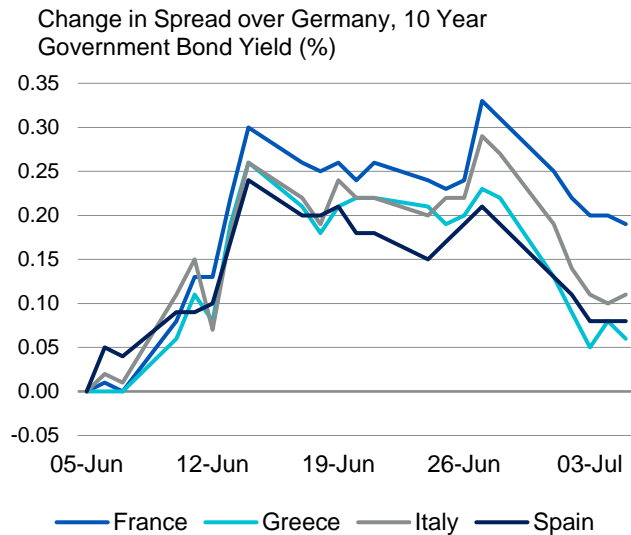
An Ensemble/centre-left coalition would also struggle with aspects of Macron’s fiscal plan. Macron’s party has been pushing for a 2025 budget that would cut France’s deficit from 5.5% to 4.4%. However, the centre-left will likely continue to prefer slower deficit reduction, some public spending increases, and tax increases.



Outcome is best of a bad bunch for markets, but structural challenges remain

For now, markets seem to be reasonably relaxed about the result. Spreads were a little tighter, albeit these are only very partial reversals of the recent weakness (see Figure 3).

Figure 3: Spreads have only partially reversed recent widening



Source: Bloomberg, abrdn, July 2024

We continue to think the headwinds to the French economy and fiscal position are structural, going far beyond the event risk associated with the outcome of this election.

France's fiscal position is precarious, with the country unlikely to escape its Excessive Deficit Procedure for

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several years. In principle this renders French government debt ineligible for European Central Bank (ECB) support, although in extremis this is unlikely to be a binding constraint. More broadly, ECB officials have shown little interest in resisting the recent weakness in the French government debt market, seeing the move as reflecting economic and political fundamentals rather than market dysfunction.

Electoral risk in France likely to remain high

The election is evidence that France's 'Republican Front', which has seen the electorate coalesce around opponents to right wing candidates in final round elections, still holds. But, while the right has underperformed relative to polling and first-round performances in these elections, Marine Le Pen will remain an influential voice in French politics and has a viable chance of securing the presidency in 2027. On the left too, Jean-Luc Mélenchon has seen his profile raised over the course of these elections and his France Unbowed party has demonstrated its electability.

Both these candidates and the parties they represent advocate for significant fiscal expansion, which is at odds with EU fiscal rules and would struggle to retain the confidence of markets. As long as they and their parties remain influential, political risk premium is likely to stay elevated.



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