



THE FRENCH ELECTION RESULTS : NO CRISIS, NO SOLUTION, SEE YOU NEXT YEAR!

There will be no economic or financial crisis in France in the coming months nor any solution to the country's problematic finances. None of the three major power blocs has emerged from the election with a working majority. And neither of the two parties – Nouveau Front Populaire (NFP) and the Rassemblement National - will be able to entice other parties into a majority coalition to push through the economic programmes that investors were so worried about. Some of the moderate left wing MPs could join the central bloc but they would be a minority presence in any alliance. And even if such a coalition were to appear, it would struggle to roll out the sort of austerity programme that France needs to meet commitments given to Brussels and satisfy rating agencies. In short, whether France has a coalition administration or a technocratic government, there will not be a parliamentary majority to reduce the deficit and no lasting political stability. A multi-party alliance would be needed to govern but the greater the number of parties, the more fragile the alliance would be. Essentially, no party has really won these elections and each bloc was already working on redefining itself or about to start doing so. French politics is astride tectonic plates which are by nature unstable and it looks highly probable that parliament will again be dissolved in a year's time.

In the meantime, France's deficits will probably not increase but nor will they be reduced. There is a risk of a one of two-notch downgrade since the state of France's finances warrant an A-rating like Spain rather than the current AA-. The country's goodwill was based on President Macron's structural reform efforts and strong political stability but both are now on hold. As for market reactions, we believe the worst that could happen on bond markets would be the OAT-Bund spread widening by around 15bp, a black mark certainly but not a real game changer.

France is now in an unsatisfactory position but its condition is hardly critical. The problem is that the longer this uncertainty lasts, the more the situation could become critical. For the moment, our asset allocation choices are unchanged. We remain neutral on European equities, having changed from being overweight shortly after parliament was dissolved. The focus will now be on the US elections which will bring their own fair share of volatility to markets. We will have time to reassess France's country risk in just under a year!

GLOSSARY

- The spread is the difference between the actuarial rate of return on a bond and the rate of return on a risk-free loan with the same maturity.
- OAT - Obligation assimilable du Trésor - are French government bonds, issued for a minimum term of 2 years and a maximum term of 50 years. Their credit is that of the State. They are therefore government debt securities.
- The Bund is the German government bond (equivalent to the French OAT) which is sometimes used as a reference for calculating the actuarial margin (spread) of eurozone bonds.

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