

# Research Euro Area

## French presidential election: Macron encore?

- **Our base case is for Macron to secure another term as President, but with the risk of a slimmer parliamentary majority to implement his policies.**
- **In contrast to 2017, EU-exit discussions are absent in the election campaign.**
- **While France has weathered the economic fallout from the COVID-19 pandemic better than other euro area peers, fiscal fragilities could come back to haunt.**
- **Markets. We see scope for a higher election risk premium to be priced in fixed income markets. The election impact on EUR/USD should be muted in our view, but EU fiscal rules reform will be key to follow.**

### A convoluted race

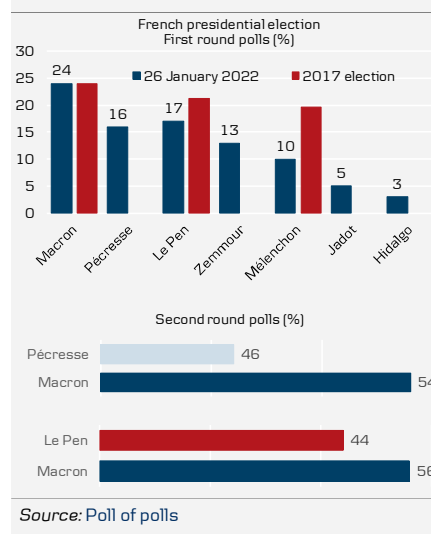
On 10 April 2022 the first round of the French presidential election will be held, with the potential final run-off scheduled for 24 April. The election is expected to be a tight race between incumbent President Emmanuel Macron and either Valérie Pécresse from *Les Républicains* or Marine Le Pen from *Rassemblement National*, who are currently leading the polls for the first round. Two months after the presidential election, parliamentary elections for the National Assembly will take place (on 12 and 19 June), which will have important implications for whether the President can also implement campaign pledges.

**Predicting the election outcome is difficult due to the broad range of candidates and the particularities of the French presidential electoral system**, with its two stages of voting. In the first round, candidates from all parties participate. Should no candidate be able to reach an absolute majority (more than 50% of the vote – this has never happened) in the first round, a second round run-off is held between the two candidates that received the most votes in the first round. To win the presidency, a simple majority (highest number of votes cast) suffices in the run-off. Hence, theoretically, it is possible for a candidate who came second in the first round, to win the presidency by receiving broader support in the second round run-off (and vice versa). As many candidates are running for President, it is unlikely in our view that one of them will receive an absolute majority in the first round and instead the election will probably be decided by the run-off on 24 April.

**Our base case (60% probability) is for Macron to secure another term as President, but with the risk of a slimmer parliamentary majority to implement his policies.** If Macron prevails, he would be the first incumbent to win re-election in France since Jacques Chirac 20 years ago. In case of a Pécresse presidency (35% probability) economic policies would probably not change dramatically, while fiscal consolidation efforts could become more prominent. A Le Pen presidency (5% probability) would likely entail a more domestically focused France, with heightened uncertainty on economic and fiscal policies.

**The election outcome will also have important implications for Europe.** With the departure of Angela Merkel from the political scene and Italy's government on shaky foundations, a new European leadership vacuum could open up if President Macron fails in his re-election bid. Hence, as the surprise potential at French elections remains high, we expect markets to increase the election risk premium and thus see a wider spread to Bunds.

### Polls point to Macron as the frontrunner



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## Political landscape skewed to the right

At the moment, seven candidates are vying for the presidency (see appendix for details on their programmes): three from the left (Jean-Luc Mélenchon, Yannick Jadot and Anne Hidalgo), three for the right (Valérie Pécresse, Marine Le Pen and Éric Zemmour) and incumbent centrist President Macron, who is expected to officially announce his re-election bid in the coming weeks.

Overall, the election campaign has so far mainly focussed on security and immigration issues and the political landscape is skewed to the right, with left-wing candidates trailing behind and struggling to emerge as serious contenders. President Macron continues to lead the polls by a comfortable margin, but the second place for qualification for the run-off remains open, although the contender will likely stem from the right of the political spectrum. For many months, polls had suggested a re-run of the 2017 election run-off between Macron and Le Pen. During September and October support for far-right columnist Zemmour rose in opinion polls, to the point that he was neck and neck with Le Pen at the beginning of November. However, after some campaign mishaps, he has been overtaken by the centre-right candidate Pécresse in the latest polls.

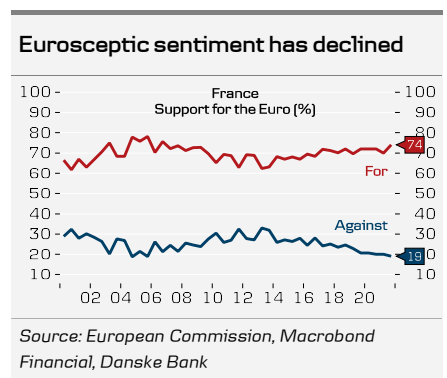
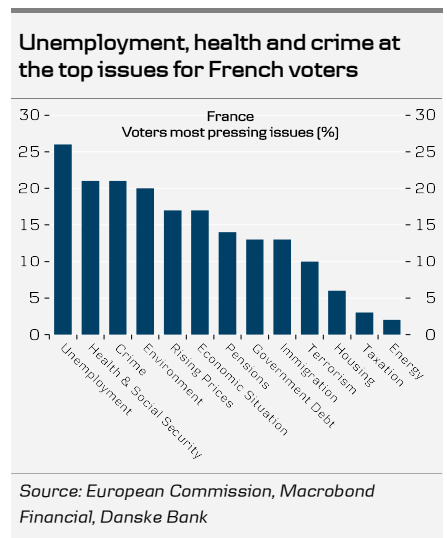
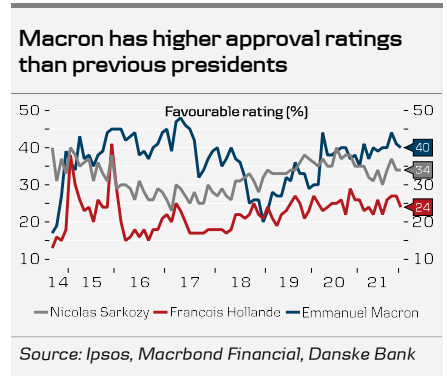
In the past, voters have always united to prevent the far-right from winning the presidency, as happened in the run-off between Jacques Chirac and Jean-Marie Le Pen in 2002 as well as in the run-off between Emmanuel Macron and Marine Le Pen in 2017. That said, the 2017 election also showed that French politics is prone to surprises. Especially, in case of a run-off between Pécresse and Macron, the race could be tight, as both are vying for the same centrist voter base. The success of Pécresse's bid for the presidency will depend on a fine balancing act between trying to win centrist voters that previously supported Macron, while also catering for the more conservative and anti-immigration wing of her party.

There also remains some uncertainty whether all seven candidates can gather the required sponsorships from 500 locally elected officials (mayors, deputies, member of regional parliaments). This could prove tricky especially for the three candidates of the extremes (Mélenchon, Le Pen and Zemmour). Candidates have until early March to gather the required signatures and a final list of candidates will be known after validation by the Constitutional Court on 5 March.

## EU-exit is not up for debate

During the crucial presidential election period, France has also taken over the EU's rotating presidency in January. This, combined with President Macron officially entering the race, could shift the campaign focus to other areas beyond security and immigration, in particular the economy and Europe.

One topic that is expected to feature prominently during France's EU presidency is EU fiscal rules reform. Macron has been one of the most vocal critics of the current Stability and Growth Pact (SGP) rules and together with Italian PM Draghi has advocated that 'key spending for the future' should be incentivised under a revised set of rules. Macron also repeatedly called for new financial tools involving a broader pooling of debt risk among EU countries, similarly as already employed in the temporary NGEU instrument. Franco-German collaboration will play a crucial role in our view. We see Germany's FDP-led finance ministry open to discussions to simplify existing rules, but sceptical of a significant watering down of current limits as well as debt mutualisation (see also *German Politics Monitor - Traffic light is flashing green*, 2 December). Especially the



idea of a ‘golden rule’, which excludes green spending from the debt/deficit calculations, is facing increasing headwinds amid plans to assign contentious nuclear and gas projects the green label in the EU taxonomy. Given deep and longstanding divisions between fiscally conservative countries in the north and fiscal ‘doves’ in the south, finding agreement on SGP reform will not be easy and an agreement before H2 22 seems unlikely in our view.

**In contrast to 2017, Euroscepticism does not play a big role in the French election campaign**, with no candidate outright advocating an EU/euro-exit. Macron remains the most pro-European candidate, but lately has also come under pressure from his rivals for his lax approach to immigration. In light of this, France’s EU presidency will also focus on a reform of the Schengen zone, as well as digital regulation, the carbon border adjustment mechanism and an EU-wide minimum wage.

### Fiscal fragilities could come back to haunt

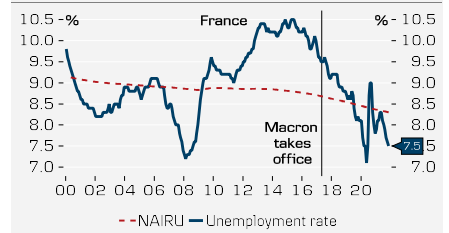
**The outcome of the presidential election will also have important implications for the future direction of the French economy**, which accounts for about one fifth of euro area GDP. France has weathered the economic fallout from the COVID-19 pandemic better than other euro area peers, with GDP already returning to pre-pandemic levels during Q3 21. Substantial government support measures, high vaccination rates and less reliance on vulnerable sectors such as tourism and exports supported France’s outperformance during the recovery. Labour market reforms enacted by Macron to ease hiring and firing, expand apprenticeships and reform professional training, helped the unemployment rate to fall to the lowest level since the 1980s before the pandemic hit. Corporate tax cuts, a reduction in company payroll charges and a big international marketing push to persuade investors that France was open for business also supported the economy. The country continues to be one of the main players on Europe’s start-up scene and the number of business starts - especially for micro-enterprises - has increased noticeably during Macron’s presidency.

**While the ambitious EUR100bn *France Relance* plan creates opportunities to raise potential growth in the long-term, persistent budget deficits could increasingly raise fiscal sustainability concerns in the market in our view**, especially if paired with renewed political uncertainty under a Le Pen or Zemmour presidency. As we also discussed in *Research Global - Public debt levels post COVID-19: much ado about nothing?*, 30 September 2020, France is one of the countries whose public finances are most vulnerable to a rise in interest rates and high government spending remains an obstacle to fiscal sustainability.

**Should Macron be re-elected, we would expect him to make another push to conclude delayed reforms** of the unemployment insurance and pension systems that could help ease the burden on public spending. Europe’s green transition will also be high on the agenda, with further increases in the domestic carbon tax (that was frozen at EUR44.6/tonne CO<sub>2</sub> in 2018) likely (read more in *Research Euro Area: Europe’s green transition - the heat is on for euro inflation*, 16 September 2021). However, fostering public acceptance and social equity will be key to realize these reforms, as the *gilets jaunes* protests also showed.

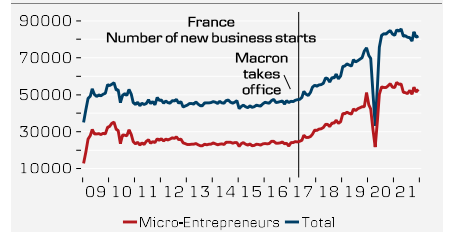
**Should Pécresse instead make the race, we would expect France to maintain a pro-European and pro-business stance under her presidency.** On the economy, she is likely to adopt a more conservative approach on fiscal policy and has been critical of Macron’s big spending packages during the COVID-19 pandemic. Her pledges to cut 200,000 government jobs, reduce the budget deficit, increase the statutory retirement age to 65 and cut taxes could help alleviate some fiscal sustainability concerns in the market. However, whether she would also be able to implement her measures in practice, will to a large extent depend on how many votes her party receives in the parliamentary elections in June.

### Labour market recovery remains one of the bright spots



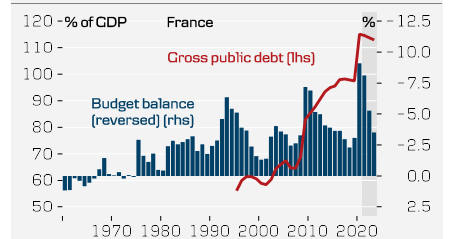
Source: Eurostat, EU Commission, Macrobond Financial, Danske Bank

### French entrepreneurship is thriving



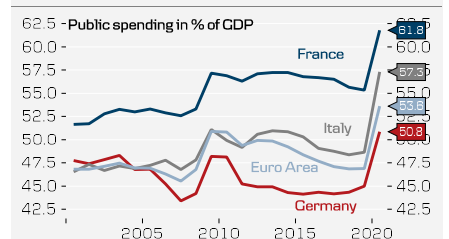
Source: Insee, Macrobond Financial, Danske Bank

### Public debt remains high amid ongoing budget deficits



Source: Macrobond Financial, EU Commission, Danske Bank

### France's public spending is still high compared to the euro area average



Source: Macrobond Financial, Danske Bank

## Fixed income: scope for higher election risk premium to be priced

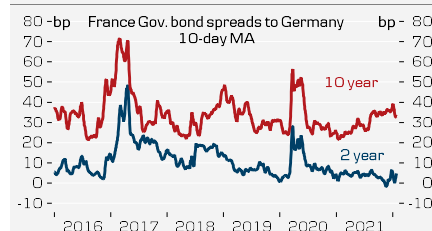
**Should Macron or Pécresse emerge as President, we expect to see a positive market reaction.** France is currently rated AA/Aa2 with a stable outlook by S&P, Fitch and Moody's, but growth-enhancing reforms and government spending cuts could eventually trigger an improvement in the credit rating outlook to 'positive' in our view. On the other hand, a Le Pen or Zemmour presidency would with high probability result in a 'cohabitation' government. The resulting political gridlock could weigh on financial markets and potentially weaken the growth outlook, making a downgrade in France's sovereign credit rating a clear risk.

While there has been a modest widening of the spread in the long end of the French curve (+10Y) versus Bunds, spreads to swaps have remained stable and the bid-to-cover has remained strong in the latest French bond auctions. Despite persistent budget deficits and high debt, France is benefitting from a very liquid government bond market, with a solid foreign investor base (close to 50%), as well as a solid yield pick-up to core-EU countries. **However, given the risk of some political uncertainty and very little priced in in terms of an election risk premium, we see value in being short France versus core EU or Denmark.** We recommended buying the 3Y-7Y segment in Denmark versus France as a top trade for 2022 partly due to the election risk, but also on the unchanged supply outlook for French government bonds, combined with a reduction in QE. An alternative would be to buy Italy and Germany versus France. Read more in *Danske Bank's EUR and Scandi Fixed Income Top Trades 2022*, 7 December 2021.

## FX: fiscal rules reform key to watch

**Going into the French election, EUR/USD will focus on two key issues in our view: (1) will there be a renewed push towards EU-scepticism? and/or (2) what is the potential for large-scale fiscal easing in the EU?** At present, there is no premium in the EUR with regard to the risk of an EU-exit and we do not expect one to be built. Instead, focus will turn to EU-wide policies. We expect a continuation of the current push towards reform of the Stability and Growth Pact as outlined above. While this type of fiscal easing is currently meeting more pushback, it is also a notable upside risk to the common currency in 2022 and hence a key issue to be followed via the French elections. Our base case for EUR/USD remains that we will see a weaker EUR, targeting 1.08 in 12M.

Spreads have narrowed compared to 2017: scope for higher election risk premium to be priced in



Note: Past performance is not a reliable indicator of current or future results.

Source: Macrobond Financial, Danske Bank

### Overview of the main presidential candidates

Candidate	Political party	Campaign pledges
Valérie Pécresse	Les Républicains	<ul style="list-style-type: none"> <li>President of the Regional Council of Île-de-France and former government spokesperson as well as budget and higher education minister under president Sarkozy</li> <li>Seen as a moderate conservative</li> <li>Increasing benefits for households with two or more children and to boost tax relief for homecare jobs</li> <li>Supports carbon tax for imports outside the EU</li> <li>10% wage increase for low-income individuals, by lowering social contributions for the middle and working class</li> <li>Increase retirement age to 65 and return to a 39h working week</li> <li>Eliminate 200,000 civil servant positions and create 50,000 jobs in the field of safety, health and education</li> <li>Supports EU Commission plans to phase out internal combustion engine vehicles by 2035</li> <li>Aims to construct six nuclear EPR reactors and welcome wind turbine</li> </ul>
Marine Le Pen	Rassemblement national	<ul style="list-style-type: none"> <li>Far-right leader focusing on immigration and security</li> <li>Defeated by Macron in the second round of the 2017 presidential election</li> <li>Has given up on the idea of taking France out of the EU, Schengen or euro area</li> <li>Promises free trains for students and young workers outside rush hour</li> <li>Pro-nuclear and aims to build new EPR reactors</li> <li>Lower retirement age to 60</li> <li>Abolish income tax for individuals under 30</li> <li>Nationalize highways and privatize public broadcasting sector</li> </ul>

Source: Candidate election programmes, Danske Bank

### Overview of the main presidential candidates

Candidate	Political party	Campaign pledges
Éric Zemmour	Reconquête	<ul style="list-style-type: none"> <li>• Far-right pundit</li> <li>• Has been convicted for inciting hatred twice</li> <li>• Bring immigration to zero and to pull France out of NATO</li> <li>• Cut taxes for the working class and businesses and abolishing inheritance tax on family businesses</li> </ul>
Jean-Luc Mélenchon	La France Insoumise	<ul style="list-style-type: none"> <li>• Far-left (Socialist republican)</li> <li>• Ran for president in 2012 and in 2017</li> <li>• Former member of the European Parliament and minister delegate of vocational education</li> <li>• 100% income tax on earnings above 360,000 EUR and full state reimbursement for health care costs</li> <li>• Member of the National Assembly</li> <li>• Critic of the EU and opponent of NATO</li> </ul>
Yannick Jadot	Europe Écologie Les Verts	<ul style="list-style-type: none"> <li>• Moderate left environmentalist and member of the European Parliament</li> <li>• Former director of Greenpeace France</li> <li>• End to the use of pesticides and industrial livestock farming and invest in education and public services</li> <li>• Proponent of carbon taxation and universal basic income</li> <li>• Lower VAT rate for products with lower environmental impact</li> </ul>
Anne Hidalgo	Parti Socialiste	<ul style="list-style-type: none"> <li>• Currently serving her second term as mayor of Paris</li> <li>• Improve salaries for teachers</li> <li>• As mayor of Paris she introduced the scheme "Paris breathing", which includes car-free zones on the first Sunday each month</li> <li>• Supports lower fuel taxes to ease burden of green transition for low-income citizens</li> </ul>

Source: Candidate election programmes, Danske Bank

### What will happen after the presidential election...?

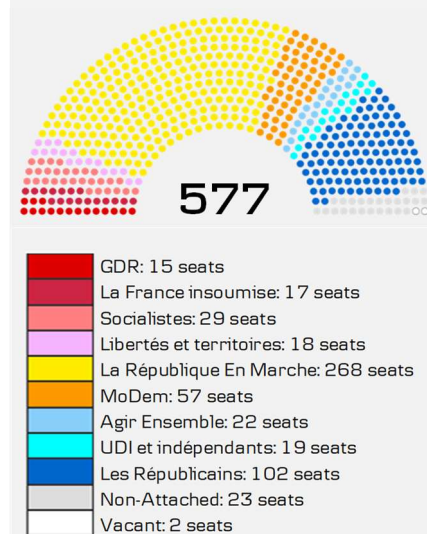
Ten days after the new President is elected, he or she will be inaugurated. On 12 and 19 June 2022, two rounds of parliamentary (legislative) elections will be held to elect the Deputies for the National Assembly. The National Assembly consists of 577 members and is elected every five years by a similar two-round voting system to the presidential election. Should Macron or Pécresse be able to win the presidency, it is most likely that their respective parties would also constitute a parliamentary majority, allowing the President to start implementing campaign pledges.

On the other hand, should Le Pen or Zemmour win the presidency, there will be a high degree of policy uncertainty, as both candidates' parties currently seem unlikely to win a working majority in parliament. In this case, the President and the majority of deputies – and thereby the prime minister who is usually chosen from the majority party – will come from different political parties. The result would be a weak and fractured government, with opposing legislature and executive and the risk of political gridlock ('cohabitation').

### ...and what powers does the future President have?

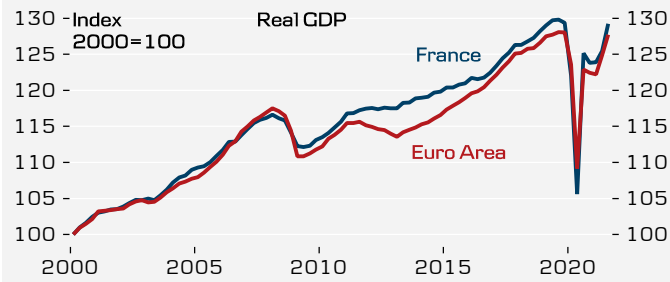
The President is the official head of state and the armed forces, leading negotiations with foreign heads of state and signing treaties. He also has the power to dissolve parliament, nominate the prime minister and the council of ministers and can call referenda on law changes. While in office, the President enjoys immunity from prosecution. Although the parliament has little control over the President's powers as such, it can theoretically repeal him from office, if he is deemed to be failing in his duties. The President can serve a maximum of two consecutive five-year terms. Usually, President and prime minister share the powers of the executive, since they will most likely come from the same political party. If there is 'cohabitation', the balance of power shifts in favour of the prime minister, since he is considered to command a higher degree of democratic legitimacy in this case, as parliamentary elections take place after presidential elections.

### Macron relies on large parliamentary majority



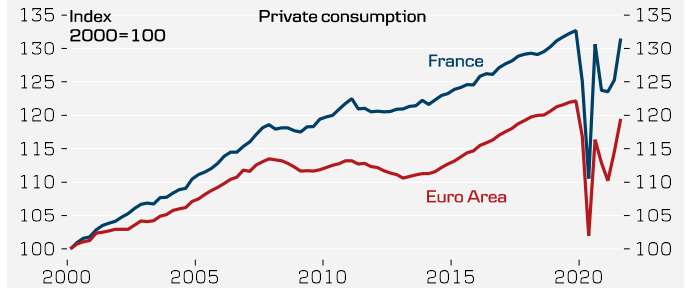
Note: Government constitutes La République En Marche (LREM), with support from Democratic Movement (MoDem) and Agir (AE)  
Source: National Assembly

**French GDP has outperformed euro area average...**



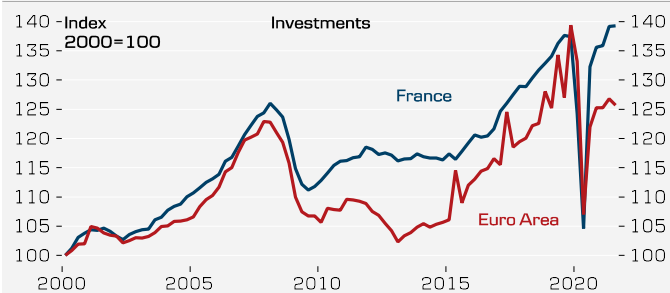
Source: Eurostat, Macrobond, Financial, Danske Bank

**...but economy remains reliant on domestic demand**



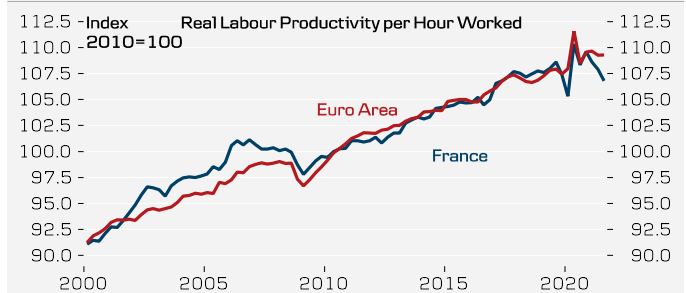
Source: Eurostat, Macrobond, Financial, Danske Bank

**Investments have recovered strongly from the pandemic...**



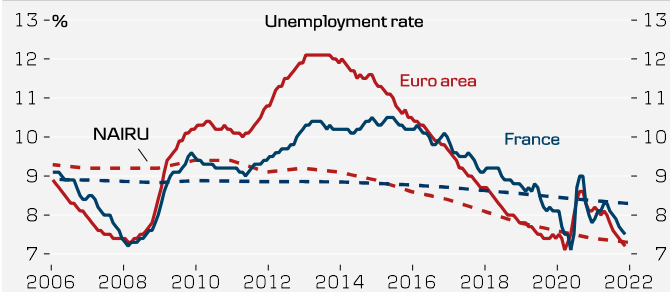
Source: Eurostat, Macrobond, Financial, Danske Bank

**...but French labour productivity has fallen behind**



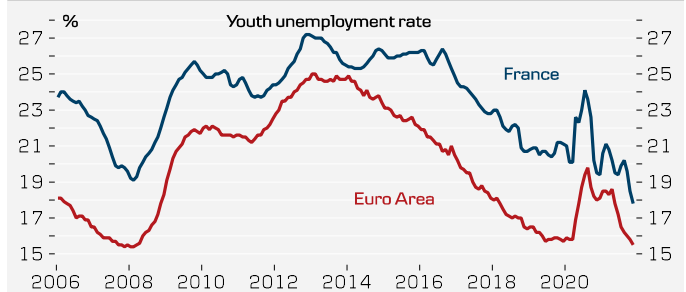
Source: Eurostat, Macrobond, Financial, Danske Bank

**Unemployment rate has fallen below NAIRU...**



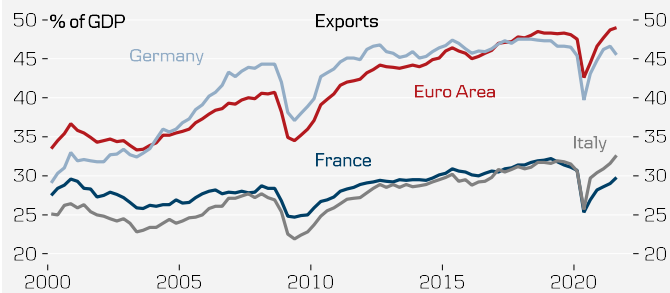
Source: Eurostat, EU Commission, Macrobond, Financial, Danske Bank

**... as youth unemployment has declined**



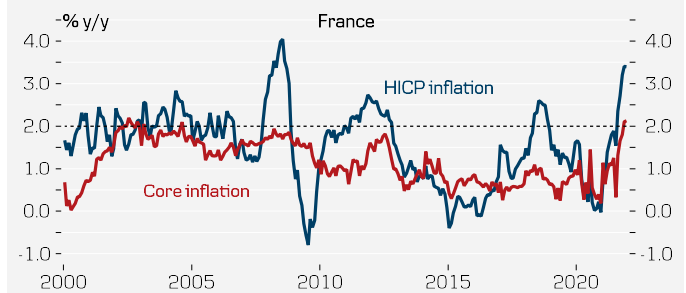
Source: Eurostat, Macrobond, Financial, Danske Bank

**Competitiveness remains a concern amid low export share**



Source: Eurostat, Macrobond, Financial, Danske Bank

**Inflation pressures have accelerated**



Source: Eurostat, Macrobond, Financial, Danske Bank

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