

MARKET COMMENTARY

French elections – House of cards?

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- The second round of the French election delivered a surprise, with the RN ending up as the third group (but the first party) in Parliament. The tactical dropouts have benefited the left bloc (NFP) and President Macron's Ensemble.
- Three large blocs are now dominating the Parliament: the left, centre and extreme right. This makes it unstable, and difficult for a majority to emerge.
- We see two main scenarios. 1/ A centre-left majority may emerge, with a full or relative majority, depending on developments within LFI. 2/ A technical government, anchored at the centre. Below we discuss potential variations, and implications. The President has asked G. Attal to stay in "for now". We suspect Parliament may topple this caretaker government around 20 July, although the opening of the Olympic Games on 26 July may extend its lifeline.
- The extreme left and right have been tamed, but the electoral results do not support political stability nor a promising reform agenda. Hence the small relief rally seen through the second round may not see much follow-through.

The second round of the French election delivered a surprise, with the National Rally winning "just" 143 seats. RN is the third largest group in Parliament (but the biggest party), despite winning most votes in the first round. The arrangements to withdraw candidates, between the NFP (Left) and the incumbent majority Ensemble (Macron's Renaissance+Modem+Horizon), thus proved very effective. The NFP won 182 seats, and Ensemble 168 – the latter being much more than anything that could be hoped for after the first round. In other words, Parliament is now dominated by three big blocs, left, centre and extreme right. This makes it relatively unstable, and difficult for a majority to emerge. President Macron is expected to seek an alliance with the left.

For now, he is waiting for the NFP to discuss and decide who they would like him to call as Prime Minister. LFI (78 seats, largest party within NFP group) sounds uncompromising (manifesto must be applied in full), whilst the Socialists, Communists and Green (respectively 69, 9 and 28) recognise the lack of an absolute majority, hinting towards responsible behaviour within a coalition.

We see two main scenarios.

- **A centre-left majority may emerge**, with a full or relative majority, depending on developments within LFI (itself at risk of an internal crisis, as some members, like Ruffin, reject the uncompromising approach of Mélenchon). In other words, the NFP would implode. After all, it was an electoral, calculated alliance, not a "love marriage" as Glucksmann, a key socialist figure, put it. It would be a risky bet, however, for the non-radical part of NFP to split from LFI already, with potentially poor repercussion on the next elections (2027 or before).

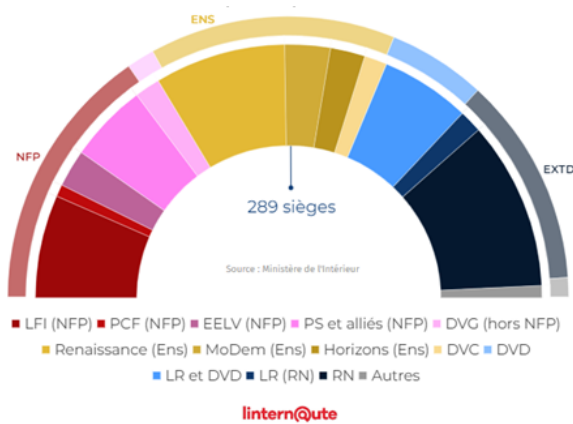
- **A technical government, anchored at the centre.** Such government would not necessarily be backed by a stable majority, but would try to gather opportunistic, and potentially varying, majorities in parliament for each law proposal.

Variations are possible. With the third chart below, we look at numerical combinations, though of course those represent purely hypothetical coalitions. Typically, selected leaders from Les Républicains have made clear they would not enter a coalition. Macron's Renaissance, let alone the other parties of Ensemble (Modem and Horizon), have said before that they would not run with LFI. Other options such a minority NFP government hardly looks possible as it would likely be quickly "censored" by parliament (blocking majority against its platform).

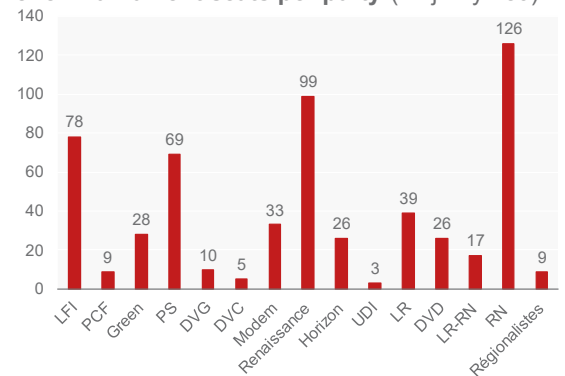
The next parliamentary session opens on 18 July and will close on 1 August. In the meantime, President Macron has just rejected PM's Attal resignation and asked him to run the government "for now", until a new PM gets called up. Presumably, the new Parliament would topple that caretaker government on 20 July, or shortly after, although the opening of the Olympic Games on 26 July may extend its lifeline. An extraordinary parliamentary session might need to be called up this summer. The next ordinary session will run from October to June. Much time will initially be dedicated to the 2025 budget, that the new government will have presumably prepared in August-September.

The market reaction has been mixed, given the prevailing uncertainty. The 10-year OAT-Bund spread is marginally tighter, at 65bp. French and European equities are opening the week positively (around +0.5% late morning). The euro opened slightly lower but has now recovered those losses (EUR/USD at 1.0840). A split parliament was our most likely scenario. This version may be slightly less toxic than initially feared, as the centrist bloc has much benefitted from the dropouts in the second round. This raises **hope that a "responsible" budget will be voted in the autumn**, under the close watch of the European Commission.

That said, any coalition that may emerge will prove fragile. Also, NFP and RN, which both called for an unwinding of the pension reform, are in position to make it happen, should they dare to; this would be a poor signal to the market. The electoral results reflect rather unnatural alliances, 1/ within the left bloc NFP – given the large differences of policy views – and 2/ ahead of the second round. This will make it harder to form a coalition. Even within Ensemble, the right wing (Horizon) may refuse the tax hikes that would inevitably emerge from a centre-left coalition. Even allies of E. Macron (e.g. G. Attal and E. Philippe, much looking to the 2027 presidential election) have started to distance themselves from the President. As such, the small relief rally seen through the second round (as it became clear that RN would fall short of a majority) may not see much follow-through at all. **The extreme left and right have been tamed, but the electoral results do not support political stability nor a promising reform agenda.**

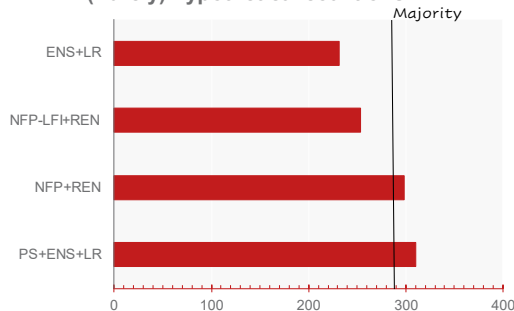


French Parliament seats per party (majority 289)



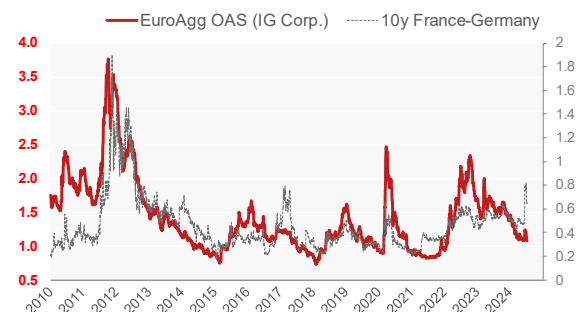
Source: Ministère de l'Intérieur, Le Figaro

(Purely) hypothetical coalitions



Source: GenAM

IG Corp. vs. OAT spreads



Source: Bloomberg, GenAM

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