

French elections: Wait until summer

Watch risks of further political fragmentation, introducing new obstacles to policy making



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Key points

- Despite increased political fragmentation, polls suggest France is likely to re-elect President Emmanuel Macron for another term. Turnout and live TV debate in between the two rounds will be key.
- Uncertainty runs high for the subsequent parliamentary elections in June. While an opposition led parliament is unlikely, ad-hoc political compromise may be needed, complicating policy making.
- Concerns over purchasing power are rising and are likely to get worse before they improve, even with candidates' proposals. The campaign has missed an opportunity to question the overall role of State.
- Current polls suggest the most likely scenario is unlikely to rock markets and France's growth is likely to outperform Eurozone peers. Despite ECB monetary policy normalisation, reinvestments should continue to provide support to French bond market.

The French presidential election takes place on 10 April (first round) and 24 April (second round). The campaign has been hijacked by the Ukraine conflict and President Macron has initially benefitted from a “rally around the flag” effect. More recently however, polls have tightened, including for the second round. Still, the overall message from the polls continues to be that Emmanuel Macron should win a second term, but the level of certainty has decreased.

In this piece, beyond taking a look at the overall French political landscape – including the less discussed parliamentary elections which will follow the presidential race - as painted by the polls, we also discuss some of the most pressing issues for the short and medium-term future for France.

No representative from the traditional centre-right “The Republicans” (LR), or centre left Socialist Party (PS) made it to the second round in 2017. This marked another crucial pivot away from mainstream parties in French politics.¹ The latest polls ahead of the first round of the 2022 presidential election suggest these traditional parties have not been able to regain momentum at a national level and that the fragmentation of the French political landscape is getting more acute. It now takes *five* candidates to gather 83% of voting intentions, compared with the first *four* candidates gathering 85% of votes in the first round of the 2017 election. In addition, extreme political parties have gained momentum, gathering

¹ after the elimination of socialist party in 2002

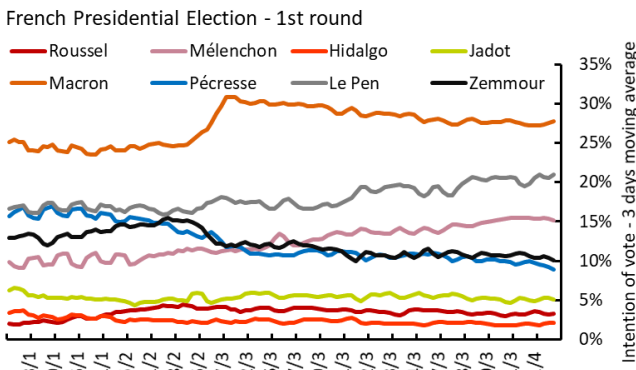
over 50% of voting intentions (+6ppt from 2017). Their proposals are less radical than 5 years ago (none are proposing a formal exit from the European Union (EU) anymore) but the French political scene has become even less predictable, with deep ramifications for policymaking beyond the presidential elections themselves.

Polls suggest Presidential status quo

Since 2017, President Macron has been performing well in polls and has consistently looked likely to qualify for 2022's second round with a healthy margin. Moreover, polls see him winning in almost every combination of other candidates polled across time – only briefly challenged by Valérie Pécresse in the wake of her designation as LR's candidate last December.

Despite his momentum ebbing recently, Macron has initially benefitted in the polls from the Ukraine crisis, and his subsequent decisiveness on policy making (Exhibit 1). Foreign affairs are typically a prerogative of the French president - even more so given Macron is also Head of the EU Council in H1 2022. His (not so targeted) fiscal measures to help cushion the fallout from the Ukraine war on the population's purchasing power, which has been hit by an inflation spike - a key theme for voters² - has also been welcomed. Additionally, Russia's invasion negatively impacted those candidates who had in the past expressed sympathy for Vladimir Putin, such as far-right politician Eric Zemmour.³

Exhibit 1: President Macron is still dominating polls



Source: Opinion Way, Kéa, Ipsos-Sopra Stéria, Ifop-Fiducial, Harris Interactive, Cluster17, BVA, Kantar, Elabe and AXA IM Research, as of April 2022

While polls suggest that this year's race will be a potential re-run of 2017, the second round appears much tighter. National Rally leader, Marine Le Pen has managed to regain some poll momentum in March, improving her chances to make it into the second round for a second consecutive time - also consistent with polls since 2017. Far-left la France Insoumise's Jean-Luc Mélenchon has benefitted from improved support in the past few weeks but remains at some distance from Le Pen. Although unlikely, his qualification for the second round cannot be entirely ruled out. Second round

² CEVIPOF poll, 28 March

³ BFM TV, 30 March

polls suggest the race between Macron and Le Pen is likely to be significantly closer than expected, with the polling difference now under 5 percentage points (ppt) by contrast to the c.16ppt gap in 2017.

In 2017, there was a decent probability no mainstream candidate would make it to the second round. Bear in mind that just 1.6m votes separated Macron and Mélenchon between the first and fourth place respectively in the first round in 2017, out of total of more than 36m cast votes. This looks less likely this time. This is mainly due to the fragmentation of the radical vote: communist and green party candidates are competing with Mélenchon on the left, while Zemmour is splitting the usual support for Le Pen on the far right.

Moreover, this is not a relative race - the election's winning candidate wins by the majority of votes cast. For a given participation rate, there is a mechanical threshold number of votes the winner needs to receive, the lower the participation, the lower the threshold. Participation dropped sizeably in 2017, especially in the second round to just 66.0%, the lowest since the beginning of the century (2017's first round was 75.8%, and circa 76% on average since 2002) but Exhibit 2 illustrates that it would need to drop by more than around 10ppt lower for Le Pen to have a chance of winning in the second round, given the historical number of votes her party has gained in the past 20 years. Of course, these calculations cannot take into account any additional displacement of voters towards Marine Le Pen. They merely reflect that it would take a very large displacement to win, even with relatively low turnout.

Exhibit 2: Actual vote is key

Participation scenario in %	70.9	66.0	60.0	55.0	50.0
Votes for Marine Le Pen* for given participation rate scenario	15,184,043	13,993,065	12,542,004	11,326,939	10,111,874
Difference to best score in 2017's second round	-4,545,568	-3,354,590	-1,903,529	-688,464	526,601

NB: At 50% election turnout in the second round, the bar for Le Pen to win the election will be lower and in fact she could win if she succeeds to gather more or less the same amount of votes than in 2017
Other assumption: unchanged number of blank and invalid votes from 2017
Participation: 70.9% is the average between two rounds in 2017 (75.8% and 66% respectively)
* assuming she gets 49.9% of vote casts

Historical votes for Le Pen/RN (mn)	
- 2019 EU**	7,830,487
- 2017 (ii)	10,638,475
- 2017 (i)	7,678,491
- 2014 EU**	8,200,713
- 2012 (i)	6,421,426
- 2002 (ii)	5,525,034
- 2002 (i)	4,804,772

(i) and (ii) refers to first and second rounds respectively, ** adjusted from lower turnout
Source: Interior Ministry and AXA IM Research, April 2022.

There are three factors to watch out for after the first round.

Firstly turnout. Turnout generates a bias not well accounted for in the polls which could be a source of surprise – as was the case in the last regional elections. A resurgence of COVID-19 cases and lower than usual interest in the election⁴ could deliver

⁴ CEVIPOF poll, 28 March

a lower than usual turnout (this may also be the case for the parliamentary elections, see below).

The second major factor will be the televised debate set for 20 April – this was widely believed to be a key moment in deciding 2017’s final outcome. Ahead of the first round, 37% of the population say they have not definitely made up their mind⁵.

The third factor is voting instructions, from candidates/parties not represented in the second round. In 2002, the so-called “Republican Front” - unity across the traditional political families to avoid an extreme candidate getting into power – worked very well. Going hand-in-hand with the reduced popularity of the traditional parties, fragmentation of the political landscape, this Republican Front has lost momentum over the last 15 years.

The most likely scenario according to current polls remains that Macron is likely to be re-elected for a second term. However, what looks likely to be more important are the subsequent parliamentary elections in June. On this issue, there is significant uncertainty. Meanwhile, the nomination of a Prime Minister and formation of a first government after the presidential election will be interesting to monitor (Exhibit 3).

Exhibit 3: Timeline of key events

Date	Event
10-Apr	First round of Presidential election
11-Apr	Voting calls for second round of Presidential election
20-Apr	TV debate
24-Apr	Second round of Presidential election
Before 13 May 2022	Transfer of power to new president and appointment of new PM
12-Jun	First round of Parliamentary election
19-Jun	Second round of Parliamentary election
July	First session of New Parliament
End-Sept	Presentation of 2023 budget

Source: Interior Ministry, media and AXA IM Research, April 2022

Parliamentary elections – a possible hurdle to governing

Although French Presidents have much more power than most of their European peers (e.g. in Germany and Italy), a majority of the lower house controlled by an opposing party to the elected President (dubbed ‘cohabitation’), would significantly limit the exercise of Presidential power beyond the role’s usual prerogatives: defence/foreign affairs, signing emergency decrees, and organising referendums, and snap parliamentary general elections.

Predictions are made more complicated by the fact there is a lack of a valid historical precedents for a re-elected president. All re-elected French Presidents in the Fifth Republic experienced ‘cohabitation’ i.e. lost a parliamentary majority at the following general election (1986/1993) including in 1997, when President Jacques Chirac called snap parliamentary elections two years after being re-elected, which his party lost. However, since

the synchronisation of the presidential and parliament electoral cycle and the constitutional revision in 2000 which reduced the Presidential term to five years, a president has never been re-elected.

In the past 20 years, newly elected presidents have always benefitted from a positive momentum at the parliamentary elections, giving them a majority in the lower house. However, the increased fragmentation of the French political landscape has made parliamentary elections particularly uncertain. La République En Marche! and junior coalition partner centrist party (Modem) have had difficulties establishing themselves at local levels in the past five years, while parliamentary elections typically reflect at least partly local and party dynamics. It is improbable that Zemmour’s Reconquête party would strike an alliance with Le Pen’s, which in turn has never managed to reflect her large national score in presidential elections into large parliamentary representation. Despite performing well at the last regional elections, a further slide in votes cast (from 2017, as currently suggested by current polls) for the traditional parties (LR and PS) also appears unlikely to be reversed. Equally, at the current juncture, we cannot rule out that these parties could suffer further departures after the presidential election, which may also help La République En Marche! and Modem.

However, the electoral system does not help predictability. Members of Parliament (MPs) are elected with a two round majority voting system which means candidates must receive at least 12.5% of enlisted voters to get themselves into the second round. This means that three or more candidates can participate in the second round. In turn, this makes last minute alliances at the local level key to the final election outcome - de facto almost impossible to predict – all the more so as turnout in parliamentary elections tends to be lower than for the presidential elections.

While political fragmentation makes full-on “cohabitation” unlikely, we think there is a non-negligible chance for the newly elected President not to have an absolute majority in Parliament, thus requiring him to seek compromise on selected laws and reforms. While most ‘ordinary’ laws require a simple majority, important bills (such as budget) or material reforms may prove more difficult to pass –making MPs voting presence/abstention critical.

There is the possibility of a more complicated governing triangle. France’s Fifth Republic system can be simplified as the relationships between the three ‘Ps’ - namely president, parliament and the population. Over the past five years, the contention has mainly been dual: the President’s plans have at times been resisted by some significant segments of the population (e.g. the yellow vest movement and with pension reform). In the event of a split Parliament, it could mean protracted, less forceful legislative proposals and reforms.

⁵ CEVIPOF poll, 28 March

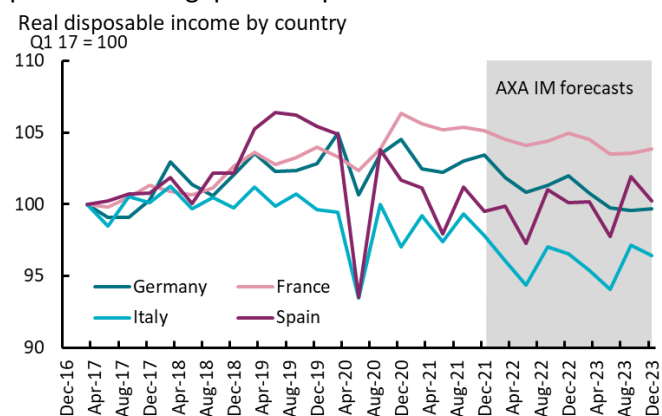
Beyond the political conjectures - uncertain for now - we consider three important themes for the country in the short and medium term.

Purchasing power is at the heart of the concerns

The surge in energy prices has brought households' purchasing power to the forefront of the political agenda (CEVIPOF⁶). Retrospectively, Macron's policies have been supportive of purchasing power. Real disposable income has risen by approximately 0.9% each year under this tenure.⁷ By comparison, it was broadly stable during François Hollande's term (+0.1% per year) or Nicolas Sarkozy's (+0.2%) but higher under the Chirac presidency (1995-2017) (+1.8% per year). These gains are linked to both primary income (from labour and wealth) but also to changes in the socio-fiscal system.

Within Macron's term we can distinguish two sub-periods. Before the COVID-19 crisis, real disposable income rose by approximately 1.5% year-on-year on average. It was slightly less than in Germany or Spain (respectively at 1.6% and 2.4%) but it changed drastically since the beginning of the pandemic. After the COVID shock, the government deployed massive fiscal support and inflation was low so real disposable income was still improving in France (1.2% per year) while it fell in Spain (-2.8%), in Italy (-1.2%) and was flat in Germany (Exhibit 4).

Exhibit 4: Real disposable income diverged during the pandemic and gap should persist



Despite material policy intervention, French household's purchasing power is likely to decline in the coming quarters, though less so than for European peers. We recently revised up our inflation forecasts to 3.9% on average for this year and 2.6% for 2023. It could have been higher, but the government has deployed several measures to cushion the blow, from energy vouchers, a freeze on electricity and gas

⁶ CEVIPOF poll, 28 March

⁷ "Une analyse macro et microéconomique du pouvoir d'achat des ménages en France" - OFCE, March 2022 (French only)

⁸ For example, electricity consumer price rise has been capped to 4% while spot market rose by approx. 300%yoy in average since Sep 2021. Electrical

prices and rebate on oil prices at the pump. Energy price normalisation is still some way off as the cost of the shock will be smoothed over several years especially for gas and electricity⁸. But structural changes such as the substitution of Russian imports and the acceleration of the energy transition will also inevitably put more pressure on inflation and thus households' spending power.

On the income side, wage growth has remained muted so far (0.6% on a quarterly basis in the fourth quarter from 0.5% on average between 2017 and 2019) – and is unlikely to increase enough to compensate for the inflation squeeze this year. In 2023, higher demand for compensation and a robust labour market could boost wages further but there is very little chance that real disposable incomes will increase significantly.

Purchasing power has been central in the candidates' manifestos. Macron's proposals were mostly focused on pursuing better reconciliation between work and pay. He intends to raise the 'purchasing power premia'⁹ up to €3,000 from €1,000 and develop profit-sharing bonuses. Another symbolic measure would be the abolition of the TV licence tax (€138 per year). Le Pen and Mélenchon's proposals are more ambitious, but it is difficult to understand how they would be financed. Le Pen proposes to abolish employer charges for wages below three times the minimum wage and reduce value added taxes (VAT) from 20% to 5.5% on fuels, electricity and gas and remove income tax for those below 30 years. On the other side of the political spectrum, Mélenchon proposes to adjust income taxes more progressively, to do more to boost middle income real purchasing power, reduce VAT on basic products and compensate for it with higher VAT on luxury goods, and offer full coverage of the education cost.

Public finances: Questioning the role of state

France's public deficit settled at 6.5% of GDP in 2021 according to Institut National de la Statistique et des Etudes Economiques (INSEE), much lower than projected in the 2022 budget bill (8.4%). It was consistent with an early fall of public debt to 112.9% of GDP from 114.6% in 2020 underpinned by the large rebound in nominal GDP (7.9%).

Large economic shocks (COVID-19 and the energy price spike) and high social tension in the context of currently suspended EU fiscal rules likely explain Macron's campaign not focusing on lowering the public deficit below 3%, in contrast with his 2017 campaign. In light of the Ukraine conflict, we think it is a reasonable baseline to expect the general Stability and Growth Pact (SGP) escape clause – the removal of deficit limits to encourage EU nations to raise public spending to support the

producers should gradually recover losses through stable higher consumer prices once spot market will decline and/or gradual increase if spot market is unchanged.

⁹ Premia is discretionary and paid by companies to employees earning less than 3.5 times the minimum wage and is completely exempted from taxes.

economy – to be maintained next year, giving another year for EU leaders to agree on amended fiscal rules. From this perspective, the “at all cost” fiscal consolidation planned by The Republicans' Pécresse seems unnecessary.

The proposed pension reforms attracted significant and (un)popular¹⁰ media attention, but the new five-year term (and little pressure to consolidate public finances in the short-term either from fiscal rules or interest rate perspectives) presents a great opportunity to debate the strategic role of the State – something absent so far in the campaign.

In a recent note by the ThinkTank reporting to the Prime Minister (PM) (Conseil d'Analyse Economique), the authors argue in favour of organising a market – involving several providers, also public (pole emploi) - to accompany mainly small and medium size companies in selecting and checking the candidates' level of competencies, adequacy for a job and/or work environment, complementing recent reforms and other active labour policies.¹¹ Besides, the issue of improving the efficiency of public spending is not a new topic to keen observers. It is a regular feature of audit office reports¹², and was also a key pillar of the CAP2022 report, published in June 2018, but again has been inaudible during the Presidential campaign. In its 15 June report, the French audit office noted that improvements can be made in health spending, employment, social resources, and housing.

Green Transition: Upshift needed

France has a large civil nuclear capacity built in the 1970s and 1980s. Nuclear power still accounts for circa 40% of primary energy consumption (versus some 5% in Germany, 10% in Spain, and nil in Italy). As a consequence, France fares relatively well when adjusting greenhouse gas (GHG) emissions to the size of its economy, where it is on average 30% lower than Germany Italy, and Spain.

Popular opinion on nuclear energy has improved too, fuelling candidates' proposals. According to a BVA poll¹³, 50% of the population considers nuclear powered electricity an asset (from 47% in 2019). In a context of high gas and electricity prices, Macron has proposed to invest in new generation nuclear plants, a shared stance with Pécresse and Le Pen, all opposing Melenchon's proposal to exit.

As a concentrated, controllable source of energy and emitting zero GHG emissions, nuclear power plant usage would support France in reducing emissions. In its most recent report¹⁴, France's High Council for Climate highlighted that France has yet to present a national strategy coherent

with the revised EU target – 55% (from -40% for the national strategy) in 2030 from 1990 levels. This comes despite acknowledged marked efforts to reduce GHG emissions in construction, energy, and industry sectors.

Outlook and risks

France was outperforming its peers when exiting the pandemic, as it was the only country with real GDP at pre-crisis levels (Q4 19) in Q3 21, helped by private consumption and investment. We think this relative GDP outperformance is likely to continue for three main reasons - its relatively closed services intense economy, lower dependence on fossil fuels and material fiscal policy mitigation cushioning high energy prices. We project French GDP to grow 2.7% this year and 1.0% next, consistent with real GDP 2.8% above Q4 19 levels in Q4 2023.

The elections pose one of the main downside risks, namely the risk to governance. If the outcome of these elections is an inability to pass meaningful reforms and an associated increase in social tensions further disrupting supply, then this may have a negative impact on activity. The second downside risk is related to further declines in purchasing power, as significant offsetting measures are unlikely to be maintained in the medium-term.

Hard to foresee a significant market reaction

The most likely scenario according to current polls is unlikely to rock markets, but a fragmented Parliament, resulting in more difficulty in passing material reforms, impeding growth performance in the long run, may make things more challenging.

As we argue above, France's growth is likely to outperform that of its peers, something that may be reflected in relative equity and bond market performance. Deep liquidity is likely to remain an advantage for the latter especially against other semi-core (i.e. Belgium).

A resilient eurozone economy, and high inflation have lifted yields, pressing a hawkish European Central Bank (ECB) to withdraw extraordinary monetary policy. We think its net asset purchases will stop at the end of the second quarter but will continue to reinvest its holdings¹⁵ from the end of June. The ECB and the Bank of France hold circa €855bn of French bonds (€545bn from PSPP and €310bn from PEPP). It represents 42% of current outstanding debt. The ECB is likely to remain a key holder and supporter of Obligations Assimilables au Trésor (OATs) for the foreseeable future having committed to reinvesting assets bought until at least end of 2024¹⁶.

¹⁰ The fifth most important theme in voting decision according to latest CEVIPOF poll.

¹¹ Note du CAE n° 71 (mars 2022) (cae-eco.fr)

¹² Audit office report on public finance sustainability, June 2021

¹³ BVA-pour-Orano-Les-Français-et-le-nucléaire-Juin-2021.pdf

¹⁴ Haut-conseil-pour-le-climat-Avis-COP26.pdf (hautconseilclimat.fr)

¹⁵ Public Sector Purchase Programme (PSPP) and Pandemic Emergency Purchase Programme (PEPP)

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