

FOCUS

France's political turmoil
Potential economic impacts

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France's political turmoil: Potential economic impacts

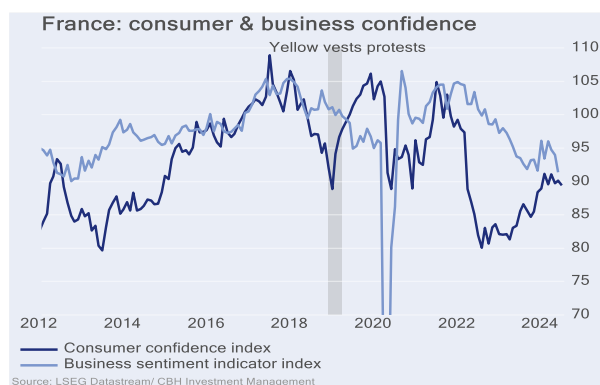
2024 was expected to be a turbulent election year with more than 80 countries voting, but everyone was surprised when President Macron dissolved parliament and called snap parliamentary elections in the aftermath of European elections.

After the 2nd round, which took place on July 7th, no party secured an absolute majority resulting in a hung parliament. The situation requires political forces to form a coalition in order to designate the future prime minister, who will be responsible for forming a new government.

Given the results, centrists will seek to form a cross-party government, but Macron rejected the option of a coalition that would include the far-left LFI (La France Insoumise).

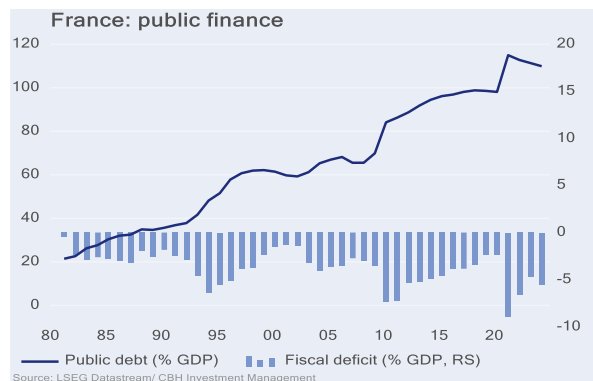
Thus, even though it is now certain that the far-right RN (Rassemblement National) will not come to power, **France will likely face months of political, fiscal and regulatory uncertainty.**

Against this backdrop **consumer and investor confidence could collapse. Economic agents will certainly postpone their decisions, especially their investments.** The situation will most probably weaken corporate investment, consumption and the housing market. However, recent history shows that economic activity can resist even with depressed consumers. The Yellow Vest episode (2018-2019) resulted in a sharp decline in consumer confidence, while retail sales and GDP showed great resilience.



Assuming the new PM is backed by the centrists, (maybe the traditional right and the moderate wing of the “Front Populaire”, **no major policy shift is expected.** However, this government will lack support and may face **difficulties in passing new legislation**, including the 2025 budget, which will require fiscal consolidation to address European Union’s concerns about the fiscal deficit and public debt.

In this context, markets, foreign and domestic investors will remain cautious. **Neither a clash with the European Union nor an excessive divergence in yields (over German Bund) is anticipated.** France still benefits from a strong institutional investor base, as evidenced by the success of its last government bond sale, which was oversubscribed 2.59 times.



Thus, we do not expect the ECB to intervene (as the BoE did following Liz Truss’s mini-budget, which triggered a debt crisis in September 2022). But France’s public finances are under pressure. Its rating was lowered by S&P from AA to AA- in May and could be challenged again, while the European Commission is considering opening an “excessive deficit procedure” against France. As a result, France’s risk premium will remain elevated.



On the FX front, the **EUR will remain under pressure** amid persistent uncertainties. Above all, the monetary policy divergence between a more dovish ECB and a relatively more neutral Fed is weighing on the single currency.

Uncertainties could slow economic growth, while the ECB’s less-restrictive monetary policy should support credit growth. Given the demographic shift, led by the retirement wave of the baby boomers, the labor market should prove resilient despite economic uncertainties, thereby supporting consumption (although the trade-off between consumption and savings remains uncertain). In this context, **downside economic risks will remain limited, and the potential impact on banks’ balance sheets will be under control. All in all, the impact on economic growth and credit risk (sovereign, corporate and household) should remain contained. However, prolonged uncertainties could weigh on potential growth in France (and the euro area as a whole), given the massive investments needed to manage the energy and digital transitions and to narrow the economic gap with the US and China.**

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