

What Macron's loss means for the economy and markets

Emmanuel Macron has lost his absolute majority in the National Assembly in the legislative elections, which will make the country much less governable and might put structural reform at risk. French bonds are reacting with a shrug, but rising yields and spreads remain a key concern



No majority, alliances needed

For the first time since 1988, the newly (r)elected French President did not win an absolute majority of seats in the National Assembly. Emmanuel Macron's supporters won only 245 deputies, below the threshold of 289 to hold an absolute majority and a far cry from the 346 seats held during the previous five-year term. The alliance of left-wing parties (NUPES) becomes the leading opposition force in the Assembly with 131 seats, provided the alliance remains in place. Its leader, Jean-Luc Mélenchon, nevertheless failed in his bid to force an alliance by gaining a majority. He will definitely not be appointed Prime Minister. On the right, Les Républicains (LR) resisted very well by taking 61 seats, which puts them in a very comfortable seat as Macron will probably turn to them to form a majority. The real winner of the elections is Marine Le Pen's Rassemblement National party, which came out on top in 89 constituencies, gaining 11 times

more elected officials than during the previous five-year period.

These results are a disaster for Macron who finds himself in great difficulty in terms of his ability to govern and implement his programme. At this stage, there are several possibilities. Either Macron manages to convince LR to form a majority, which would be more right-wing than Macron's position. This seems difficult at the moment, as LR is reluctant, but this could change in the next few days, especially depending on the allocation of certain ministries or key positions. Alternatively, Macron could try to get the support of left-wing elected representatives who refused to join the NUPES alliance, and some right-wing elected representatives in an effort to form a majority. It is possible that no majority will emerge and that each law will require intense negotiations to obtain ad hoc support. In the context of an economic slowdown (and probably even recession), high inflation and a public deficit of 6.5% of GDP in 2021, this could quickly become unmanageable.

In any event, this is a new era for French politics, which will have to learn to deal with coalitions, agreements and consensus - something that most European countries are used to, but not France.

What is certain is that a reshuffle of the current government will take place. Some ministers have failed to win in their constituencies and will therefore have to leave. This is notably the case for the Minister of Ecology, Amélie de Montchalin, and the Minister of Health, Brigitte Bourguignon. But the reshuffle could go much further in order to satisfy possible partners of a new majority.

Any reform will be difficult to implement

From an economic point of view, the National Assembly's new composition means that any reform will be very difficult to implement. Little progress can be expected on the most complicated issues, including pensions. Unless, of course, a coalition with the right-wing LR takes place. In that case, we could have more right-wing policies than Macron suggested in the presidential elections, which might be favourable in terms of fiscal consolidation.

On European integration and European affairs, these are the areas where the President has the most leeway and the least need for support from the National Assembly. Clément Beaune, the Secretary of State for European Affairs, narrowly won his seat and will therefore be able to remain in government. In the context of domestic political blockages, Macron may therefore want to devote more energy to diplomacy and Europe.

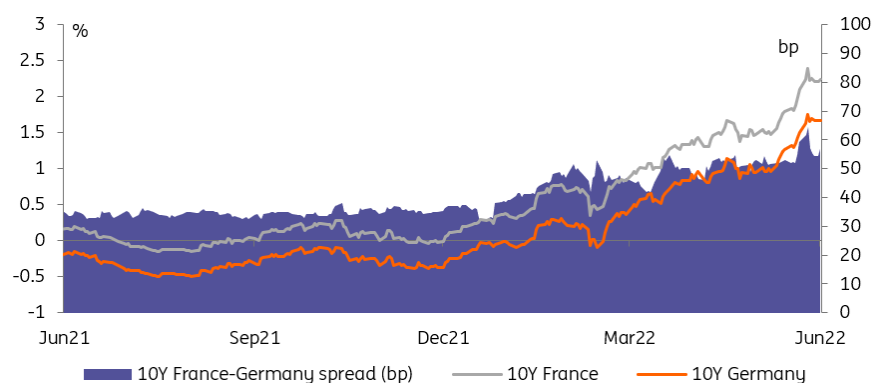
French bonds: gallic shrug

The reaction in rates markets is likely going to reflect the mixed impact of the election result on a number of policy axes: fiscal consolidation, structural reforms, and European integration. Perhaps the best reason for investors to remain sanguine is that much remains to be decided on how Macron's party will govern with the support of other party members in parliament. This may seem counterintuitive in a rising rates environment, one where fiscal and debt trajectories will receive increased attention.

Widening sovereign spreads make sense in an era of policy tightening

As we are fond of repeating, the market context matters. Widening sovereign spreads make sense in an era of policy tightening, especially as the European Central Bank is about to call time on its net sovereign bond purchases. This in turn could unnerve investors who are supposed to replace the central bank as the marginal buyer of French debt. The ECB pre-empted that debate last week by 'accelerating' work on a new financial fragmentation facility. Even though French bonds are unlikely to be a direct beneficiary, they have followed the tightening seen in peripheral spreads.

Rising yields and spreads make bond investors nervous



Source: Refinitiv, ING

At around 55bp, the spread between 10Y French and German bonds is higher than the QE-era norm (roughly 34bp average since 2015). We suspect political developments will take a back seat over the coming weeks as the new policy direction is ironed out. Instead, the (potentially acrimonious) debate over the design of new ECB instruments will continue to dictate direction. One proposal relayed by Bloomberg last week, for the ECB to sell core bonds (and so potentially French ones) as it buys peripheral ones, illustrates the risks facing French government bonds, so we are reluctant to call for further tightening just yet.

FX: Euro has other concerns

Perhaps because it is also a US public holiday today, EUR/USD has barely budged on the news that President Macron's party has failed to secure a majority in parliament. This may also be because it is too early to conclude how Macron's government will govern and which alliances can be secured on a policy-by-policy basis. Macron's loss of an overall majority and the likely struggle ahead to implement his reform agenda looks to be a mild negative for the euro.

Yet the bigger picture of stagflation in Europe has a much larger say in euro pricing. Here, the euro trade-weighted index is barely 1% off the lows of the year – even after this month's hawkish shift by the ECB. Failure of EUR/USD to gain after the hawkish ECB meeting on 9 June is a reminder that the euro is a pro-cyclical currency, and that tighter policy may damage the euro through the relative growth/equity flow channel.

We expect EUR/USD to continue trading towards the lower end of a 1.02-1.08 range this summer as the Fed pushes ahead with its aggressive tightening cycle.

Author

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.