

Elections in France: less risk of the extreme scenarios

Key messages

- Uncertainty is likely to persist until a new government is formed.
- There may be less emphasis on fiscal tightening and structural reforms, but it is unlikely that there will be significant changes in economic policy.
- France's stance on the EU is likely to remain broadly unchanged.
- We expect the OAT-bund range to be 55-70 bps in the medium term.

The results of the second round in the French legislative elections were a surprise. The hard right National Rally (RN) came third with 143 seats. The left-wing New Popular Front (NFP) coalition of Greens, centre-left Social Democrats and far-left anti-capitalists came first with 182 seats. The centrist bloc, *Ensemble*, which supports President Emmanuel Macron, came second with 168 seats. No single party or bloc secured enough votes to form a majority government, leaving three possible outcomes:

- **Rainbow coalition:** this broad coalition could include *Ensemble*, *Les Républicains* and some NFP parties such as the Socialists and the Greens.
- **Technocratic government:** an outsider could lead the newly-formed government and become Prime Minister.
- **Impasse:** a political stalemate could occur if no coalition is formed, which remains a risk.

Uncertainty is likely to persist until a new government is formed. Prime Minister Gabriel Attal has announced his resignation, and President Emmanuel Macron is expected to appoint a new prime minister soon. Gabriel Attal will remain in office until a new Prime Minister is appointed.

It is unlikely that there will be significant changes in economic policy. However, with fewer seats for the *Ensemble* party, and a stronger influence from the left-wing coalition, there may be less emphasis on fiscal tightening and structural reforms. We do not expect a reversal of previous reforms (e.g. the pension reform) or the implementation of many new reforms.

If a rainbow coalition is formed, the latter is likely to pass a budget with an agreement on limited policy measures. Large spending packages are unlikely in this scenario. The biggest risk is that no government is formed and no budget is passed. In this scenario, 2024 will be rolled over, leading to some fiscal tightening due to the lack of indexation for some items.

In either scenario (i.e. a rainbow government or a political impasse) we see a risk that the government's plans will not be in line with the European Commission's fiscal recommendations. While we expect the new government to eventually reach an agreement with the Commission, there could be some tension along the way.

France's stance on the EU is likely to remain broadly unchanged. The new government will not necessarily be as strong a supporter of EU integration as the previous *Ensemble*-led government, but it is unlikely to be an outright Eurosceptic.

The financial markets have ruled out the risk of an extreme scenario: the CAC40 opened slightly higher on Monday morning, and the 10-year OAT spread was slightly narrower (66 bps), continuing last week's tightening trend. We expect the OAT-bund range to be 55-70 bps in the medium term.

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