French presidential election
…and what it means for markets in the EU and the Nordics

Daniel Bergvall, Marius Daheim, Richard Falkenhäll, Carl Hammer, Jussi Hiljanen, Johan Javeus
Conclusions

- Le Pen is unlikely to win in the 2\textsuperscript{nd} round (May 7) regardless of which candidate she faces.
- Worries for a French euro exit are exaggerated due to both legal and popular hurdles. French public support for euro membership is very strong.
- **A Macron or Fillon win:** Markets would breathe a sigh of relief
  - Market moves should be relatively small
  - Stronger EUR and downward pressure on intra-European spreads.
  - SEK will strengthen and Swe-Ger spread will tighten slightly.
- **Le Pen win:** Market worries will intensify, even if the road to a referendum on the EU is long and full of hurdles.
  - EUR will weaken and intra-European spreads will widen.
  - SEK and NOK will weaken initially in a risk-off reaction but, soon after, safe haven flows will start to dominate, strengthening the Nordic currencies.
# Expected initial market reactions

<table>
<thead>
<tr>
<th>Euro-zone</th>
<th>Hamon</th>
<th>Base scenario: Macron / Fillon</th>
<th>Le Pen</th>
</tr>
</thead>
<tbody>
<tr>
<td>ECB</td>
<td>Apr 27 meeting: No changes to policy</td>
<td></td>
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<tr>
<td>Ger 2y</td>
<td>Unch</td>
<td>+10bps</td>
<td>-5bps</td>
</tr>
<tr>
<td>Ger 10y</td>
<td>-5bps</td>
<td>+15bps</td>
<td>-20bps</td>
</tr>
<tr>
<td>Fra 10y (Spread chg.)</td>
<td>+10bps (+15bps)</td>
<td>-15bps (-30bps)</td>
<td>+25bps (+45bps)</td>
</tr>
<tr>
<td>EUR/USD</td>
<td>-1.5 figs</td>
<td>+2.0 figs</td>
<td>-5.0 figs</td>
</tr>
</tbody>
</table>

| Sweden    | | | |
|-----------| | | |
| Riksbank  | Apr 27 meeting: Riksbank likely to reduce easing bias from 6bps to 3bps on back of higher than expected inflation and growth |
| Swe 10y (Spread chg.) | Unch (+5bps) | +10bps (-5bps) | -5bps (+15bps) |
| EUR/SEK   | Unch | -5.0 figs          | +12.0 figs  |
| NOK/SEK   | Unch | Unch               | +0.5 figs   |

Note: Spread refers to yield spreads vs. Germany.
## End 2017 FI/FX forecasts in different scenarios

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<tr>
<td>ECB policy</td>
<td>QE ext. with current pace, no rate cut</td>
<td>QE tapering in Q4, no rate cut</td>
<td>QE ext. with current pace, rate cut poss.</td>
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<tr>
<td>Ger 2y</td>
<td>-0.80%</td>
<td>-0.60%</td>
<td>-0.90%</td>
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<tr>
<td>Ger 10y</td>
<td>0.25%</td>
<td>0.75%</td>
<td>0.15%</td>
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<tr>
<td>Fra 10y (Spread level)</td>
<td>1.15% (90bps)</td>
<td>1.15% (40bps)</td>
<td>1.25% (110bps)</td>
</tr>
<tr>
<td>EUR/USD</td>
<td>1.02</td>
<td>1.03</td>
<td>0.98</td>
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<tr>
<td>Riksbank policy</td>
<td>No more QE, rate hike in Feb-18</td>
<td>No more QE, rate hike in Dec-17</td>
<td>QE ext. at least to end-17, hike in mid-18 at the earliest</td>
</tr>
<tr>
<td>Swe 10y (Spread level)</td>
<td>0.70% (45bps)</td>
<td>1.25% (50bps)</td>
<td>0.45% (30bps)</td>
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<tr>
<td>EUR/SEK</td>
<td>9.05</td>
<td>8.95</td>
<td>9.25</td>
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Note: Le Pen scenario assumes that there will be no EU/EMU referendum and that markets have to some extent calmed down by end-2017. Spread refers to yield spreads vs. Germany.
French election basics

Presidential election – April/May 2017

- **1st round (April 23).** All candidates face off. To participate a candidate needs to be a French citizen and have collected 500 signatures from elected officials
- **2nd round (May 7):** If no candidate receives >50% of votes, a second round will be on May 7 between the top 2 in the 1st round.

Parliamentary election – June 2017

- Elections to parliament (National Assembly) will be held on June 11 and 18, 2017.
- 577 MP’s are elected from single constituencies in a two-round voting system. If a candidate receives >50% and >25% of registered votes there is no second round.
- In the 2nd round, the two candidates with most votes plus any additional candidate that received >12.5% participate.
- To be able to change the direction of policy in France, Le Pen also needs strong support in parliament.
Open race who will join Le Pen in 2nd round

- **1st round**: April 23; If no candidate receives more than 50% of votes (never happened) a 2nd round will be held on May 7

- **Polls** suggest 2nd round will be between 1) Le Pen (FN) and 2) Macron (EM) OR Fillon (LS). If the left unites behind one candidate, this person has a higher probability of reaching the 2nd round than Macron or Fillon.

- **Le Pen to lose in 2nd round**. Le Pen is expected to win the 1st round (26-27% of votes) but loose the 2nd round regardless whether she stands against (Macron, Fillon or the united Left). Polls predict that the outlook for the 2nd round is 60-40 probability in favour of Macron or Fillon (gap has been closing). Most political observers also expect a left candidate to beat Le Pen. In local elections, FN 1st round winners have in most cases lost in the 2nd round, and our main scenario is that the presidential election will follow the same pattern.

- However, if Le Pen gains ground in polls, uncertainty will rise going into the election, but we expect the effect on the real economy to be minor.

- **Worries for a French euro exit are exaggerated** due to hurdles in the form of both legal rules and public opinion.
Public opinion – what are polls saying?
Race is very even between who will join Le Pen in 2nd round

- Usually a choice between the LR and PS. This time it is different as the traditional Left (PS) has been hurt by: 1) President Hollands low popularity; 2) a stance too far to left; and 3) the Conservatives’ (LR) recent financing scandals. A possible united Left has increased odds of a left candidate in 2nd round.
- 1st round favourites: Macron/Fillon & Le Pen
- 2nd round favourite: Very even between Macron & Fillon
- Poll “Who will be next president”: Macron
- Poll “Most honest candidate”: 1) Hamon, 2) Macron
- Polls show a larger share of voters abstaining in 2nd round if Fillon stands against Le Pen. Macron as a centrist candidate might have a better chance of attracting both right- and left-leaning voters

**Polls first round**

- Jan-17 to Feb-17
- Charts showing Hamon, Macron, Fillon, and Le Pen

**Polls second round**

- 60 vs 40
- 57 vs 43
- 55 vs 45

Macron (EM) vs Le Pen (FN)
Fillon (LR) vs Le Pen (FN)
Macron (EM) vs Fillon (LR)
The candidates’ policy programs

- The most important fault lines run between A) Macron/Fillon’s pro-market reform agenda and their intention to stay within the EU/EMU, and B) Le Pen’s nationalist/protectionist agenda and her intention to leave the EU/EMU.

- **Le Pen (Front National, FN):** Nationalist/populist right. Anti-EU and anti-euro, wants referendum on EU/EMU. Banque de France to print money for the Treasury, Reindustrialisation and smart protectionism (opposes free trade), cut income taxes, keep 35-h week and pensions at 60y. Exit Schengen, more police, prisons and cut immigration. Against privatisation.

- **Macron (En Marche, EM):** Former minister for economy under Hollande. Pro-European. Wants to position himself as neither left nor right, economic liberal and pro business, stimulate growth with pro-business reforms and preserve a strong social safety net. Cut government spending to 50% of GDP (from 56-57%). Limit wealth tax. Reform the labour market. Keep 35h week with exemptions possible. Lower social contributions.

- **Fillon (Les Républicains, LR):** Prime minister under Sarkozy’s presidency. Wants to reduce the public sector, cut civil service jobs, abolish wealth tax, and increase the retirement age. Offer training to jobless and more pressure to accept jobs. Warns against threat of Islamic totalitarianism and has called for dialogue with Russia.

- **Hamon (Parti Socialiste, PS):** Former Hollande minister of education. Shorter working week, tax robots and provide universal basic income.
Referendums in the 5th republic

- **Referendums**: The constitution allows that proposed laws on the organization of state powers, economic reforms and some other things can be decided by referendums. However, judicially a referendum is not enough to make France withdraw from an existing international agreement (i.e. such as the EU membership). To do that the constitution needs to be amended.

- **Article 89** of the constitution says that proposals to make such amendments must first be approved the National Assembly and the Senate. Given FN’s weak standing in parliament with only 2 MPs out of a total of 900 (a result of the 2 round electoral system) parliamentary approval to hold a referendum on EU membership is on paper very unlikely. However, a convincing election victory for Le Pen could still be enough to persuade a majority in parliament to let the people make the final decision on EU and allow a referendum.

- **de Gaulle**. To complicate matters there is an example from 1962 when president de Gaulle went directly to the people in a referendum to change the constitution without using article 89. While the legal community agreed this was an illegal move it nevertheless got the job done. Ultimately, it’s almost impossible for lawmakers to go against the will of the people.
The public opinion on EU and EMU
Still strong French EU/EMU support

- While scepticism about EU in general seems to be spreading in Europe, support for the common currency is very solid in the Eurozone countries.

- In France, support for the EU and EMU has dropped. More people are negative than positive, but positive + neutral still holds a clear majority.

- Yet, when asked for details, a rather strong view emerges that the EU benefits France and there is strong support for the euro.

- Thus, in the event of a French referendum on the EU/euro, the most likely result is that the remain camp wins.
How worried are financial markets?

- French government yield spreads to Germany at highest level since 2012 and...
- ...stock markets are again lagging Germany
- We see uncertainty/worry connected to the election as having larger financial than real economic effects

Euro zone: Fr-Ger spread at highest level since 2012 but still clearly lower than Sp or It

Equities: Starting to lag Germany, again

Source: Bloomberg
Swedish krona
Back to its status as a safe haven?

- During 2012/13 when the euro-crisis intensified, SEK was treated by the FX markets as a safe-haven currency.

- From May 2012 to Aug 2012, EUR/SEK collapsed from 9.20 to below 8.20. During this time the Swiss National Bank intervened heavily in EUR/CHF and recycled (still relatively small) amounts into SEK (sell EUR/SEK). This was a signal to the market to embrace SEK (and NOK) as safe-haven currencies.

- Riksbank halted the EUR/SEK move by cutting the repo rate twice in Sept and Dec 2012.
Swedish krona
Conditions of 2012 not present

- In 2012 Riksbank policy deviated from ECB (being more hawkish).
- Riksbank expected inflation to normalise towards 2% and SEK was projected to stay strong => the board had a higher acceptance for a strong SEK vs today.
- In 2012 correlations (intra-EZ spreads vs. EUR/SEK) indicated euro zone stress strengthened SEK. Today the pattern is not obvious (yet).
- **Swedish rates are punitive** for a long SEK position and **Riksbank still has the FX intervention mandate** likely to be used should EUR/SEK plummets fast towards 9.00.
- Hence, we would **expect a more limited decline in EUR/SEK** should Le Pen win the election (target 9.25 by Dec-17).
Norwegian krone
Thin liquidity and NB obstacles for strong NOK-performance

- During the Eurozone crisis in 2011/12 the NOK outperformed a generally weak EUR on the back of rising peripheral risks in the EZ. However, the correlation was probably lower between EUR/NOK and peripheral risks than for other currencies.

- Norges Bank didn’t react until EUR/NOK went below 7.30 with verbal interventions as the NOK had become too strong.

- The correlation with EZ peripheral risk declined after the oil price begun to fall sharply in mid-2014.

- In recent years the krone has mostly traded on domestic factors as expectations on NB monetary policy, the oil price and risks related to the Norwegian economy.

- Although NOK would appreciate on the back of general EUR weakness should Le Pen win the Presidential election, the currency will probably suffer from its liquidity handicap and the fact that NB may react on a fast appreciation.

Initial short-term reactions

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EZ peripheral risk and EUR/NOK
Appendix: The French economy (1)
Not as bad as one might think – France an average EMU country

- GDP: Growing faster than euro area average, slower than Germany. GDP/capita back at pre-crisis level.

- Indicators have recovered, France is no longer far below the regional average/lagging behind Ger/Sp/It.

- Unemployment is falling but households are still a bit hesitant

- The problems are structural: a large government sector (also in a European context), high taxes and an inflexible labour market
Appendix: The French economy (2)

French economy performing better than Euro zone average
GDP, index 100=2008 Q1

Unemployment: France is Euro area average
Per cent of labour force, SA

ULC: France in line with Germany since 2000
ULC in manufacturing, based on hours worked, index 2000=100

Falling real per capita GDP, France in line with Euro area average
PPP, EU28=100

French consumers relatively gloomy
Balance

Share of non-performing loans less of a problem compared to Italy, Spain and EMU average
Per cent of total lending
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