

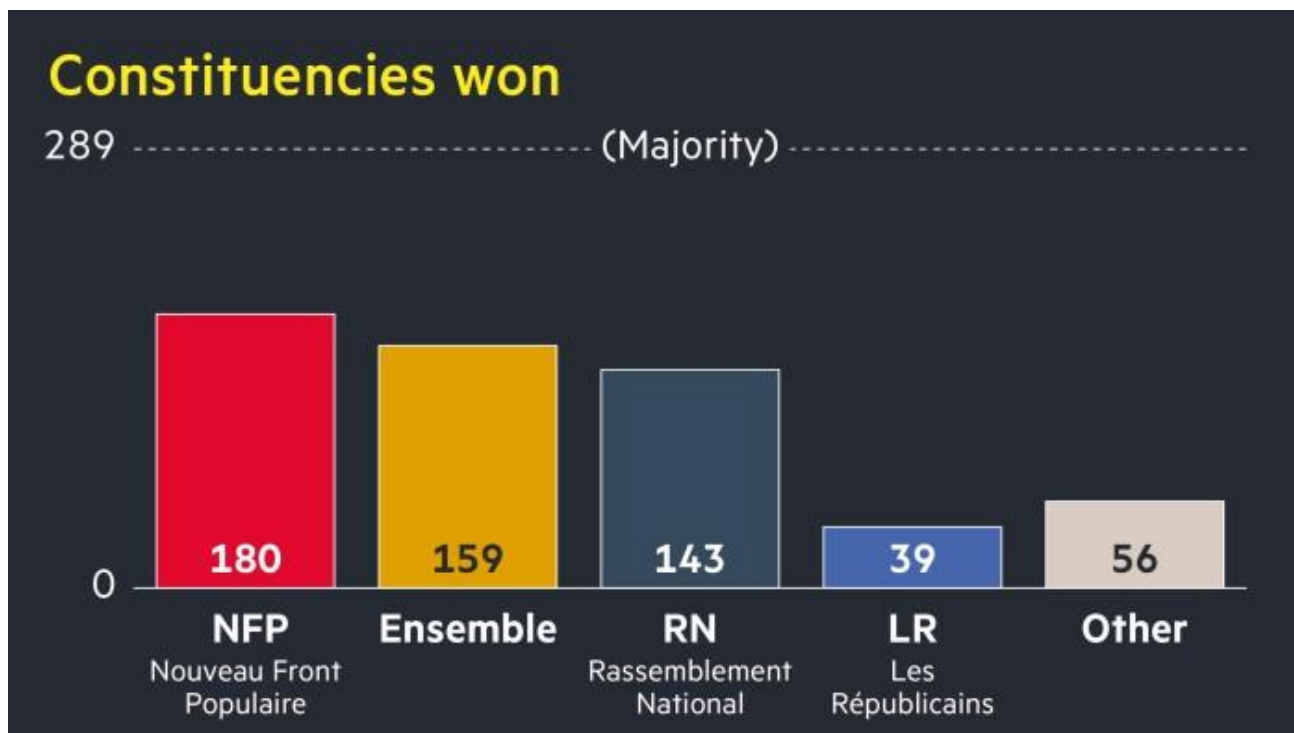
The impact of France's hung parliament

By Angelo Katsoras

President Macron's decision to hold parliamentary elections following the EU vote has backfired. His gamble that support for the far right and far left would collapse in favour of his party once the future of France was on the line did not pay off.

Although agreements between the far-left New Popular Front and Macron's coalition, Ensemble, to withdraw candidates in over 200 ridings succeeded in relegating the far-right National Rally party to third place, Macron's coalition, which is expected to lose around 86 seats, is all the more squeezed between the far right and the far left. Indeed, despite underperforming expectations, the National Rally's seat total will increase from 89 to 143 seats. As for the New Popular Front bloc, which won the most seats (180), it consists of several parties, from the far-left La France Insoumise, the Greens, and Communists to the more moderate Socialists. It is very likely that, in addition to arguing with Macron's forces, it will have to contend with significant internal disagreements among its members.

Moreover, while markets may breathe a sigh of relief that the denial of a majority to either the far right or far left reduces the risk of overspending and of seeing a spike in bond yields, Macron now faces a country mired in deadlock. This poses major challenges not only for France but also for the EU.



Source: "French leftwing parties jostle to lead new government after unexpected victory," Financial Times, July 8, 2024

How France could be impacted by a hung parliament

- While a hung parliament makes an increase in deficit-financed spending less likely, it will make it nearly impossible to pass further economic reforms or spending cuts. The president has broad authority over defence and foreign policy, but Parliament has control over budget and spending measures.
- While the far right and the far left are far apart on most issues, they do have some things in common. For example, they both support lowering the retirement age for state pensions, which Macron raised from 62 to 64. The National Rally supports bringing the retirement age back to 62, whereas the New Popular Front is in favour of giving people the right to retire at 60. **We believe the market is underpricing the risk of the two sides agreeing to make changes to the state pension system.**
- France currently ranks third in terms of most indebted country in the EU, behind Italy and Greece. Its debt-to-GDP ratio has risen to 112%, up from 86% in 2019 and 65% in 2007. The European Commission recently identified France as one of the countries violating fiscal rules on account of its high debt and deficit levels. However, unlike tiny Greece during the early 2010s, France's systemic importance prevents the EU Commission or the European Central Bank from taking tough measures.



Impact on EU

- The political and economic challenges confronting France today are similar to those facing Germany, where a deeply unpopular coalition government is struggling with the lowest economic growth in the G7. German exports are threatened both by global trade tensions and by China's increasing recourse to home-grown alternatives. **With the EU's two largest economies distracted by their internal challenges, the EU will find it much harder to advance its agenda.**
- France's political deadlock and high debt levels make it even less likely that countries like Germany and the Netherlands will agree to joint borrowing at the EU level. The EU COVID aid package is likely to remain a one-off. In fact, German Finance Minister Christian Lindner's stated recently that any move by the ECB to support French debt after the election would raise serious "legal and constitutional" questions.¹

Bottom line: Political deadlock not only threatens France's long-term growth prospects, it also means the country will be too distracted by domestic issues to provide EU leadership. This state of affairs, combined with Germany's difficulties, raises the risk of a leaderless EU at a time when it is grappling with low growth and heightened geopolitical tensions worldwide. Finally, France is the latest European example of where support for traditionally centrist parties has declined in favour of alternatives on the far right and left of the political spectrum.

¹ "French stocks and bonds sink ahead of election," The Financial Times, June 28, 2024



Subscribe to our publications: NBF.EconomicsStrategy@nbc.ca – To contact us: 514-879-2529

General

This Report was prepared by National Bank Financial, Inc. (NBF), (a Canadian investment dealer, member of CIRO), an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange.

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete and may be subject to change without notice. The information is current as of the date of this document. Neither the author nor NBF assumes any obligation to update the information or advise on further developments relating to the topics or securities discussed. The opinions expressed are based upon the author(s) analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein, and nothing in this Report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances. In all cases, investors should conduct their own investigation and analysis of such information before taking or omitting to take any action in relation to securities or markets that are analyzed in this Report. The Report alone is not intended to form the basis for an investment decision, or to replace any due diligence or analytical work required by you in making an investment decision.

This Report is for distribution only under such circumstances as may be permitted by applicable law. This Report is not directed at you if NBF or any affiliate distributing this Report is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that NBF is permitted to provide this Report to you under relevant legislation and regulations.

National Bank of Canada Financial Markets is a trade name used by National Bank Financial and National Bank of Canada Financial Inc.

Canadian Residents

NBF or its affiliates may engage in any trading strategies described herein for their own account or on a discretionary basis on behalf of certain clients and as market conditions change, may amend or change investment strategy including full and complete divestment. The trading interests of NBF and its affiliates may also be contrary to any opinions expressed in this Report.

NBF or its affiliates often act as financial advisor, agent or underwriter for certain issuers mentioned herein and may receive remuneration for its services. As well NBF and its affiliates and/or their officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. NBF and its affiliates may make a market in securities mentioned in this Report. This Report may not be independent of the proprietary interests of NBF and its affiliates.

This Report is not considered a research product under Canadian law and regulation, and consequently is not governed by Canadian rules applicable to the publication and distribution of research Reports, including relevant restrictions or disclosures required to be included in research Reports.

UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 70 St. Mary Axe, London, EC3A 8BE.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA") which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.

Copyright

This Report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of NBF.