

VIEW ON THE FRENCH ELECTIONS

Europe is currently embarking in a series of elections, which have the potential to spark further political shocks and induce financial market turmoil on the continent. Our team of Portfolio Managers in London examine the current political landscape in France and look at the likely outcome of the upcoming Presidential election, as well as the possible implications.

Executive Summary

- Macron and Le Pen remain ahead in the polls
- Le Pen's wish to abolish the Euro is not popular even amongst Front National's voters
- Fillon is very resilient despite having his reputation tarnished
- Melenchon has recently gained a lot of last minute momentum, overtaking Hamon
- Le Pen will lose in the second round if opposed to a candidate from a traditional party, it is more difficult to predict the outcome if she faces another anti-establishment candidate like Melenchon
- France leaving the European Union and/or the Euro remains at this stage a very remote possibility

The French presidential elections are taking place on the 23rd of April for the first round, followed by a second round on the 7th of May should none of the 11 candidates achieve 50% of the popular vote in the first round. For the first time in modern French history, the incumbent President, Socialist Francois Hollande, is not running for a second term because of poor approval ratings. There are five frontrunners: Far-Right Marine Le Pen, Centrist Emmanuel Macron, Centre-Right Republican Francois Fillon, Centre-Left Socialist Benoit Hamon and Far-Left Jean-Luc Melenchon. None of them are likely to secure an outright majority, therefore a run-off between the candidates coming first and second in the first round is expected on the 7th of May.

The most controversial candidate contesting the Presidential election is probably Marine Le Pen, who took over the Front National (FN) leadership from her father in 2011. From the moment she took over the leadership, she set out to considerably soften the tone of the party (specifically toward the Muslim and Jewish communities) at a time when populism

became more widely accepted across Europe. Her main achievement to-date was her election as a Member of the European Parliament (MEP) in 2004. Her main manifesto pledges are to: implement tighter immigration controls and to organise a referendum to leave the European Union (EU) as well as the Euro. Despite being a recent source of concern for the market, leaving the EU and the Euro remains a remote possibility as the President would need the parliament's approval to set these projects in motion. Recent polls also show that if such a referendum were to take place, the leavers would be some distance away from being able to secure a majority, especially concerning the Euro.

Her closest challenger in the opinion polls is the centrist Emmanuel Macron. He is still only 39 and has a genuine opportunity of becoming France's youngest ever President. He has never participated in an election before but he was an economic adviser to President Hollande before being appointed Economy Minister in 2014. During this time, his pro-business stance was increasingly clashing with the left of the Socialist Party and this served as the catalyst for him to form his own party "En Marche!" (translated as "Let's move forward") before launching his presidential candidacy. His program revolves around a EUR 50 billion public investment plan, a large cut in corporate tax rates and the introduction of more flexible labour laws.

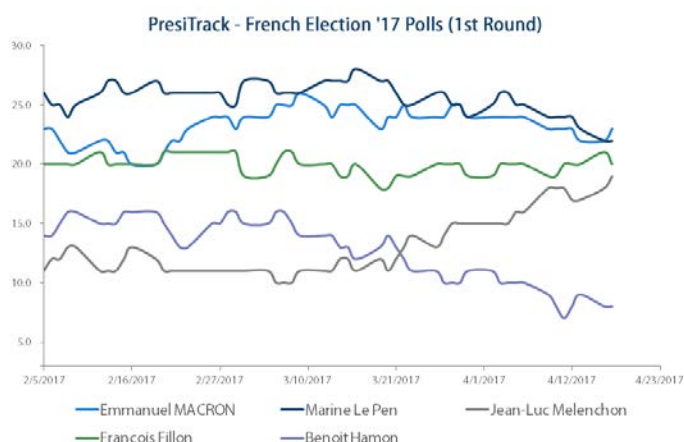
The candidate for the centre-right is Francois Fillon. He won his party's nomination by defeating Nicolas Sarkozy and Alain Juppe, whose reputations have been tarnished by lawsuits over the years. But Fillon's campaign has since been jeopardized by allegations of his own, that his family improperly benefited from public funds. However, he hasn't stepped down, and even complained that he was victim of a conspiracy. He has promised to reduce the size of the public sector, remove the wealth tax and re-negotiate the 35-hour work week.

The candidate running for the Socialist Party is ex-education minister Benoit Hamon, who defeated Prime Minister Manuel Valls during the party's primary. His program consists of populist measures that range from taxing robots that replace the jobs of humans, making labour laws less flexible and increasing benefits for the unemployed and for those on the minimum wage.

The last and most recent serious contender is Jean-Luc Melenchon. He left the Socialist Party in 2008 to found the Left Party (the equivalent of a new Communist Party). He was elected to the European Parliament in 2009 and remains a MEP

today. A critic of the EU's economic liberalism, he wants to reform European treaties (common agricultural policy, common security and defence policy, EU stability pact) or leave them altogether if such is not possible. He would also replace the existing presidential system (The Fifth Republic) by an assembly based on proportional representation. Finally, he plans to increase benefits significantly, albeit without a clear plan to finance them.

Figure 1: 1st Round Election Polls



Source: OpinionWay/ORPI

Conclusion

Currently, Emmanuel Macron and Marine Le Pen are virtually tied in the polls (22% to 24% of vote intentions in the first round). However, Le Pen could well benefit from a lot of hidden votes (i.e. people who don't want to publicly admit that they will vote for the Front National).

Fillon, despite the negative headlines brought against him remains very resilient, and benefits from a strong base, so he is definitely not out of the race. Hamon is struggling to differentiate himself from Melenchon, who is much more charismatic. As a result, Melenchon is now gaining momentum and is credited with 16% to 18% of the votes in the first round, a score similar to Fillon.

Although it is difficult to predict what would happen in the second round if Le Pen is facing Melenchon, because this situation has never occurred in the past, it is quite clear that Le Pen has a much harder challenge to win if she stood against Macron or Fillon. This is simply because the other parties will call their electors to unite against Le Pen in the second round, and very few of them would switch to a Front National vote.

Hence, even though election uncertainty has weighed on French assets (with the 10-year OAT-Bund spread widening by more than 50bps since July 2016) and will likely continue to do so until the second round election, even with a Le Pen win, the most negative scenarios outlined above are unlikely to prevail. Indeed, the French constitution has many checks and balances built-in that prevent the future president from taking unilateral decisions and, thus, we do not expect a major surge in risk aversion in European fixed income markets.

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