

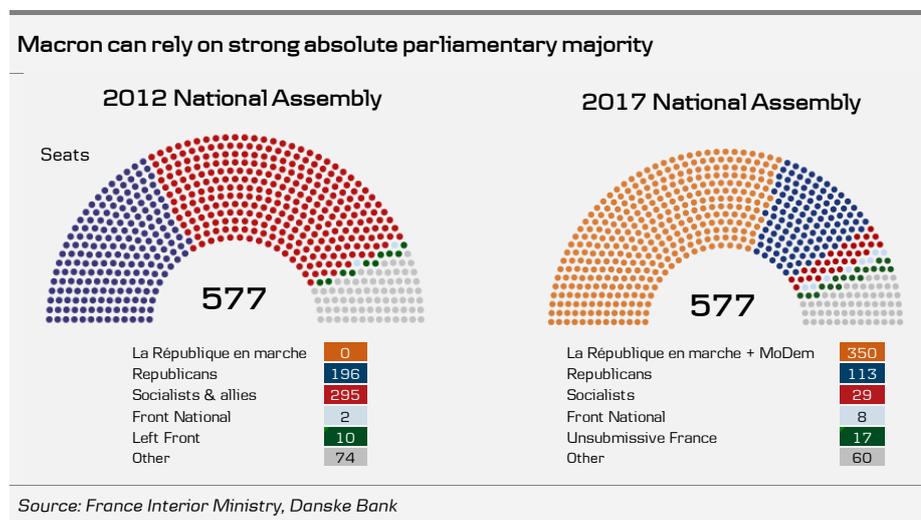
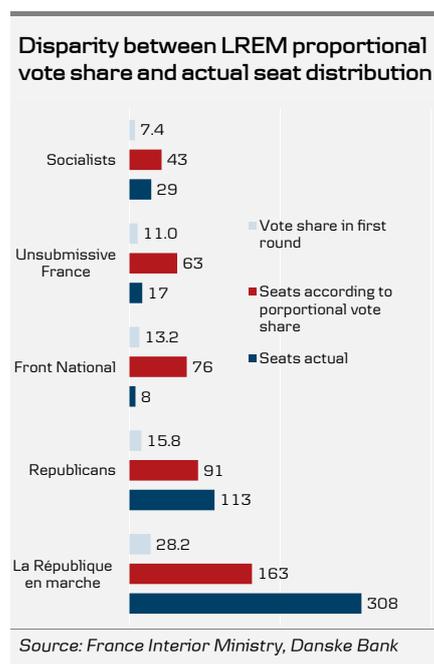
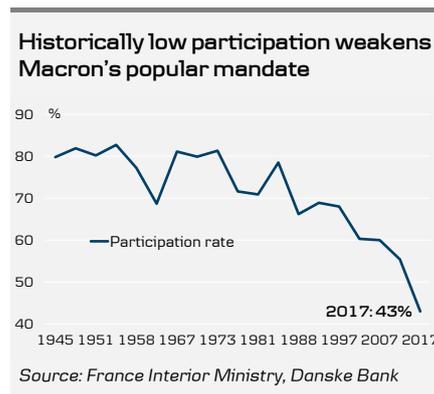
# French Election Monitor #6

## After Macron wins majority, focus turns to reforms

President Emmanuel Macron’s party *La République en marche* (LREM) has secured an absolute majority after yesterday’s second round of the parliamentary election for the National Assembly. With 350 seats, the coalition of LREM and Democratic Movement (MoDem) will become by far the largest faction, followed by the Republicans with 113 seats and the Socialists, who have suffered their worst defeat in the party’s history (from 258 seats in 2012 to 29 seats in 2017). Many LREM deputies are newcomers to politics and the diversity in terms of candidate backgrounds and gender have been strong winning factors for the party (39% of elected deputies are now women). Front National will increase their seats in parliament from two to eight and Marine Le Pen has been elected as a deputy for the first time. However, the election result was still a clear disappointment for the party, which got 13.2% of the vote in the first round and targeted at least 15 seats to be able to form a parliamentary group that delivers more speaking time.

Despite the resounding win for Macron and his party, the strong election result also comes with a pinch of salt. The historically low participation rate (43%) is weakening Macron’s popular mandate. The disparity between LREM’s dominance in parliament and its ‘real strength’ in the country (see chart), caused by the two-round voting system, risks that a large share of the public sees their views under-represented in parliament, increasing political alienation and laying the grounds for another populist backlash in a few years’ time. Convincing a sceptical public of the necessity of contentious reforms will hence be a challenge for Macron in the politically fragmented country.

However, for now, Macron has positive momentum on his side, as the French have voted for political renewal. After the Brexit vote, support for the EU has increased according to a recent survey. The tough EU negotiation position favoured by France and Germany in the upcoming Brexit talks and the prospect of the UK leaving the EU chaotically without a deal is also unlikely to fuel enthusiasm among the French public for taking a similar step in the near future.



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## Domestic reform progress key for Macron's envisioned euro zone reforms

Now that Macron has secured the means to implement his programme, the focus will revert to domestic policy making, with the planned labour market reform as the first big test of his presidency. Macron plans to overhaul the labour code and among other things give companies more flexibility to negotiate wages and working hours with employees directly. A draft bill may already be discussed at the end of June, when the new parliament gathers for its first session and in the absence of roadblocks, legislation could be passed as early as September. France's stubbornly high unemployment rate of 9.6% indicates that reform of the rigid labour market is long overdue but the process is unlikely to be smooth. Powerful unions have already voiced their opposition to some of the planned changes. Once Macron has succeeded in his planned reforms of the labour market, the 2018 budget law will be the next important item on the agenda.

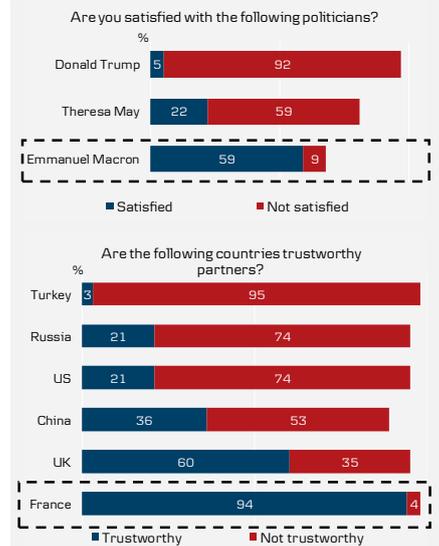
A good track record on the domestic reform agenda and compliance with European budget rules is also important for Macron to build credibility and support in Germany for his envisioned eurozone reforms, such as creating a fiscal union with a common euro area budget. A first Franco-German ministerial summit will take place on 13 July, but any real push for deeper EU integration will only begin after the German parliamentary election on 24 September, which Angela Merkel's CDU party is expected to win. Although Angela Merkel has hinted at radical EU reforms after her first meeting with Macron on 16 May, there remain many sceptics in her party who would prefer small and symbolic steps towards closer EU cooperation, for example through joint investment projects or alignment of corporate taxes, rather than the big changes Macron is envisioning. Another hurdle on the way for deeper EU integration is that several of Macron's proposals such the establishment of a eurozone budget and finance minister would require EU treaty changes and likely entail a multi-year process imbued with political risks. The degree of Merkel's willingness to press ahead with wide-ranging eurozone reforms will not least also depend on the CDU's coalition partner after the election, where a coalition with the Social Democrats (SPD) would strengthen the prospect of wide-ranging reforms under a re-invigorated Franco-German alliance, whereas a coalition with the free-market FDP could dampen the probability of grand leaps forward in deeper EU integration.

## Election result underlines the new European political order

The European fixed income market has since the first round of the French general election been prepared for an absolute LREM majority. Hence, the market impact today has been limited. French bonds have performed strongly since the Presidential election and the 10Y spread to Germany has tightened from 75bp at it widest to 35bp currently. 10Y France is now trading more or less at par with Belgium, but still with a small premium to Austria and the Netherlands, which is fair given the marginally weaker French rating. The average spread between France and Germany was 31.5bp in the 10Y segment in 2015, so the room for further spread performance is after all limited.

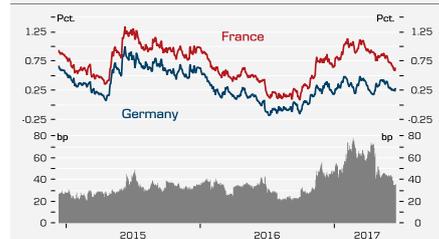
The absolute majority for Macron is yet again a confirmation that the political fears for 2017 that have haunted the European government bond market since the start of 2017 have now done a 180 degree turn. The first catalyst for this new political optimism was the Dutch general election and the French Presidential election, which showed that support for right-wing anti-EU and euro parties was much smaller than expected. This was followed by comments from German Chancellor Merkel after the G-7 summit that Europe can no longer 'rely' on the US and the UK, developments that have convinced the market that Europe is able to cope with its debt and banking problems. Recently, the EU and Greece

### Macron enjoys high trust and support among German public



Source: Infratest Dimap, Danske Bank

### French bonds have recently performed against Germany, 10Y generic



Source: Macrobond Financial, Danske Bank

### Little room for further French performance going forward, 10Y spread, bp



Source: Macrobond Financial, Danske Bank

reached a debt agreement: a deal has been struck in respect of Monto de Paschi in Italy and in Spain, Banco Popular was taken over smoothly by Santander a few weeks ago. This new political order in Europe is in general positive for periphery bond markets, where we recommend investors to overweight duration. For more, see *Government Bonds Weekly: New political environment in Europe - stay long the periphery*, 16 June 2017.

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Report completed: 19 June 2017 at 10:08 GMT

Report first disseminated: 19 June 2017 at 11:10 GMT