



How will financial markets react to early parliamentary elections?



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The result of last Sunday's legislative elections in France confirms the trend towards a more parliamentary than presidential regime by the political authorities. This time, there is a search for a coalition, a possibility President Macron had dismissed during the previous legislature in 2022, despite the lack of an absolute majority.

Three scenarios seem to be emerging for the formation of the next government:

- Seeking an absolute or, more likely, a relative majority, with a broad "rainbow" coalition among the groups closest to the centre.
- Forming a left-wing government with a prime minister from the NFP group. However, without an absolute majority, the most "extreme" left-wing reforms could lead to a motion of no confidence.
- The inability to form a governing coalition in the absence of a significant relative majority. In this case, the formation of a technical government, similar to Italy's experience with Mario Monti from November 2011 to April 2013, could be considered.

Given the current context, the most probable hypothesis points to a relative majority, with a shift of the political center towards the left compared to the previous government. The choice of the prime minister will be the first element by which to judge this new orientation. More reassuring for the markets, the deputies from le Rassemblement National Rally and la France Insoumise, parties considered as Eurosceptic, are not in a position to gather an absolute majority to topple the government. Therefore, French support for the European project is not threatened.

Consequences for the Markets

Since the dissolution of the French National Assembly on 9 June, the French stock market has evolved in view of the various potential political scenarios.

In the week following Emmanuel Macron's decision, European stock markets fell in reaction to the widening spreads¹ of French government bonds by about 30 basis points², and the contagion to peripheral countries like Italy. The emergency creation of a broad left-wing coalition under the name "Nouveau Front Populaire" initially caused investors to fear the implementation of measures detrimental to France's credit quality in the event of their victory. The markets corrected, with French stocks dragging "Eurozone" values in their wake. Last Friday evening, the CAC 40 had fallen by 4 per cent compared to the day before the announcement of the dissolution and the Eurostoxx by 1.9 per cent, while the global MSCI index rose by 2.9 per cent².

Although some observers might think that this decline is modest given the uncertainty raised by this early election, it is important to put a few elements into perspective. Firstly, these events have occurred at a time when global markets are very well oriented, with successive records of American and Japanese stocks, driven by expectations of rate cuts and a sufficiently resilient global economy to anticipate rising profits. Secondly, financial markets are much more concerned with the overall macroeconomic environment and the political situation in the United States than with the French case, given their respective implications for the global economy. Finally, the share of profits of CAC 40 companies made in France represents only 15 per cent of their total profits, while the profits made in France by Eurozone companies are only 7.5 per cent.

Of course, a surge in the OAT spread and contagion to peripheral countries, in the event of an exacerbated power struggle with the European Union, would have a more significant impact via interest rates. At this stage, it seems to us that the underperformance of French stocks is logical, given the increase in relative capital costs linked to the widening of spreads on ten-year bonds (only 12 basis points compared to the situation before the dissolution²) and the uncertainty about France's budgetary orthodoxy in the coming months.

In view of the above, it is understandable that equity markets have not overreacted to a debt market that is showing a relative resilience. Indeed, French government bonds are trading at levels close to those of Spain and Portugal, two countries whose ratings by agencies are two notches below France's rating. However, the modest correction of French stocks does not constitute an opportunity due to the uncertainties that will persist.

The US cycle and its impact on interest rates will remain the main driver for the markets. In this sense, the growing likelihood of a Donald Trump victory following Joe Biden's failed debate is heightening inflationary fears, particularly if he is elected at a time when activity and inflation are above the Fed's tolerance.

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(1) Yield difference between a bond and an equivalent maturity loan deemed to be “risk free”.
(2) Source : Bloomberg, 08/07/2024.

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(1) Source: Rothschild & Co Asset Management, 31/07/2026.

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