

The Ultimate Guide to the 2017 French Elections – Part IV

The outcome of the first round on 23rd April remains a close call and I am once again reminded of President de Gaulle who, in a nod to the French electorate's heterogeneity, asked how it was possible to govern a country where 258 varieties of cheese exist¹.

This granular political landscape has come into focus in recent weeks. Polls show that in the first round National Front candidate Marine Le Pen and the centre-left independent Emmanuel Macron are still slightly ahead of far-left candidate Jean-Luc Mélenchon and Republican François Fillon but the margins are barely statistically insignificant.

Moreover, a large share of voters – up to 45% of the registered electorate – remain undecided on whether and how they will vote. These voters will likely swing the election.

Nevertheless, I am sticking to my core scenario that Macron will make it to the second round which he would win regardless of whom he faces given his strong cross-party political support and reasonably high popularity amongst voters.

While all the main candidate advocate some kind of reform of the EU and eurozone, Le Pen is campaigning on the premise that France needs to leave the eurozone and has promised to hold a referendum on France's EU membership if elected.

Implied euro volatility has surged – a trend partly attributed to markets pricing in a higher probability of either Mélenchon or Le Pen being elected president. But actual euro volatility remains subdued and the fall in the euro and 2 and 5-year French government bond prices in recent weeks has been modest.

The consensus forecast, which I share, is that the Euro and French government bonds will rally if Macron or Fillon is elected president while the Euro would weaken sharply and French yields rise significantly should Le Pen or Mélenchon become president.

However, with an almost infinite number of scenarios to consider, any forecast of where European financial markets may end up and how they get there remains tentative at best.

There has been little focus on the elections for the French National Assembly, to be held over two rounds on 11th and 18th June and yet they will decide the composition of one of France's law-making institutions and dictate from which party hails the Prime Minister.

Unless Fillon becomes President, it is likely that for the next five years the President and Prime Minister will not come from the same party or share the same political agenda – a period of “Cohabitation” which would clip the authority of Le Pen, Mélenchon and to a lesser extent Macron, and is usually associated with political instability.

¹ *“Comment voulez-vous gouverner un pays où il existe 258 variétés de fromage?”*, Charles De Gaulle, 1962

21 Questions & Answers

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PART IV

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1. WHO WILL BE ELECTED PRESIDENT?

The outcome of the first round remains a close call. The latest polls show that National Front candidate Marine Le Pen and the centre-left independent Emmanuel Macron are still slightly ahead of far-left candidate Jean-Luc Mélenchon and Republican François Fillon but the margins are barely statistically insignificant. Moreover, there is still a large share of voters – up to 45% of the registered electorate according to my estimates – who are undecided on whether and how they will vote. These voters will likely swing the election. Nevertheless, I am sticking to my core scenario that Macron will make it to the second round which he would win regardless of whom he faces given his strong cross-party political support and reasonably high popularity amongst voters.

First round – A close call with still a potentially large share of votes up for grabs

With only 10 days to go before the first round of the French presidential elections on Sunday 23rd April and 24 days before a likely second round on Sunday 7th May, the outcome of the 2017 French presidential elections remains difficult to predict. One explanation is that opinion polls are fundamentally flawed and therefore of little or no use. I would argue that opinion polls which ask a sample of voters for their voting intentions in the first round have informational value but have limitations in terms of their ability to predict the outcome, in particular when:

- i) There are three or more candidates with broadly similar levels of popular support once statistical margins of error are factored in.
- ii) The share of the electorate who will actually turn out and vote for a candidate (as opposed to a blank vote) remains uncertain; and
- iii) The share of voters polled who may vote for a different candidate on election day is high;

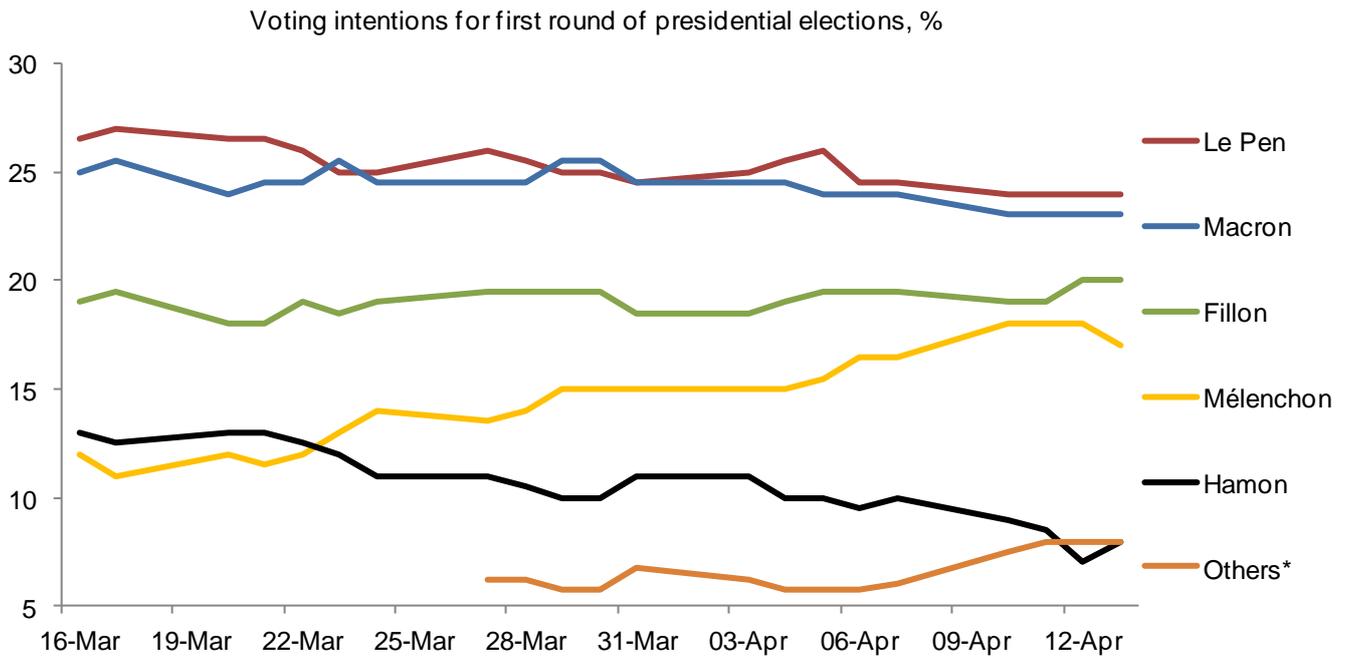
Arguably all three of these conditions apply to the forthcoming first round.

I. Four candidates are within touching distance of each other

Recent opinion polls show that support for Le Pen and Macron has edged lower to around 24% and 23%, respectively, while support for Fillon is back to 20% and has surged for Mélenchon to around 17% (see Figure 1). Based on a 95% statistical confidence level, the margin of error in these polls is about +/- 2 percentage points and therefore support for Fillon (18-22%) and Mélenchon (15-19%) may in actual fact be only fractionally lower than support for Macron (21-25%) and Le Pen (22-26%).

Socialist Party candidate Benoît Hamon has seen his support tank to below 10% (and the aggregate share of votes for the six minor candidates) and he is effectively out of the presidential race in my view. He is polling badly for a number of reasons, including 1) voters' backlash against an unpopular Socialist government and President and 2) having to share the left-wing vote with Mélenchon who over two TV debates has proved far more eloquent, inspired and inspiring.

Figure 1: A four-horse race for the first round



Source: Les Echos, L'Internaute

Note : * Aggregate support for Nathalie Arthaud, François Asselineau, Jacques Cheminade, Nicolas Dupont-Aignan, Jean Lassalle and Philippe Poutou

This even distribution of support among four candidates contrasts with previous presidential elections. In eight of the past nine elections, 20% support was sufficient to get a presidential candidate to the second round, with Jean-Marie Le pen getting through to the second round in 2002 with only 16.9% support.

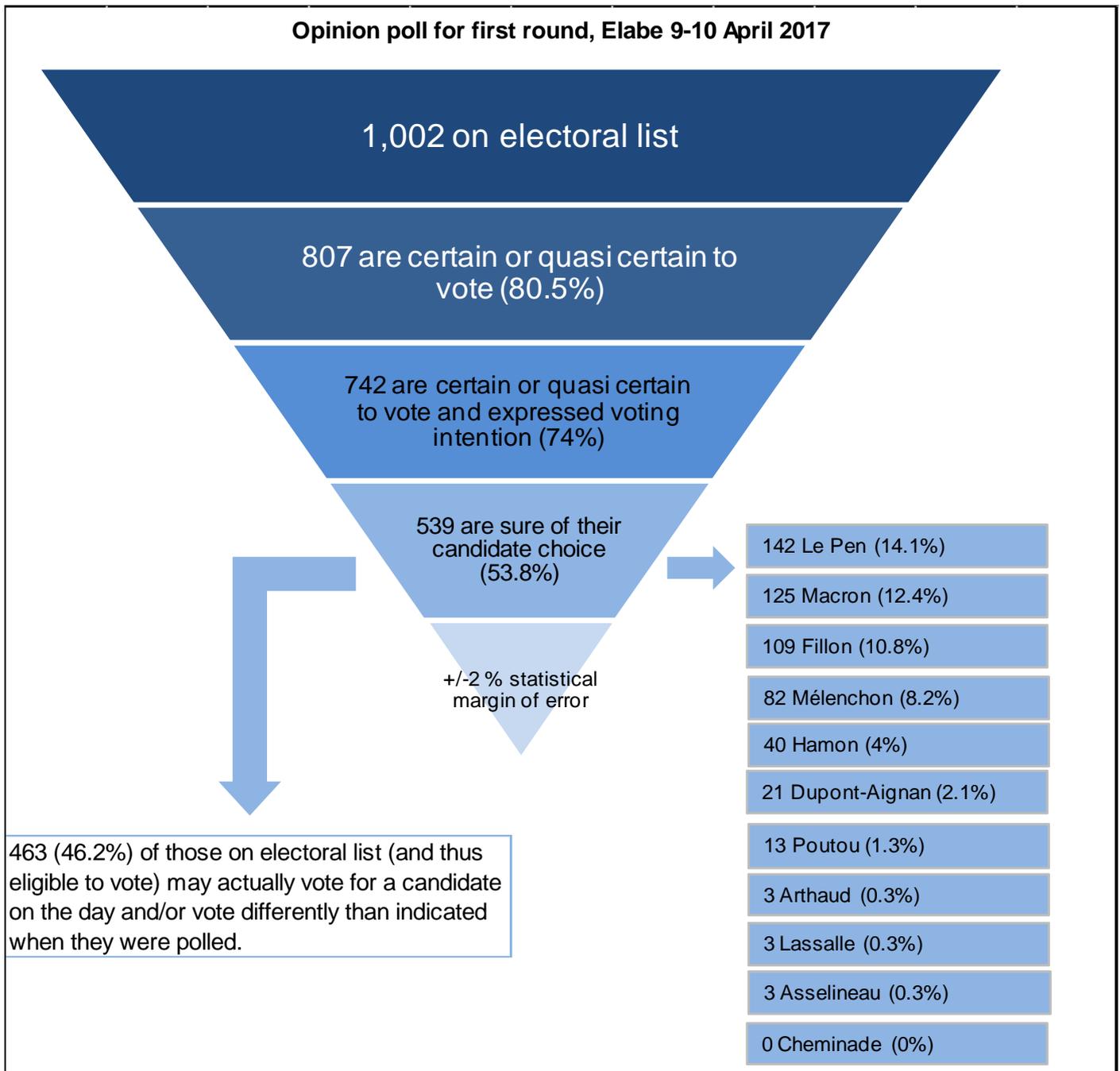
- In the run-up to the first round of the 2007 elections, polls had Republican candidate Nicolas Sarkozy five percentage points ahead of Socialist Party candidate Ségolène Royal on about 30% support, 11 percentage points ahead of third-placed François Bayrou and a significant 16 percentage points head of Jean-Marie Le Pen. Polls thus pointed to a statistically significant probability of Sarkozy and to a lesser extent Royal making to the second round, with Bayrou and Le Pen third and fourth respectively – which indeed turned out to be case.
- Similarly, in the 2012 elections, François Hollande and Nicolas Sarkozy were both on about 27% in the polls, well ahead of Marine Le Pen (16%) and Mélenchon (13%) and again polls correctly “predicted” the ranking of the top four candidates.

The key take-away, unsurprisingly perhaps, is that in an open race opinion polls have historically correctly predicted the actual ranking of the candidates in the first round, even if in some cases they slightly under or over-estimated the actual share of votes won. And ultimately the candidates’ ranking in the first round is more important than the actual share of votes won, even if the latter may be relevant in the second round of voting. Conversely, when the race is tight – as is seemingly the case in this year’s elections – the ability of polls to accurately predict candidates’ ranking is diminished.

II. Turnout and intention to cast a valid vote

Historical evidence suggests that voter turnout can affect the outcome of the first round. Specifically when voter turnout has been low (2002 elections) or below average (2012, 1995) the National Front and far left candidates have done well in the first round and broadly better than predicted by polls (see [The Ultimate Guide to the 2017 French Elections, Part III](#), 5 April 2017). Conversely, centrist candidates have performed strongly and better than expected based on polls when voter turnout has been high (1974, 1988 and 2007), as I detailed in [The Ultimate Guide to the 2017 French Elections – Part I](#) (7 March 2017).

Figure 2: A registered voter is not the same as a decided voter



Source: [Elabe](#)

Note: Percentages are percentage of registered voters – i.e. 14.1% of registered voters polled are sure that they will vote for Marine Le Pen

One explanation is that voters who occupy the political centre-ground may be less inclined to turn up and vote than those who are backing candidates on the far left or right of the political spectrum (i.e. they are less “politicized”).

Until recently surveys suggested that a large share of registered voters were still undecided as to whether they would actually vote on 23rd April and that about 8% of those intending on voting did not yet know who they would vote for (if anyone). But more recent surveys point to voter turnout of about 80% – which would be broadly in line with the average of the past nine presidential elections (see Figure 2). This percentage is seemingly quite fluid but if turnout is average in the first round, precedent would suggest that no candidate will materially benefit.

III. Candidate switching

Recent surveys point to 29% of voters who are certain or quasi certain of voting and have picked a candidate in opinion polls may yet vote for a different candidate in the actual first round. That ratio remains low for Le Pen at around 17% and has fallen for Macron to 27% from 33% in the past week (see Figure 3).

Put differently the share of voters who may change their mind on election day and not vote for Macron has decreased and is now slightly below the average for all 11 candidates (29%), which in turns reduces the risk of the centre-left candidate under-performing in the first round relative to opinion polls. That ratio is also still low for Fillon (23%) but still significantly higher for Mélenchon (35%) despite its recent fall. The ratio has risen further for Hamon and now stands at 46%.

Figure 3: About 29% of voters may still vote differently than indicated in polls

Elabe opinion poll for first round, 9-10 April 2017			
Candidate	A: % support in opinion polls for first round	B: % of voters who may vote for a different	C: % of voters who will definitely vote for candidate ⁽²⁾
Macron	23	27 (-6)	16.8
Le Pen	23	17 (-2)	19.1
Fillon	19	23 (+4)	14.6
Mélenchon	17	35 (-4)	11.1
Hamon	10	46 (+7)	5.4
Dupont-Aignan	4	29	2.8
Poutou	2.5	29	1.8
Arthaud	0.5	29	0.4
Lassalle	0.5	29	0.4
Asselineau	0.5	29	0.4
Cheminade	0	29	0.0

Source: [Elabe](#)

Note: (1) Figure in brackets is percentage point change recorded from 5th April poll; (2) % of voters who will definitely vote for a candidate (Column C) is calculated as % of support in opinion polls (Column A) minus voters who may yet vote for a different candidate (Column B).

On the surface this suggests that support for Le Pen, Fillon and Macron is reasonably robust. But ultimately not knowing what share of voters will change their minds come election day and to whom they will switch their vote introduces an extra layer of uncertainty and reduces the predictive potency of opinion polls.

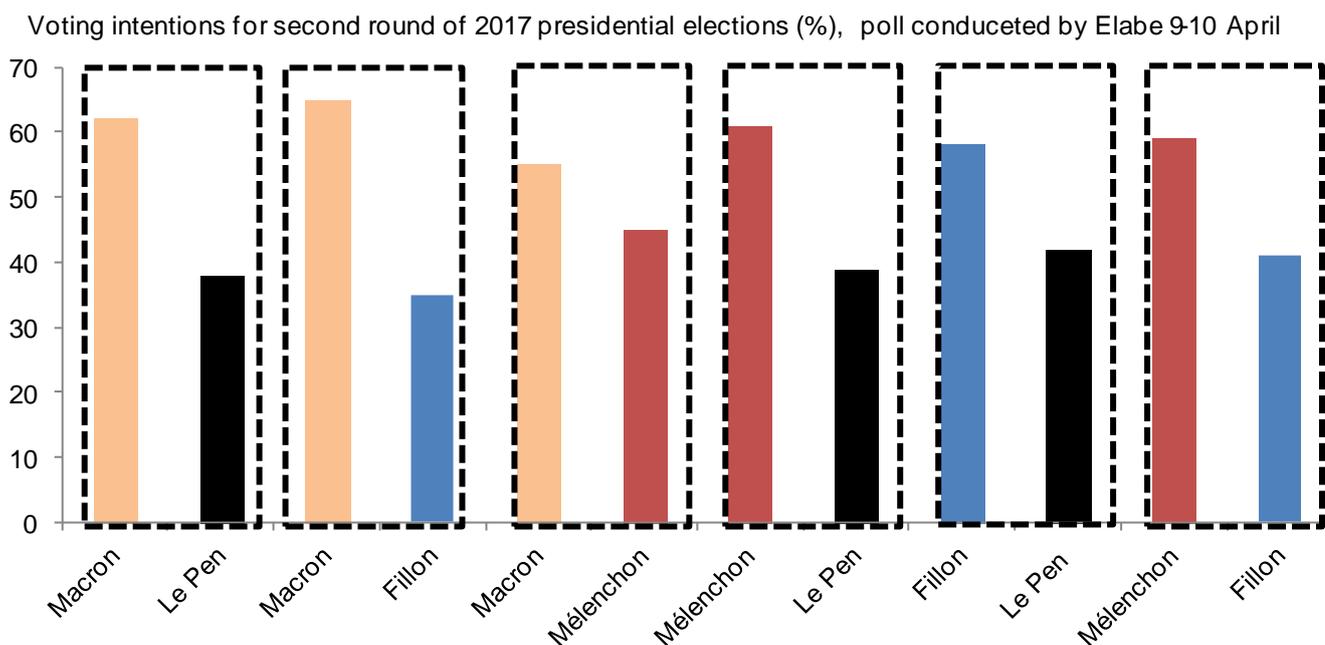
If the votes potentially up for grabs – about 46% of registered voters according to the Elabe survey (see Figure 1) – are proportionally distributed among the candidates, then opinion polls suggest that Le Pen and Macron will proceed to the second round on 7th May. However, if a disproportionate number of these votes ultimately go to Fillon and in particular Mélenchon, these two candidates have a decent chance of finishing in the top two in the first round.

Second round – Macron would win...if he can make it past the first round

While my core scenario remains that Le Pen and Macron will proceed to the second round, I acknowledge that it is a call of only modest conviction. Knowing who will make it to second round would of course make it much easier to predict the eventual winner, but we can still probably narrow the field.

According to recent polls, Macron would in the second round beat Mélenchon and in particular Le Pen and Fillon by significant margins (see Figures 4 and 5). This is not totally surprising given his reasonably high positive ranking with voters (see below) and significant political support as epitomised by the 1829 elected officials who supported his candidacy (see [The Ultimate Guide to the 2017 French Elections, Part II](#), 29 March 2017). Moreover, 40 senior French economists on 13th April gave their backing to Macron in a letter to [Le Monde](#) newspaper, as has former IMF chief economist Olivier Blanchard.

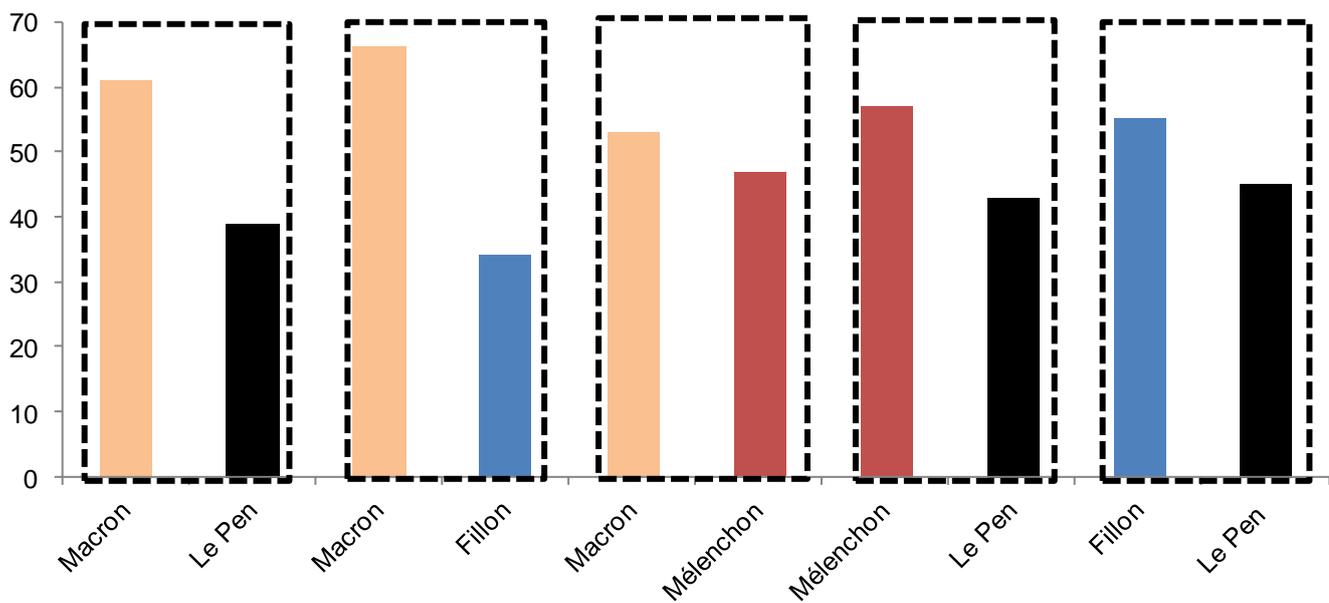
Figure 4: Second round polls show Macron beating all three other candidates...



Source: Elabe

Figure 5: ...although his margin of victory against Mélenchon would be more modest

Voting intentions for second round of 2017 presidential elections (%), poll conducted by Kantar Sofres 9 April



Source: Kantar Sofres

Note: No poll was conducted for Fillon vs Mélenchon on the basis that these two candidates are the least likely to face off based on current opinion polls for the first round

Conversely, Le Pen would lose against the other three candidates and by large margins, averaging only 40% of the popular vote. Mélenchon would become president if he faced off against Fillon or Le Pen in the second round while Fillon would win the second round only in a run-off with Le Pen. I would note that opinion polls correctly predicted the winners of the second round in the 2002, 2007 and 2012 elections despite the 2012 and in particular 2007 elections being reasonably close fought contests. Polls in 2007 had Sarkozy beating Royal by about five percentage points with 52.5% support (he won with a six percentage point gap) and in 2012 polls had Hollande beating Sarkozy by about 8.5pp (he won by 3.2pp).

The importance of the “protest vote”

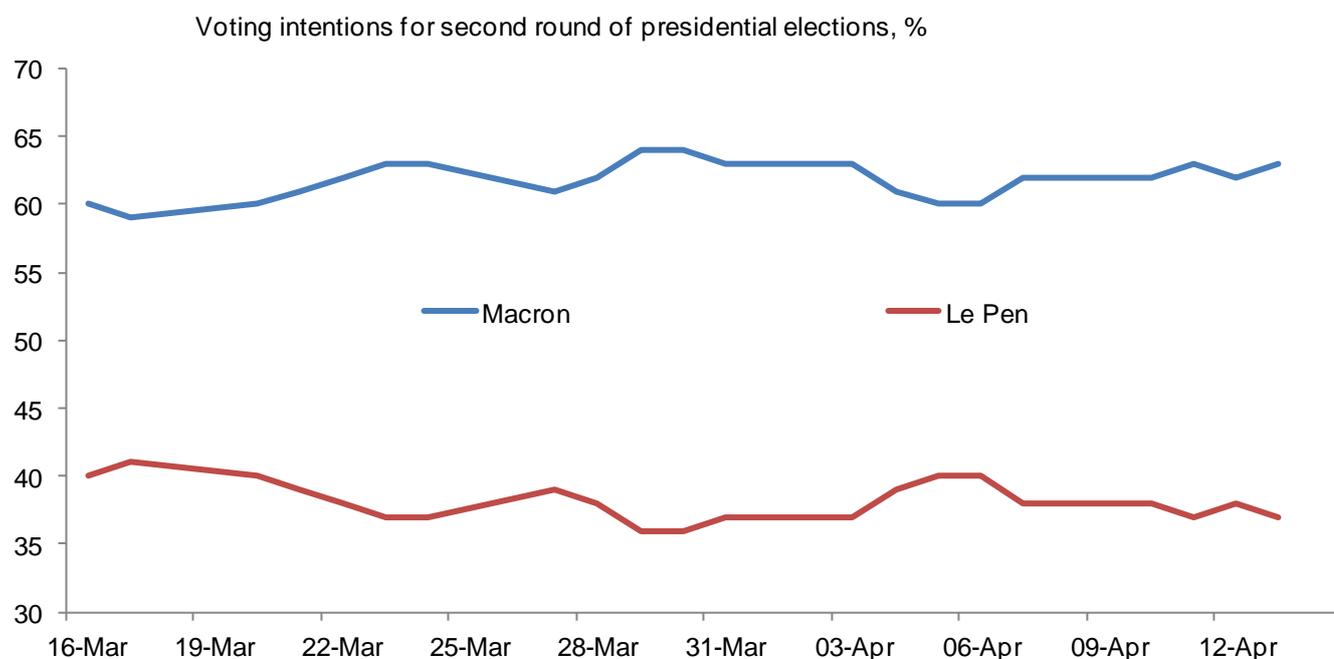
It seems counter-intuitive that Macron is by no means guaranteed to make it to the second round and yet would beat all candidates by statistically significant margins whereas Le Pen could well make it to the second round despite a high probability of then losing regardless of who she faces. This apparent discrepancy is partly a by-product of the two-round voting process for French presidential elections. In the past nine elections, voters were on average able to choose from 10 candidates in the first round. They were thus presented with the opportunity to support a candidate in the first round as a protest vote against mainstream candidates or in a number of cases the incumbent President, knowing that their candidate was unlikely to ultimately make it to the second round let alone become president.

There was evidence of this phenomenon in the 2002 presidential elections when Jean-Marie Le Pen, the founder of the National Front party, outperformed opinion polls and came second in the first round with 19% of the votes. He was however comprehensively beaten in the second round, winning only 17.8% of the vote

(the lowest share of votes ever won by a second round candidate). Two things happened. First, the majority of those who voted for neither Chirac nor Le Pen in the first round voted for Chirac in the second. Also, some of those who voted Le Pen in a first round “protest vote” either switched their support to Chirac or did not vote at all in the second round. In essence, the French electorate were simply unwilling to elect as President a controversial extreme-right candidate, regardless of their misgivings about Chirac.

Importantly, I believe that this “protest vote” is again in play in these forthcoming elections and explains why polls have Le Pen losing against the far-left, centre-left and Republican candidates. Moreover, polls show that the large gap between Le Pen and Macron has been pretty constant over the past month (see Figure 6). Le Pen does not enjoy broad political support, with only 627 elected officials sponsoring her candidacy (which amounted to only 4.4% of all sponsors). Another reason why Le Pen continues to fare poorly in second round polls, in my view, is that she remains unpopular and did little to boost her popularity in the two recent televised debates (see below).

Figure 6: Macron has consistently maintained a sizeable lead against le Pen in polls for the second round



Source: *Les Echos*

Moreover, Le Pen has seemingly pushed her policies further to the right recently, possibly with the intention of cementing popular support among far-right supporters. While this may help her win votes in the first round, the risk is that it both alienates second round voters who had been attracted to the National Front’s more moderate stance in recent years and crystallises broad-based political support against Le Pen – as was the case in the December 2015 regional elections (see [The Ultimate Guide to the 2017 French Elections, Part III](#), 5 April 2017). For these reasons, I continue to believe that Le Pen will not be elected president, regardless of how she performs in the first round.

Mélenchon winning the popularity contest, Le Pen and Fillon still unpopular

Conversely, Mélenchon performed strongly in both televised debates, with his oratory skills and passion overshadowing the bland performance of the other main candidates (and in particular Hamon and Fillon in my view). Mélenchon's popularity has soared since the first televised debate on 20th March with polls showing that his positive rating has in the past month jumped 19 percentage points to 51% – the only politician to breach the 50% mark and the largest monthly increase in popularity since this poll was initiated in the autumn of 2015 (see Figure 7).

Among the other presidential candidates, Macron is second (44% positive rating), Hamon third (33%), Le Pen fourth (32%) and Fillon fifth (23%). This broadly tallies with second round polls which show that Mélenchon would lose only against Macron while Le Pen would lose against the other three main candidates and Fillon would only beat Le Pen.

Figure 7: Mélenchon has seen his popularity surge in past month, Le Pen and Fillon still unpopular

Elabe poll, 6 April 2017: How voters view senior French politicians (ranked by aggregate of positive and very positive image; presidential candidates bolded)						
Ranking	Politician	Party	% of all voters who have:			
			Very positive image	Positive image	Negative or very negative image	Positive/very positive image one month change (percentage points)
1	Jean-Luc MELENCHON	France Insoumise*	14	37	37	+19
2	Emmanuel MACRON	En Marche!*	11	33	45	-1
3	Alain JUPPE	Republican	10	34	41	-3
4	Francois BAYROU	Democratic Movement	3	31	48	+2
5	Benoît HAMON	Socialist Party	8	25	52	-1
6	Marine LE PEN	National Front	13	19	60	+4
12	Nicolas DUPONT-AIGNAN	France Arise	5	23	46	+7
20	François FILLON	Republican	8	15	68	--

Source: [Elabe](#)

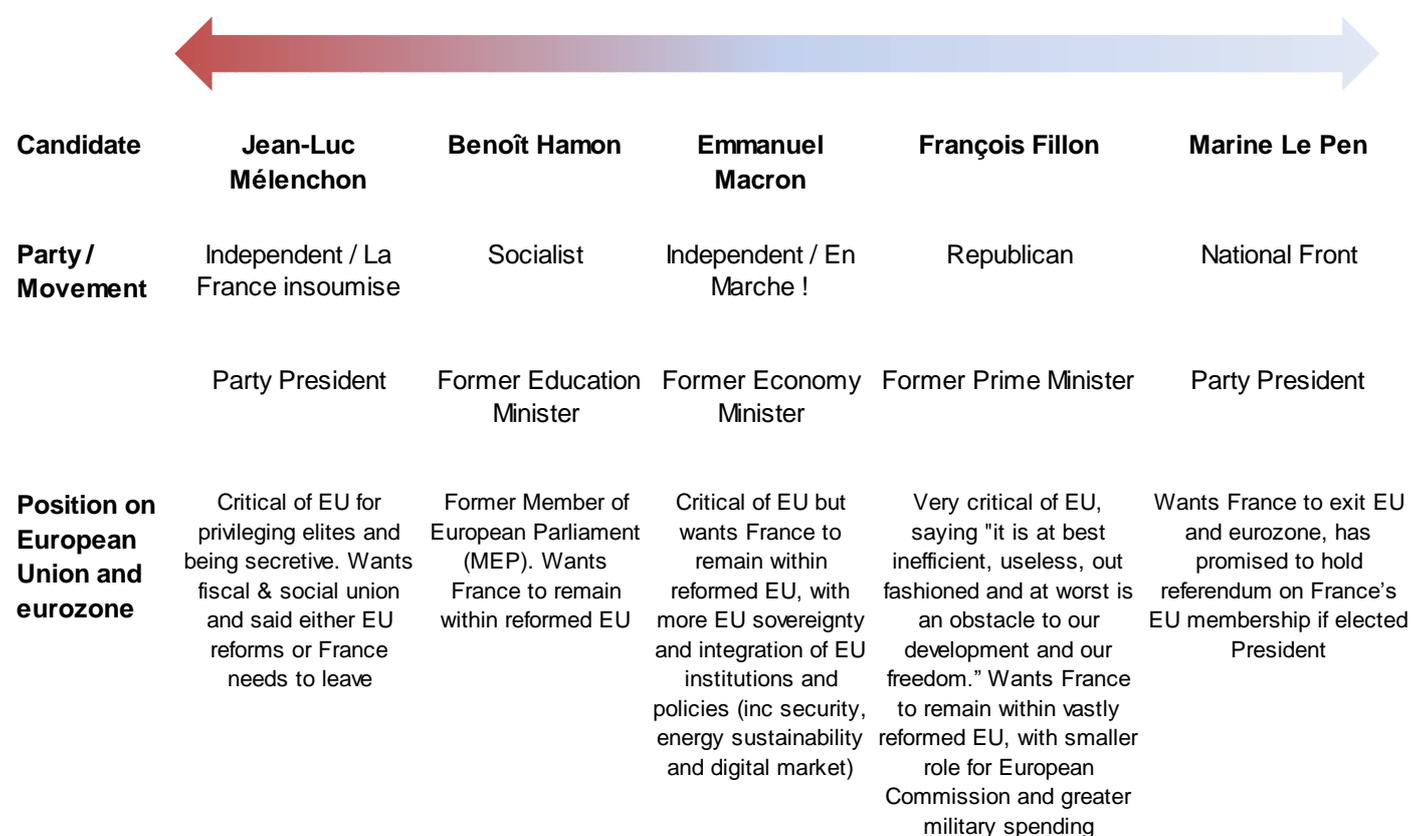
Note: * Political movement rather than party per se

The risk for Macron and Fillon is that this first round protest vote ends up being significant and that Mélenchon continues to grab votes from Hamon, other left-wing candidates (Nathalie Arthaud, Philippe Poutou) and potentially even from Macron (centre-left) and Le Pen (far right but with a populist program), pushing the two “mainstream” candidates out of the top two positions. Nevertheless, I still think that Macron is the most likely to be president based on the cumulative odds of him making it to the second round and winning it. Whom he defeats in the second round and by what margin would affect the path taken by French and European financial assets but probably not their terminal point in my view.

2. WHAT ARE THE POSSIBLE IMPLICATIONS FOR THE FUTURE OF EUROZONE AND EU?

France has historically enjoyed significant political and economic influence in helping shape EU policy thanks to its founding-member status², relative economic power within the EU and close ties with Germany. Therefore, the direction the new president sets out for the EU and France's position within the EU will be of great interest at a time when slow economic growth, social discontent, immigration and terrorism have helped fuel nationalist parties' popularity in Europe (see [Paradox of acute uncertainty and strong consensus views](#), 3 January 2017). France's influence on Eurozone and ECB monetary policy has arguably been less potent, with the Banque de France (and other eurozone central banks for that matter) in the shadow of the German Bundesbank.

Figure 8: The French political spectrum – From far left to far right and views on Europe (main candidates)



Source: *Ministère de l'Intérieur, European Parliament, Assemblée Nationale*

The main French presidential candidates have differing views on the functioning, role and future of the eurozone and in particular the EU and France's role within (see Figure 8). All candidates advocate some kind of reform of the EU but Front National leader Marine Le Pen is campaigning on the premise that

² The Treaty of Paris established the European Coal and Steel Community (ECSC) in 1951 and was signed by Belgium, France, West Germany, Italy, the Netherlands and Luxembourg. In 1957, these six countries signed the Treaty of Rome, which created the European Economic Community (EEC) and established a customs union. The ECSC and EEC were arguably the precursors to the European Union which was formally established when the Maastricht Treaty – whose main architects were German Chancellor Helmut Kohl and French President François Mitterrand – came into force on 1 November 1993.

France needs to leave the eurozone and has promised to hold a referendum on France's EU membership if elected. The main thrust of her argument is that France's economy is losing out to Germany and would perform better outside the eurozone and EU. Whether she would have the popular and political support to call for a referendum is debatable in my view.

Hamon, Macron and Fillon all want France to remain within the eurozone and EU. But while Hamon favours a loosening of fiscal and income policies, Macron and in particular Fillon are more forcefully pushing for France to streamline its labour market laws and social benefits in order for France to better compete within the eurozone and EU. Fillon has also been more vocal in calling for a broad-based and deep reform of the European Union's institutions and inner-workings.

3. HOW WILL FINANCIAL MARKETS REACT?

Investors have been hedging their currency positions and implied euro volatility has surged – a trend partly attributed to markets pricing in a higher probability of either Mélenchon or Le Pen becoming president. But actual euro volatility remains subdued and the fall in the euro and 2 and 5-year French government bond prices in recent weeks has been modest.

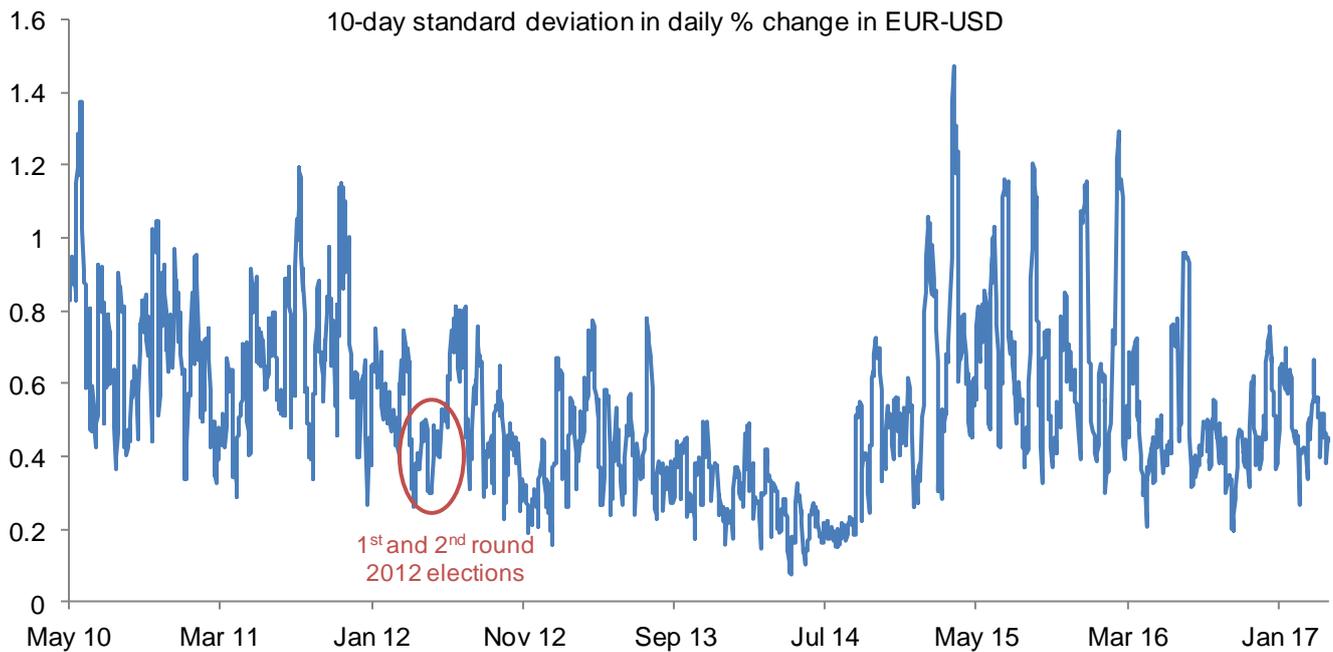
The consensus forecast, which I share, is that the Euro and French government bonds will rally if Macron or Fillon is elected president while the Euro would weaken sharply and French yields rise significantly should Le Pen or Mélenchon become president. However, with an almost infinite number of scenarios to consider, any forecast of where European financial markets may end up and how they get there remains tentative at best.

Implied euro volatility has jumped to multi-month highs but actual volatility still subdued

With the first round (and therefore the second round) increasingly difficult to call, investors have been hedging their currency positions and the cost of insuring against a change in the euro (implied euro volatility) has surged. The price of 1-month options' contracts on the EUR/USD pair has risen to its highest level (12%) since the fortnight before the Brexit vote on 23rd June 2016.

But actual euro volatility remains subdued and the euro's depreciation in recent weeks has been modest, with factors exogenous to the French elections, including decent eurozone macro data and European Central Bank (ECB) policy and rhetoric, providing some support to the common currency. Figure 9 shows that the 10-day standard deviation in the daily percentage change in the EUR/USD cross remains in line with its historical average. Moreover, it is only marginally higher than before and after the 2012 presidential elections between François Hollande and Nicolas Sarkozy – two experienced candidates from the mainstream Socialist and Republican parties.

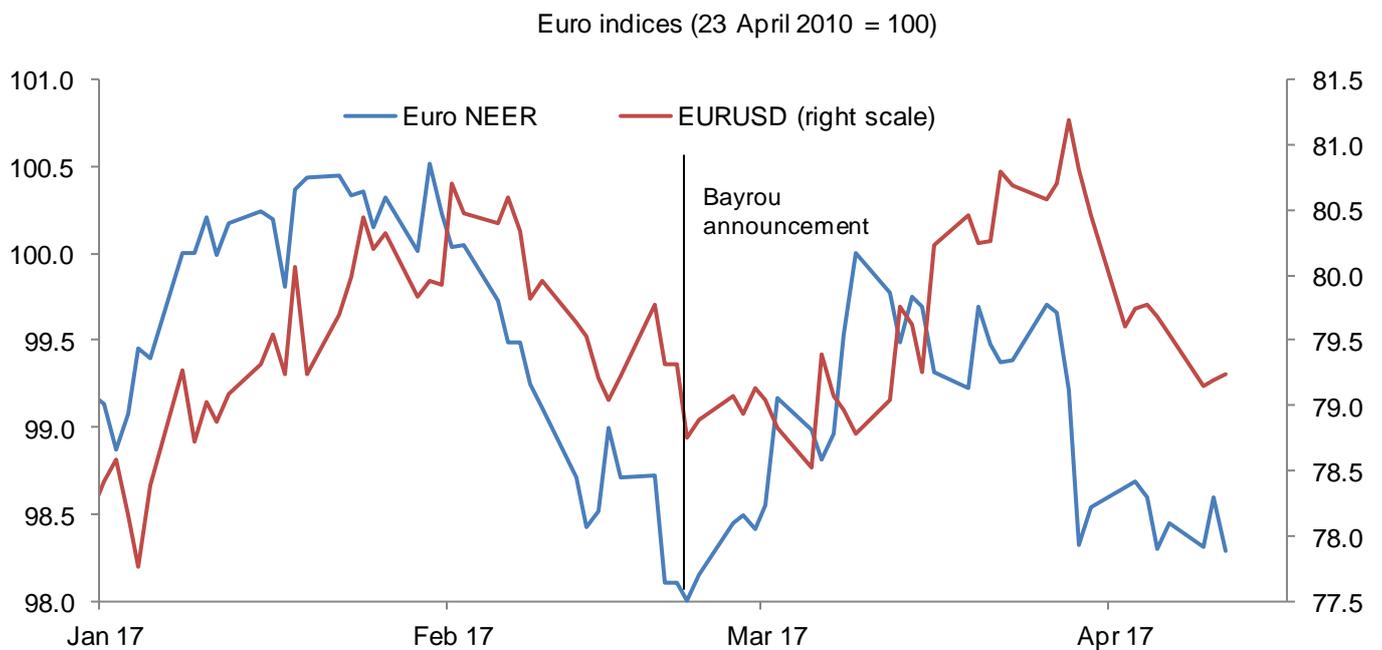
Figure 9: Actual volatility in EUR/USD remains in line with historical average and 2012 presidential elections



Source: investing.com

The euro has weakened versus the Dollar and in NEER terms in the past fortnight (see Figure 10). I believe this trend is due in part to the rising odds of a second round run-off between Le Pen and Mélenchon as Mélenchon and in particular Le Pen are very critical of the European Union and espouse populist policies (see Figure 8). But ultimately the Euro remains comfortably within the ranges in place year-to-date.

Figure 10: Euro has weakened but remains within year-to-date ranges



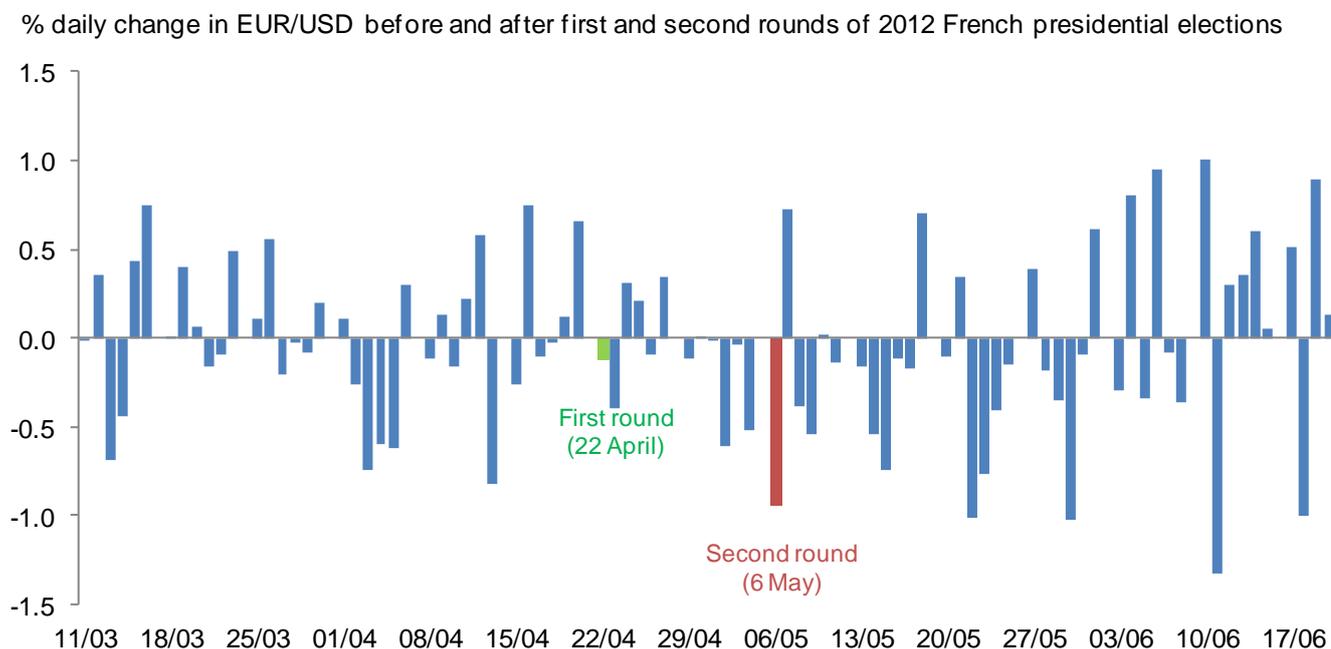
Source: investing.com, [ECB](http://ecb.europa.eu)

Note: NEER is Nominal Effective Exchange Rate (the euro's exchange rate against a GDP weighted basket of the currencies of the eurozone's trading partners)

Figure 11 reveals that EUR/USD did not close more than 1% up or down on the day between 11 March and 20 June 2012, with the cross particularly subdued between the first and second round of the elections. It is conceivable that, if Macron and Fillon face off in the second round, Euro volatility (actual and implied) will stabilise and even moderate between now and 7th May. I would however expect volatility to rise, in decreasing order of magnitude, if:

- i) Le Pen and Mélenchon make it to the second round. While Mélenchon’s stance on the EU and eurozone is far less extreme than Le Pen’s, polls suggest that he would beat the far-right candidate in a second round run-off by about 59% to 41% (see Figures 4 and 5).
- ii) Fillon and Mélenchon make it to the second round as polls suggest that Mélenchon would beat the Republican candidate in a second round run-off by about 59% to 41%.
- iii) Fillon and Le Pen make it to the second round as polls suggest it would be a reasonably close contest, with Fillon beating Le Pen but only by 56% to 44%.
- iv) Macron and Mélenchon make it to the second round as polls suggest it would be a reasonably close contest, with Macron beating Mélenchon but only by 54% to 46%.

Figure 11: Daily change in EUR/USD did not exceed 1% before, during and after 2012 presidential elections



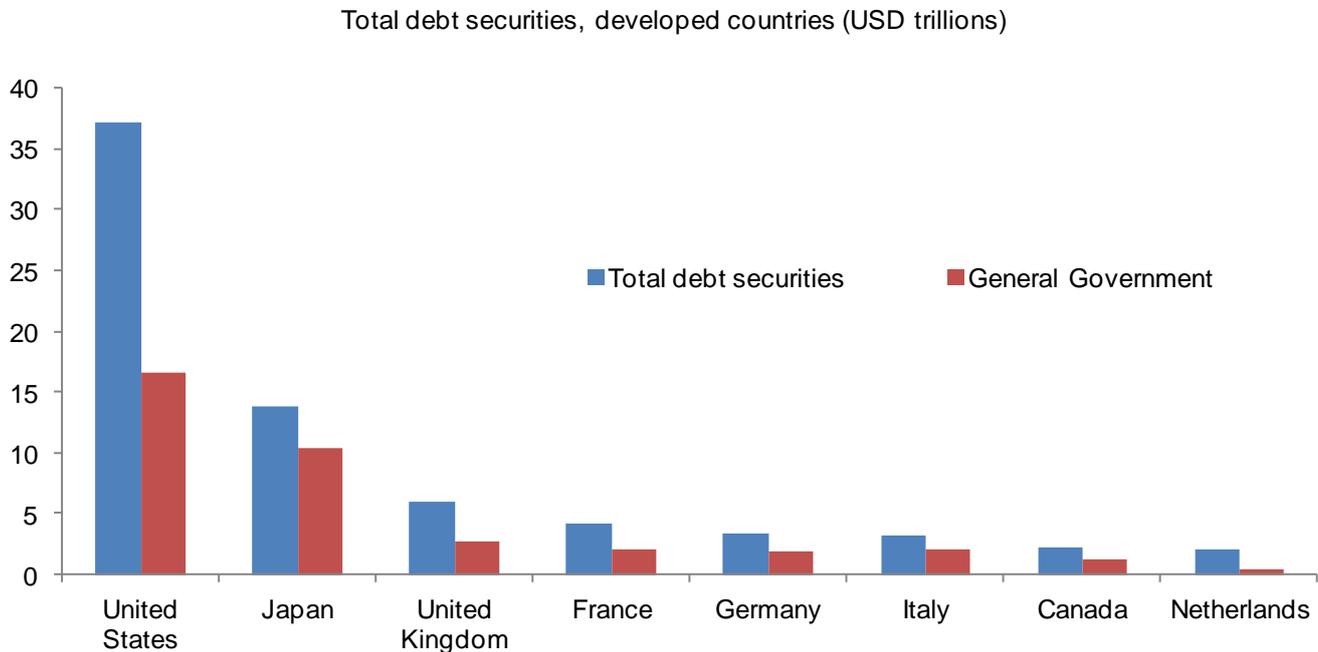
Source: investing.com

French government bond markets still reasonably well behaved

France has one of the largest debt markets in the world. As of end-June 2016, outstanding French government and corporate debt stood at \$4.15trn, of which half was government debt (see Figure 12). This

is the fourth largest amount of outstanding debt within developed economies after the United States, Japan and United Kingdom according to the BIS.

Figure 12: France has one of the largest debt markets in the world

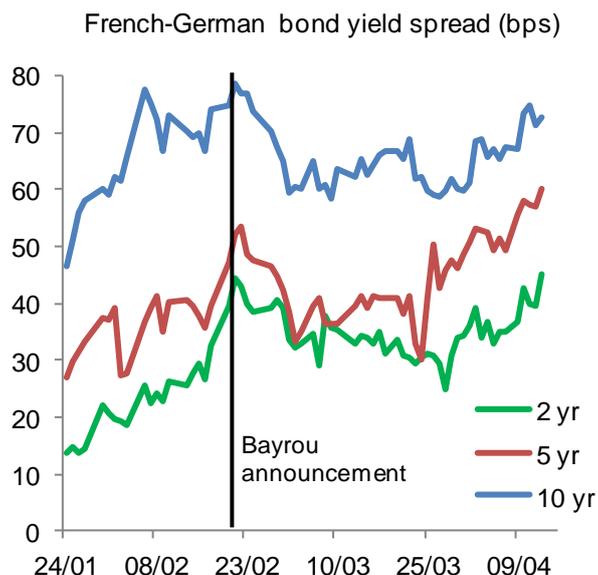


Source: Bank for International Settlements (BIS)

The spread between French and Germany government bond yields, which is somewhat more sensitive (than the euro) to domestic issues, has risen across the curve since late March (see Figure 13). The widening in the 2, 5 and 10-year spreads of about 15bp, 30bp and 10bp, respectively, since 24th March has been partly attributed to markets pricing in a higher probability of either Mélenchon or Le Pen being elected president.

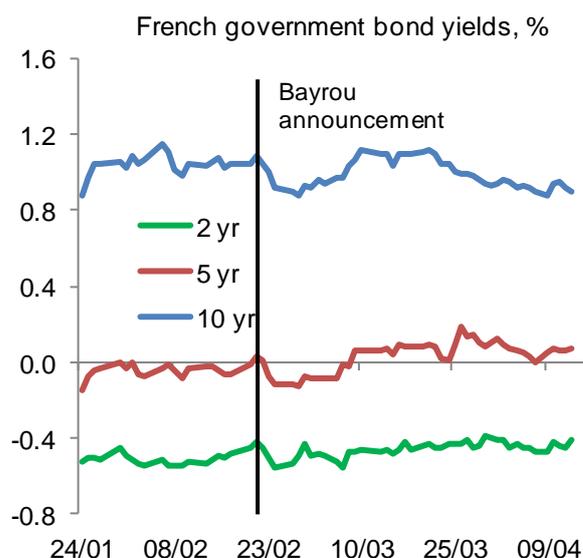
However, this trend is in fact largely due to falling German yields rather than rising French yields (see Figure 14). French bond yields have actually been quite well behaved, with 10-year yields down about 14bp since 24 March, 5-yr yields up 7bp and 2-yr yields up only 2bp. So, like the euro, French government bond yields are showing only a modest reaction to the fact that markets (and electors) still face a very tight race for the French presidency.

Figure 13: French-German bond yield spreads have risen about 18bp since 24 March...



Source: investing.com

Figure 14: ...but this has mostly been due to fall in German yields, with French yields pretty stable



Source: investing.com

Almost infinite number of paths for Euro and French bond yields in coming months

The consensus forecast at this stage seems to be that the Euro will rally and French government bond yields will fall if Emmanuel Macron or François Fillon is elected president while the Euro would weaken sharply and French yields rise significantly should Marine Le Pen or Mélenchon become president.

This is borne out from the price action after François Bayrou, a centrist, announced on 22nd February that he would not run for president but instead support Macron’s presidential bid. The EUR/USD cross bounced only very modestly (see Figure 10) but French 2yr, 5yr and 10yr government yields fell by over 10bps (see Figure 14). Moreover, the admittedly modest depreciation in the euro and rise in 2 and 5-year French government bond yields in recent weeks is likely in part attributable to the rising probability of Mélenchon making it to the second round alongside Le Pen.

I broadly agree with this consensus view. However, forecasting the path of the Euro and French government bond yields before and after the first and second round is at this stage still very much an exercise in “ifs” and “buts”, for a number of reasons.

First, the sharp rally in the Dollar, US yields and US/global equities in the weeks following Donald Trump’s victory in the November US elections has taught us, if anything, that the traditional approach to predicting how political events impact financial markets may be flawed. The broad consensus was that a Trump victory would materially weaken the Dollar and equities and that is how markets traded in the run-up to the 8th November elections. But only since early March has the Dollar and US equity rally lost steam.

Second, even if we assume that Le Pen, Macron, Fillon and Mélenchon all have a credible chance of making it to the second round, this still implies twelve possible permutations for who wins and comes

second in the first round (see Figure 15). Moreover for each of these combinations, there are two possibilities – the winner of the first round also wins the second round (like in the 1965, 1969, 1988, 2002, 2007 and 2012 elections) or the winner loses the second round (like in the 1974, 1981 and 1995 elections). So there are currently 24 credible scenarios to contemplate even if opinion polls suggest that some scenarios are more likely than others, with each scenario likely to have a somewhat different bearing on the Euro, French bond yields and other financial markets.

Figure 15: Four candidates could realistically make it to the second round, implying 24 possible scenarios

24 possible scenarios for first and second round of presidential elections				
	First round		Second round winner	
			Scenario 1	Scenario 2
Scenario 1	1 st place	Le Pen	Macron	Le Pen
	2 nd place	Macron		
Scenario 2	1 st place	Macron	Macron	Le Pen
	2 nd place	Le Pen		
Scenario 3	1 st place	Le Pen	Le Pen	Fillon
	2 nd place	Fillon		
Scenario 4	1 st place	Fillon	Fillon	Le Pen
	2 nd place	Le Pen		
Scenario 5	1 st place	Macron	Macron	Fillon
	2 nd place	Fillon		
Scenario 6	1 st place	Fillon	Fillon	Macron
	2 nd place	Macron		
Scenario 7	1 st place	Le Pen	Mélenchon	Le Pen
	2 nd place	Mélenchon		
Scenario 8	1 st place	Mélenchon	Le Pen	Mélenchon
	2 nd place	Le Pen		
Scenario 9	1 st place	Macron	Macron	Mélenchon
	2 nd place	Mélenchon		
Scenario 10	1 st place	Mélenchon	Mélenchon	Macron
	2 nd place	Macron		
Scenario 11	1 st place	Fillon	Mélenchon	Fillon
	2 nd place	Mélenchon		
Scenario 12	1 st place	Mélenchon	Fillon	Mélenchon
	2 nd place	Fillon		

Source: National opinion polls

Third, each of these 24 permutations carries a number of sub-combinations depending on the winner's margin of victory over the second-placed candidate in the first round and how the other major candidates performed. With an almost infinite number of scenarios to consider, any forecast of where the Euro and French bond yields may end up and how they get there remains tentative at best.

Finally, the outcome of the June legislative elections and appointment of the French Prime Minister could accentuate or neutralise the post presidential election move in financial markets.

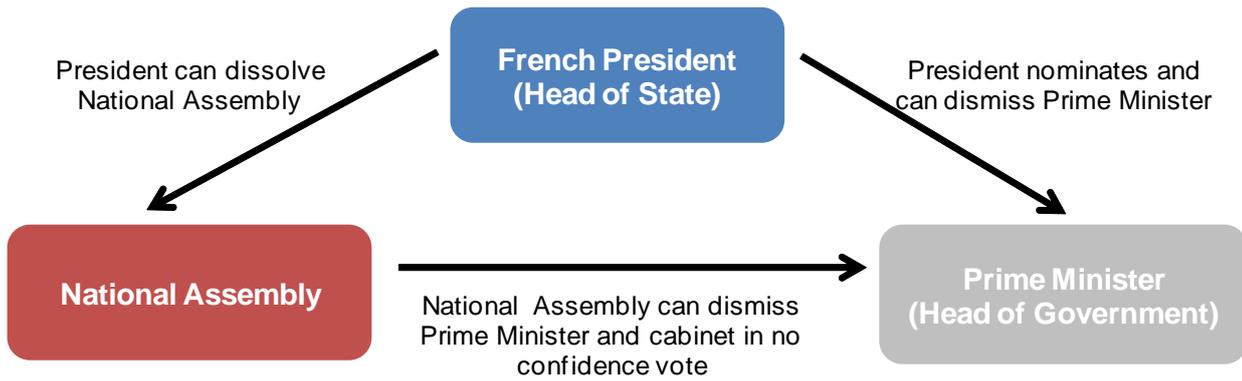
4. WHAT ABOUT LEGISLATIVE ELECTIONS AND PRIME MINISTER?

There has been little focus on the elections for the lower house of parliament, the National Assembly, to be held over two rounds on 11th and 18th June. Yet these elections are arguably as important as the presidential elections as they decide the composition of one of France's law-making institutions and in turn usually dictate from which party hails the Prime Minister. Unless Fillon becomes President, it is likely that for the next five years the President and Prime Minister will not come from the same party or share the same political agenda – a period of “Cohabitation” which would clip the authority of Le Pen, Mélenchon and to a lesser extent Macron, and is usually associated with political instability.

- 577 députés (delegates) of the National Assembly will be elected, representing 539 constituencies in metropolitan France, 27 French territories abroad and 11 constituencies of French living abroad. A party needs 289 seats to have a parliamentary majority³.
- The National Assembly can overthrow the prime minister and other ministers in a vote of no-confidence (this has admittedly happened only once under the Fifth Republic, in 1962). So while the President appoints the Prime Minister, who largely handles the day-to-day running of the country, he/she is de facto forced to appoint a Prime Minister who enjoys a majority backing of the National Assembly (see Figure 16). The Presidential and National Assembly elections are held close to one another in order to reduce the odds of “Cohabitation” whereby the President and Prime Minister hail from two different political parties or coalition of parties.
- The Prime Minister is normally chosen from within the National Assembly, but there have been rare occasions when this has not been the case (Dominique de Villepin, for example, served as Prime Minister from 2005 to 2007 without ever having held an elected office).

³ In the first round, a candidate must obtain a majority of the votes representing at least 25% of registered voters in order to be elected (each voter, who must be aged 18 or over and of French nationalist, gets one vote). Otherwise, candidates which obtained the votes of at least 12.5% of registered voters in the first round proceed to a second and final round (if no candidate fulfils this condition, the two candidates who won the most votes in the first round proceed to the second round). The candidate with the most votes in the second round is elected a delegate.

Figure 16: The checks and balances on French executive and legislative powers

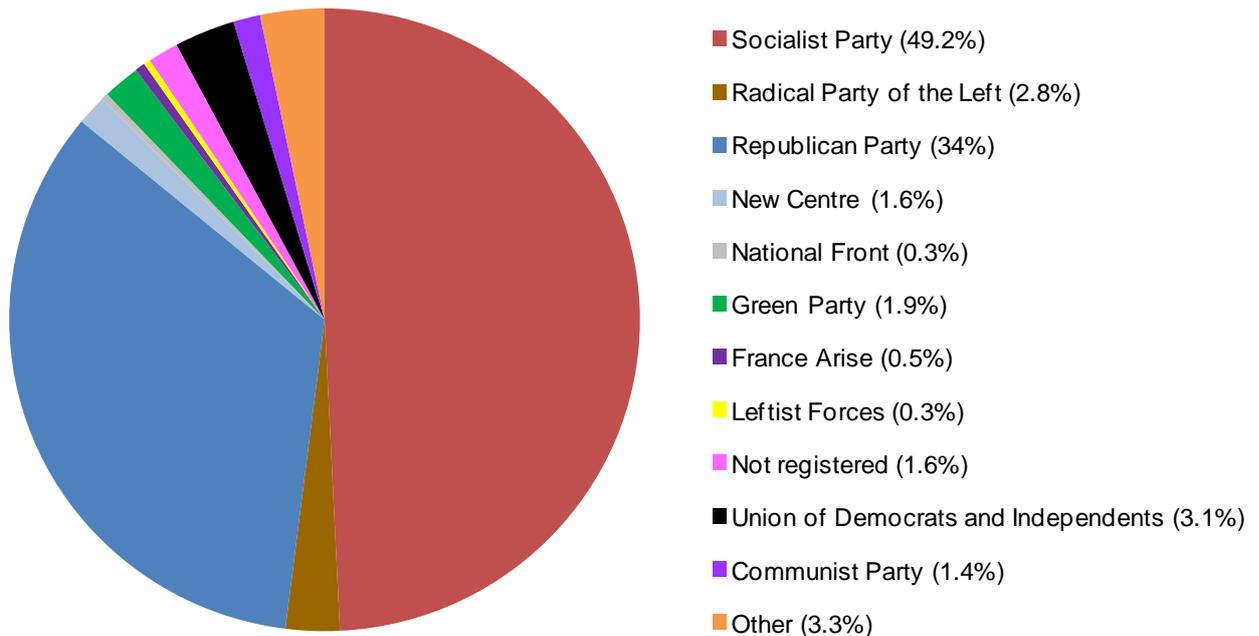


Source: Assemblée Nationale, Conseil Constitutionnel

- The Socialist Party of President François Hollande is currently by far the largest party (with 284 delegates), as depicted in Figure 17. It is five delegates short of a parliamentary majority but through coalitions with other leftist parties (including the Radical Party of the Left) can form a majority. President Hollande has thus enjoyed the freedom to appoint three successive Socialist prime ministers – Jean-Marc Ayrault in May 2012 (who Hollande dismissed), Manuel Valls in March 2014 (who resigned to run for the presidentials) and Bernard Cazeneuve in December 2016.

Figure 17: Socialist Party coalition is likely to lose the slim majority it currently enjoys in National Assembly

Current composition of French National Assembly (% of total delegates)



Source: Assemblée Nationale

- The main opposition, the Republican Party, currently has 196 seats. It is has historically been politically aligned with the centre-right Union of Democrats and Independents (18 delegates) and New Centre (9 deputies). The National Front only has two seats – a situation not too dissimilar to the United Kingdom Independent Party (UKIP) which has only one seat in the 650-seat [House of Commons](#).

Spectre of “cohabitation” looms large

“Cohabitation” occurred twice under President Mitterrand and once under President Chirac but under most scenarios the Prime Minister will likely hail from a different party than the President following this year’s twin elections.

Opinion polls – which have admittedly been few and far between in the past year – suggest that the composition of the National Assembly will change quite significantly in the June elections. Specifically, the Socialist Party and centre-left parties are tentatively forecast to lose over 100 delegates to the benefit of the National Front which is expected to gain a massive 60 delegates (but still be well short of a parliamentary majority). While the Republicans may fail to win a majority, they are also likely to significantly increase their share of seats and could conceivably form a majority coalition with centre-right parties.

Therefore, should Macron who has no party to back him up win the presidency he would likely have to appoint a Prime Minister who enjoys the backing of either the Republican Party or at a stretch a centre-right coalition of parties. This would in turn curtail his ability to push through a more leftist agenda, in my view. Similarly, should Le Pen or Mélenchon become president, they would probably have to work with a centre-right majority in parliament and have no choice but to appoint a Prime Minister who enjoys the Republican Party’s backing. This would in effect dilute their authority and ability to push through more extreme policies which do not have a majority backing.

The bottom line is that Le Pen and Mélenchon, and to a lesser extent Macron, would in the event of winning the second round, likely have to adapt their policies in order to garner parliament’s support, which in turn would reduce the scope for more extreme right-wing or left-wing policies, in my view. This may do little to change markets’ initial reaction to the presidential election outcome but could colour the French political landscape for the following five years.

LEXICON

Assemblée Nationale: National Assembly, the Lower House of French Parliament

Cohabition: A situation whereby the President and Prime Minister hail from two different political parties

Conseil Constitutionnel: A jurisdiction created in 1958 whose main task is to ensure that French laws are compatible with the Constitution. It is composed of nine members appointed by the President for a term of nine years. The current president is Laurent Fabius, a former Prime Minister and Minister of the Economy.

Debout La France: The party of Nicolas Dupont-Aignan (translates to France Arise)

Europe Ecologie Les Verts: Green Party

En Marche!: The political movement led by Emmanuel Macron (translates to On the March! or Forward!)

Front National: National Front Party led by Marine Le Pen

La France Insoumise: The political movement led by Jean-Luc Mélenchon (translates to Unsubmissive France)

L'Élysée: The official residence of the President of France since 1848

Lutte Ouvrière: The party of Nathalie Arthaud (translates to Workers' Struggle)

Ministère de l'Intérieur: French Ministry of the Interior

Nouveau Parti anticapitalist: The party of Philippe Poutou (translates to New Anticapitalist Party)

Parti Communiste Français: French Communist Party

Parti Radical de Gauche: Centre-left party with close affiliation to Socialist Party (translates to Radical Party of the Left)

Quinquennat: The five-year term served by each President of France

Sénat: Senate, the Upper House of French Parliament

Solidarité et Progrès: The party of Jacques Cheminade (translates to Solidarity and Progress)

Union des Démocrates et Indépendants: Centre-right party (translates to Union of Democrats and Independents)

Union Populaire Républicaine: The Party of François Asselineau (translates to Popular Republican Union)

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