



## Focal Point

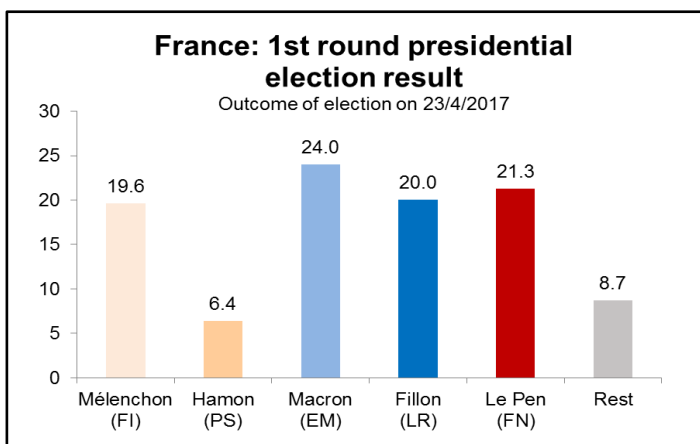
# Macron's election would lower political risk premium

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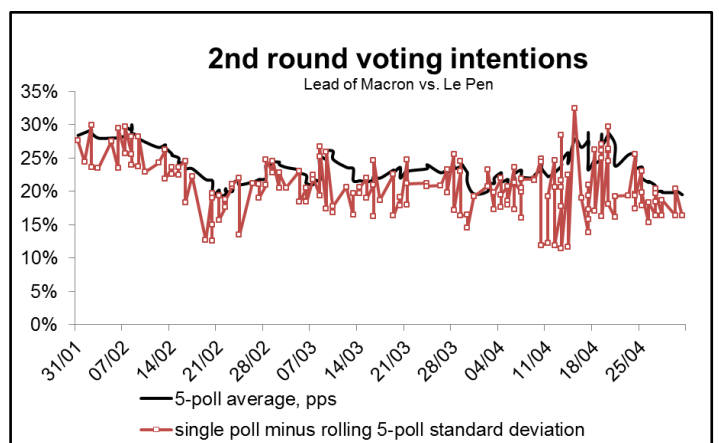
- Following Macron's victory in the first round of the French presidential elections as well as favorable polls, we continue to expect him to be elected as France's next president on May 7.
- Thereafter, the focus will shift towards the June parliamentary elections and the question whether the new president will be able to push through his agenda.
- We do not expect Macron's party to get the absolute majority in the National Assembly but deem it likely that he will be able to form a coalition in order to push ahead with his reform agenda. That said, there is still great uncertainty and polls on the parliamentary elections will only be published after the presidential vote.
- While financial markets responded with relief to the first round, Macron's ultimate election and the removal of a political tail risk is expected to support risk sentiment.

The first round of the French presidential elections on April 23 resulted in a clear victory of the center candidate. As predicted by polls before, the Front National candidate, Marine Le Pen, and the candidate of En Marche, Emmanuel Macron, got the highest share of votes – thereby qualifying for the run-off to be held on May 7. The turnout ratio was 77.8%, after 79.5% in the first round of the 2012 election. Financial markets took the outcome with relief as it defied concerns that the forecasting power of polls has deteriorated sharply. French government bonds traded higher and equity markets got a boost as well. Looking ahead, the key question is whether Macron will also win the second round of the election on May 7 and what this would imply for financial markets.



## Victory of Macron in second round highly likely

The indication for the second round of the French presidential elections is very clear. Over the past months Macron has consistently done well against Le Pen in run-offs according to polls. The lead of the former over the latter fluctuated but its 5-day average never fell below 20 percentage points. Even if one moves to single forecasts and considers the lower (5-day) standard deviation of polls, the lead of Macron over Le Pen was 11 percentage points at the lowest (see chart below). Moreover, the closer the elections date the smaller becomes the forecasting error. Three days before the second round of the elections, the historical forecasting error is below one percentage point. Hence, from a statistical perspective a victory of Macron in Sunday's election seems very likely even though unforeseen events like terror attacks remain a wildcard.



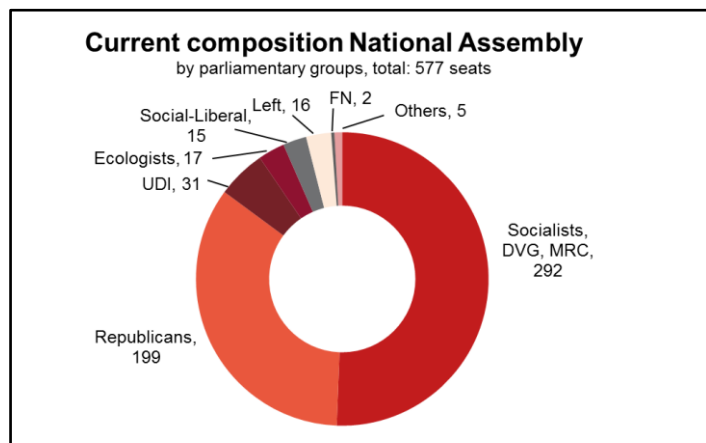
## The agenda of Macron

Before heading for the Presidency, Macron was Minister of the Economy from August 2014 to August 2016. However, he left the Socialist Party already in August 2015 and founded En Marche in April 2016. He belonged to the right wing of the Socialist Party. Political analysts describe him as social liberal or social democrat and he is widely viewed as a centrist.

During his time as a Minister of the Economy he pushed through the so called 'Loi Macron' in August 2015 which liberalized services sectors (transportation, notaries) and introduced some further flexibility to the labor market. The agenda of Macron foresees measures to improve the flexibility of the labor market, to lower social security contributions as well as corporate taxes, thereby boosting innovation. He pledges for more flexibility regarding the 35h-week and wants to increase the retirement age to 65 years. Regarding public finances, he plans savings (of € 60 bn) in order to finance the expenses. On the European level he argues for more integration and supports the establishment of a European Finance Minister.

### Focus to shift towards parliamentary elections

Looking further ahead, the key question is whether the future President Macron will be able to push through his agenda. In order to do so he first of all needs the backing of the National Assembly. Currently, Macron's En Marche party has no deputies in the National Assembly and the parliamentary group (consisting of Socialists, DVG and MRC) backing the incumbent Socialist president Hollande holds the majority of 292 out of 577 seats.



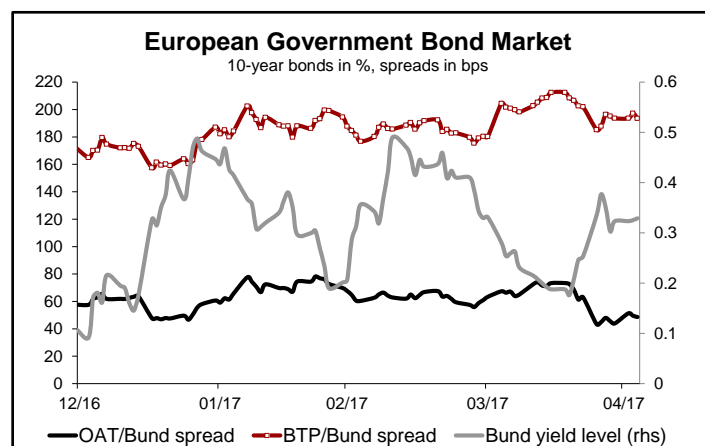
Legislative elections will take place on June 11 and 18. They are held right after the presidential elections in order to minimize the risk that the newly elected president will have to cope with a government led by political competitors (so called cohabitation). Polls on the June elections covering the whole of France have not yet started. However, on May 3 a poll for a newspaper (Les Echos) covered metropolitan France without Corsica. Based on this poll EM would get between 249-285 deputies, the conservatives 200-210 deputies, the Socialists would get only 28-43 deputies and the Front National would be able to get between 15-25 deputies. Hence, Macron's party would fall just short of an absolute majority. However, this is just the first poll and following the second round of presidential elections the forecasts will be published more regularly. As it stands now, we do not expect En Marche to get the absolute majority in the national assembly. Still, he may be

able to form alliances with the more centrist parliamentary members from the Socialist and center-right.

In our view, the 2017 French election campaign shows that there is a strong will of change. Voters favor a centrist-reformist and euro-friendly course. Politicians have to deliver. The fact that polls show an increase in the number of Front National deputies in the National Assembly is a warning signal that a further postponement of changes could benefit radical and Eurosceptic forces. Having this in mind there are strong incentives, especially for the Socialists and the conservatives to cooperate with Macron. Looking further down the road, we therefore stick to our view that France will increase its reform momentum while the Frexit risk will be off the table, at least for the coming five years.

### Macron's election to support financial assets

Financial markets responded to the first round of the Presidential elections with relief. For example, since April 21 the 10-year Bund yield has risen by 13 bps, the 10-year OAT/Bund spread has fallen by 24 bps and the EuroStoxx 50 has increased by more than 5% to the highest level since summer 2015.

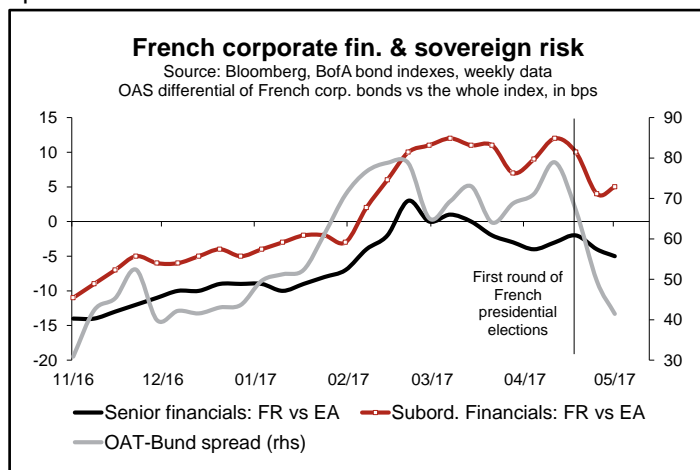


Therewith, financial markets have already discounted to a large extent the expectation of Emmanuel Macron becoming the new French president. Consequently, the immediate market response to the ultimate confirmation is forecast to remain rather muted. Nevertheless, the election is unlikely to be a non-event as the final removal of a political tail risk should support risk sentiment and is likely to support risky assets for the time being. What is more, financial assets reacted unevenly to Macron's victory. While the 10-year OAT/Bund spread is on its year-low (at 44 bps), the 10-year BTP/Bund spread is still above the annual average.

Going forward, we see scope for Bund yields to increase further. With the most immediate source of political risk behind, financial markets are seen to focus on the sound euro area macroeconomic fundamentals and the expected less dovish policy stance of the ECB. In this environment the Bund curve is likely to bear steepen moderately. The increase in OAT yields is expected to lag a bit. However, a lasting move of the 10-year OAT/Bund spread below the 40 bps threshold (from 43 bps currently) is not on the cards – particularly as the parliamentary elections in June will already cast their shadow and a stable majority for En Marche is far from certain.

Southern European sovereign bond spreads are seen to benefit from Macron's election. Although spreads have tightened over the last weeks, we see leeway for the strong performance to continue. However, this applies only to a limited extent for Italian BTPs. Italian sovereign bonds have underperformed since December. With the political concerns unlikely to vanish in the months to come (looming general elections at latest in spring 2018), the scope for tighter BTP spreads appears limited. Though, the generally friendly market environment should prevent a spread widening in the near term.

Euro area corporate bond spreads finally broke out of the trading range and with no major hurdles ahead, there is scope for a continuation of the rally. Although the ECB has reduced its corporate bond purchases since the start of April, the central bank remains an important buyer in the market and against the background of sound balance sheets, euro area corporate bond spreads have leeway to tighten more in the weeks to come. Deep diving more into financial corporate bonds, we expect French names to further reverse the underperformance suffered since November 2016. The Option Adjusted Spread differential of French financials vs the whole index has only partially recovered after the first round of presidential election and we see room for a further tightening in relative terms along with the decline in the OAT-Bund spread already occurred. In particular, corporate Investment Grade French senior (subordinated) financial bonds should outperform their peers by around 10 bps (15 bps) in terms of relative spread movements.



Finally, with the near-term political risks vanishing and increasing profits, we reiterate our conviction of a preference of euro area equities versus more expensive US ones. That said, as the 12-month PE for the MSCI EMU has already approached the 15X level, the 16X one (cyclical top since 2004) should be seen as an upper bound, leading to a more prudent portfolio allocation.

# Imprint

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