

European Economics

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France: thinking the unthinkable

French Presidential and legislative elections are, in our view, the key political event in the euro area this year. There is a fat tail risk – the victory of Marine Le Pen – but also an opportunity for a fresh start in France and in Europe, if the center-right or the centrist Macron win.

Recent allegations have blurred the political outlook. The participation of favourite candidate Francois Fillon is in doubt, after revelations of the allegedly fictitious employment of his wife and children. The three-time presidential candidate, Francois Bayrou, has recently announced he could take a decision for the good of the country, in mid-February, hinting he might run again.

Meanwhile, the socialist party saw an unexpected victory of the leftist candidate, Benoit Hamon, in the primaries, that, on one side, increases the probability of pro-European and pro-market Emmanuel Macron to reach the second round (and to win the presidential elections). And on the other argues for a possibility of a unified left front, with far-left candidate Jean-Luc Melenchon, that could still re-open the race and push a far-left candidate in the second round of the elections. It is uncertain and as confusing as it looks!

For now, this has been a boon for Macron... and Le Pen... Marine Le Pen, the far-right candidate, is sitting comfortably on her position, ahead in the polls for the first round – but still widely expected to lose, and by a large margin in the second and final round. Clearly, the situation might change with the above mentioned developments and **we examine what might actually happen in the case of a Le Pen victory in the main text of this note.**

A recent poll placed Fillon, for the first time, behind Macron. The conservative candidate is credited with only 19% and 20% of the voting intentions (according to whether or not Bayrou enters the race): that is a drop of 5/6 points in just four weeks. According to the same survey, Le Pen would face Macron in the second round, but lose with 35% of voting intentions against 65% for Macron.

... but new developments should be expected in the next couple of weeks. The results of the Fillon investigation will likely be provided soon, given the sensitivity of the issue in the middle of Fillon's presidential campaign – Fillon asked his party to give him two weeks – so we should expect the situation to be resolved by that time. If he or his wife were to be charged, Fillon said he would renounce the candidacy. For now, no other Republican candidate has been designated to replace him although a few names are circulating. The strength of the “Republicans” is more in the views of the party, shared by the voters, than specifically on those of their candidate. As such, we still think it is possible that a potential replacement candidate could still attract sufficient voters for the center-right to win the elections, which is consistent with current polling. But clearly the situation is more fluid than it was only a week ago – and investors need to monitor the situation carefully. Stay tuned.

First round of the Presidential elections: April 23

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The likelihood of Marine Le Pen reaching the second and final round of the Presidential election is very high, according to polls, and has been so since the start of the campaign. But polls indicate her chances to win the presidency remain low, as we discussed in detail [here](#). Indeed despite some similarities with Trump, Marine Le Pen is not an outsider, her vote potential has been tested – even recently, after the terrorist attacks – and is close to 30% of the electorate. It might be pushed up to 40%, counting on a lower participation rate, stretching her popularity and taking into account a further shift in political sentiment. But reaching a 50%+ support would likely require significant innovations in what is now an established and well-defined political positioning. It is true that latest polls show Marine Le Pen gaining some ground, but within a limited range and still hovering around 30%.

The center-right candidate, Francois Fillon is losing momentum. A recent survey placed Fillon, for the first time, behind Emmanuel Macron. The conservative candidate is credited with only 19% and 20% of the voting intentions (according to whether or not Francois Bayrou – a three-time centrist presidential candidate – enters the race): a drop of 5 points in just four weeks. Fillon is suffering from the ongoing case about his wife's and children allegedly fictitious employment. The results of the investigation should hopefully be out soon given the sensitivity of the subject in the middle of Fillon's presidential campaign.

- (1) If Fillon and his wife are not charged: he will be able to pursue his candidacy and will have to quickly reverse his score trend. Let's bear in mind that he is at present the only candidate with a clear project out, and has been an easier target for opponents and from the press as a consequence. As such, we would expect the recent trend to reverse when other candidates finally publish their programs too.
- (2) If he and/or his wife are charged: he said he will resign as presidential candidate. As of now no other Republican candidate has been designated to replace him although a few names are circulating in the press unofficially: Francois Baroin, Valerie Pecresse, Xavier Bertrand... We do not expect new Republican primaries in this case given the lack of time until the presidential election. We would expect the potential candidate to likely be younger than Fillon (to better face Emmanuel Macron) and to embrace largely Fillon's political project.

It's not about the person but about the party: If Fillon doesn't run it may not be seen as a fundamental flaw for the center-right's chances of winning, as he is viewed by many as the embodiment of the values of his party's electorate at present. He is a strong candidate because the Republican party is strong in France. Without doubt his resignation would have negative impacts – but, unlike Macron, if he resigns other party leaders would be able to take his legacy. That is why we believe the Republican party would likely still be in a good position to win the presidential – and even more so the legislative elections (in June).

On the centre-left side Benoit Hamon, former minister of education won the Socialist primaries and will represent the party in the upcoming presidential election. We do not expect him to be relevant given that all surveys rank him 5th and with voting intentions too low to allow him a chance of reaching the final round. His victory marks Francois Hollande's failures and highlights the division within the Socialist party.

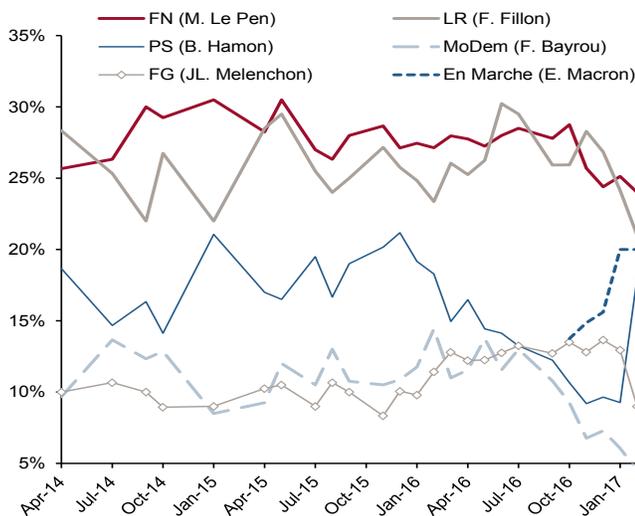
What does this mean for Emmanuel Macron? Hamon's markedly left positioning should allow Emmanuel Macron to capture (center)-left voters that find Hamon too left wing. Nevertheless, as of now, it doesn't appear to us this will be enough to secure Macron's place in the second round of the presidential election. It is true that Macron has been the political revelation of these recent months and has proved very successful in riding the wave which has propelled him to the third place in the Presidential election polling. He has also been named as the most popular French politician in the December Odexa survey,

beating the 24 other politicians present in the survey. Yet, he is still lacking broad political support. To reach the second round he will probably need to attract the endorsement of centre-left politicians (possibly even Hollande?), given that he is not backed by a proper party structure.

Hamon's victory appears to be bad news for the far-left candidate, Jean-Luc Melancon, we believe. The latest survey showed Melancon will cumulate around 10% of voting intentions – 6% less than before Hamon was elected. Melancon score is not enough to secure him a position in the final round, but high enough to create a surprise if Hamon and him were to create an alliance – although this has been rejected by Melancon so far. If the latter were to reach the second round, in a face-off with Marine Le Pen – admittedly an unlikely scenario at this stage – this would be the only clear chance for a far-right victory in France, in our view.

Figure 1: Macron gaining momentum

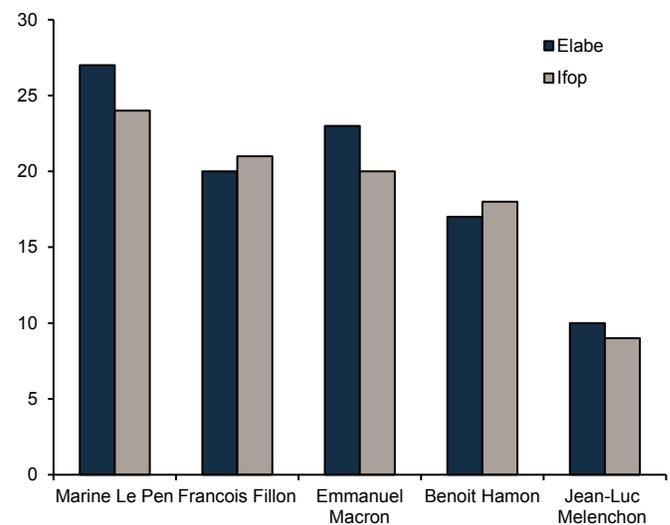
Monthly average of various polls



Source: Monthly average of various polls, Credit Suisse Economics Research

Figure 2: First round of the Presidential election

Based on latest polls



Source: Elabe, Ifop, Credit Suisse Economics Research

Second round (May 7): blocking Marine?

According to most recent polls, three candidates are more likely to make it to the second round: Fillon, Le Pen and Macron.

If Le Pen were to face either Fillon (or a center-right substitute) or Macron in the second round, we expect her to lose by a large margin, of at least 40-to-60%, based on current polls. To win the second round she would have to find many more voters (millions) than she has reached so far, even in relatively conservative estimates of participation. We believe this is very unlikely to happen given that no other candidate (from the first round) will call to vote for her.

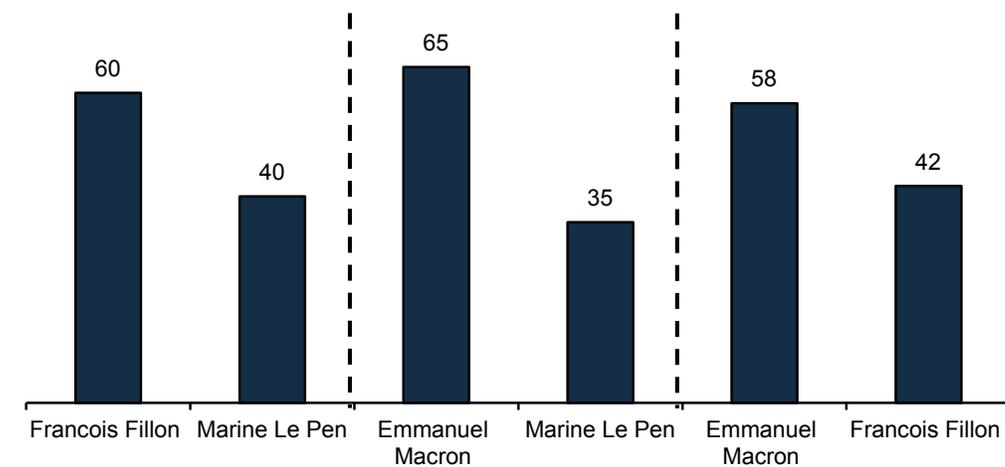
A loyal electoral base will help her accessing the second round but is not going to help her in winning the presidency as she likely won't be able to attract new voters easily – with a center-right candidate and Macron seen as sufficiently mainstream to gather additional support from the more traditional right or left voters, that would have lost their first-choice candidate in the first round, we believe.

In the case of a Fillon vs. Macron contest, polls suggest Macron would win. While the current uncertainties on Fillon's candidature make all these polls more fluid, we believe, they would still be relevant in case of a replacement candidate, as we discussed above.

As we already mentioned, however, investors need to monitor the situation closely: a potential transfer of votes to Macron would be stabilizing, in our view, while a drift in the support towards Marine Le Pen – or a lower participation intention in the vote, due to rejection of politics altogether – would put pressure on financial assets, we believe.

Figure 3: Fillon or Macron?

Kantar Sofres, 27 January 2017



Source: Kantar Sofres-One Point, Credit Suisse Economics Research

Parliamentary elections (June): A “safety valve”

French presidential elections are always followed by parliamentary ones, to ensure that powers are not (only) in the hands of the President. Parliamentary elections will take place in June, via a two round elections that will select 577 MPs. Currently the center-left has a parliamentary majority, as shown in Figure 4, but according to a recent survey this is likely to shift and the (center-)right should gain a significant parliamentary majority in the upcoming elections. As for the far-right Front National, Marine Le Pen's party, they currently only have a couple of seats in parliament: while the expectations are for a very significant increase, with between 58 and 64 seats the Front National would be miles away from majority (Figure 5).

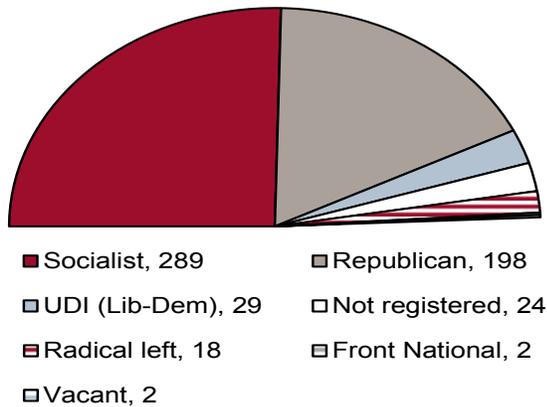
It is our understanding that in the hypothetical scenario where Marine Le Pen wins the Presidential elections, she would have very limited powers. Without parliamentary majority Marine Le Pen would have to form a coalition government (so-called “cohabitation”). She would have to choose a Prime Minister from the majority party (most likely a center-right one) sharing her powers with the Prime Minister – and to a large extent in subalternate position relative to the PM, in what French constitutionalists call the “inversion” of powers.

In the case of cohabitation the President is de facto “neutralised”, and power is transferred to the Prime Minister (Box 1), who would manage domestic policies while the President represents France abroad and decides – with limitations – on foreign policy.

The President appoints the Prime Minister but (s)he must come from the group which has majority in parliament. The majority group actually proposes a candidate, that the President can accept – or reject, if (s)he believes someone else could better do the job. The group then has to propose someone else until the President agrees. This ping-pong

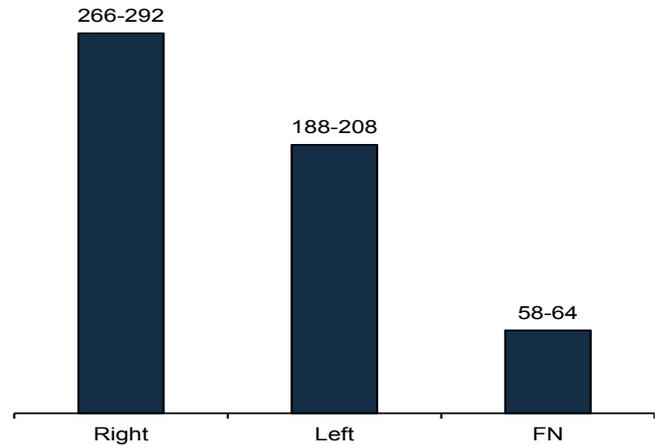
cannot go on forever, though: if the President continuously refuses candidates then (s)he could potentially be removed from office on the ground of duty breach. Additionally, if the President does not accept to govern in cohabitation the only choice (s)he has is to resign.

Figure 4: Current composition of the Parliament



Source: Credit Suisse Economics Research

Figure 5: Seat projection for 2017



Source: Opinion Way, Credit Suisse Economics Research

Box 1: In the case of cohabitation the President loses part of his/her powers to the Prime Minister. Below is the list of the reduced powers the President has under a coalition government:

- Although he/she still appoints the Prime Minister, he/she needs to be coming from the majority party in Parliament.
- He/she cannot choose his cabinet members, apart from the defense and foreign affairs department.
- The President cannot dismiss the Prime Minister, only the Parliament can.
- No laws can be implemented without the agreement of the Prime Minister and/or the Parliament.
- He/she can still dissolve the parliament, but only one year after the elections (which could well happen, but shouldn't change the outcome ex-ante).
- He/she signs laws and decrees and can nominate the civil servants and soldier of the State.
- He/she can initiate referendums but only if the proposition comes from the Prime Minister or either one of the two chambers.
- He/she can trigger Article 16 which gives the President full powers, but the approval of article 16 needs to be justified. And it only happened once with De Gaulle under the 5th Republic. The full powers are granted for 30 days and can be renewed if necessary.

The bottom line is that a President without a majority in parliament must govern with a PM and government of a different political side which limits very significantly his/her powers.

A "Frexit" referendum – is that even possible?

A few hours after the UK voted leave in the EU referendum, Le Pen announced on Twitter that she too would push for a European referendum if elected President in 2017.

But having a referendum on leaving the European Union in France would not be that simple. Actually, it is a very complex endeavour and one that is made even harder in a cohabitation framework.

A. Can the president decide to propose a referendum alone?

No – In a cohabitation a president alone cannot decide to trigger a referendum: a referendum proposition can only come from either one of the two chambers (lower or upper) or the government by the PM intermediary.

B. What type of referendum?

1. The legislative referendum (via art.11)

Art.11 of the French constitution says: *"The President of the Republic may, on a recommendation from the Government when Parliament is in session, or on a joint motion of the two Houses (...) submit to a referendum any Government Bill which deals with the organization of the public authorities, or with reforms relating to the economic, social or environmental policy of the Nation, and to the public services contributing thereto, or which provides for authorisation to ratify a treaty which, although not contrary to the Constitution, would affect the functioning of the institutions."*

It is our understanding that art.11 cannot be used to have a referendum on France leaving the European Union as it does not say anything on withdrawing from and existing international agreement, nor say anything about repealing an existing treaty. In other words, if Marine Le Pen wanted to put the following question "Should France remain a member of the European Union – or leave?" to a referendum she couldn't use article 11¹, but would have to change the constitution first, using the – heavier, procedurally – article 89².

2. The constitutional referendum (art.89)

Art.89 of the French constitution says: *"The President of the Republic, on the recommendation of the Prime Minister, and Members of Parliament shall have the right to initiate amendments to the Constitution. A Government (...) Bill to amend the Constitution must (...) be passed by the two Houses in identical terms. The amendment shall take effect after approval by referendum. (...)"*

Overall, having a EU referendum in France is not impossible but difficult to implement as it requires a constitutional change. For (hypothetical) President Le Pen to make such a constitutional change she would firstly need to be backed by the Prime Minister and then to get a draft law amending the constitution being voted by both chambers – which looks unlikely if not outright impossible: as we discussed above she won't have a majority in the Lower House in the Parliamentary elections – while a majority in the Senate is if anything even more difficult to reach (actually, impossible, for at least some years), as only half of the Senators are replaced every three years. .

¹ Moreover, having a referendum on a simple question such as the above is not allowed in France, differently from the UK. Before launching a referendum (not just on EU membership, by the way, but on all topics) the government must first prepare a draft law.

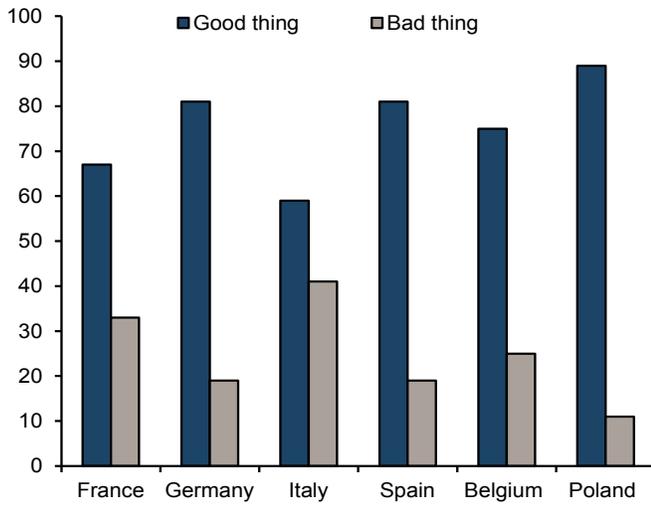
² The only way Marine Le Pen could actually try to use article 11 to have a referendum on the EU would be through a so-called "shared initiative" referendum where the parliament would propose a project that will have to be accepted by 20% of member of parliament (115 MPs) and 10% of electorate rolls. The project will then have to go through the constitutional council and a judge will have a month to decide if the project is constitutional. Given that the project will imply repealing an international treaty, it is highly likely that the judge would rule it as unconstitutional. And if so, the government would have to proceed via article 89.

C. Finally, in the highly hypothetical scenario of a referendum, would French people vote to exit the European Union?

Unlikely. French people are attached to the European Union, a recent survey made in October 2016 showed that 69% felt attached to the EU. Additionally, most French people think that France is stronger in the EU, to fight against terrorism (62%) and to cope with economic competition coming from the US and Asia (59%).

Figure 6: Do you think belonging to the EU is a...?

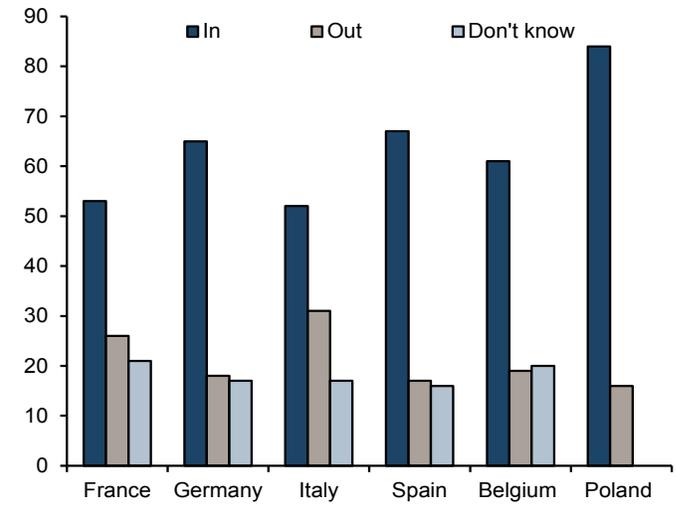
Eurobarometer



Source: Credit Suisse Economics Research, Eurobarometer

Figure 7: If there was a referendum would you vote...?

IFOP, July 2016



Source: Credit Suisse Economics Research, IFOP

France, Europe, and the meaning of sovereignty

The concept of sovereignty has been used (and abused) by politicians – not just in France. From Le Pen’s viewpoint, sovereignty probably means the ability of the country to be in charge of its destiny, on its own, and also include monetary sovereignty (i.e., the return to a national currency and to an independent central bank, as opposed to the euro and to the ECB). That’s akin to the views expressed by many in the UK in the Brexit debate – and has very similar echoes in, for example, the Dutch or Italian extremists parties.

In traditional political science, sovereignty is often defined as the ability to reach one’s own objective – or to impose one’s will. Sovereignty is supreme authority, the freedom to do what is perceived as required, without constrictions from the outside.

Macron (and Fillon too, although to a lesser degree), instead, put forward a concept of “European sovereignty”: France, even if legally sovereign, would not be effectively sovereign in today’s world without sharing – and driving – European sovereignty. Several key topics (defense, global warming, ...) are inherently akin to a broader concept of sovereignty in the 21st century – while others – like the preservations of similar (European) values in a context of large economic and social blocks, such as Russia, China and the US suggest the need for a shared concept of sovereignty.

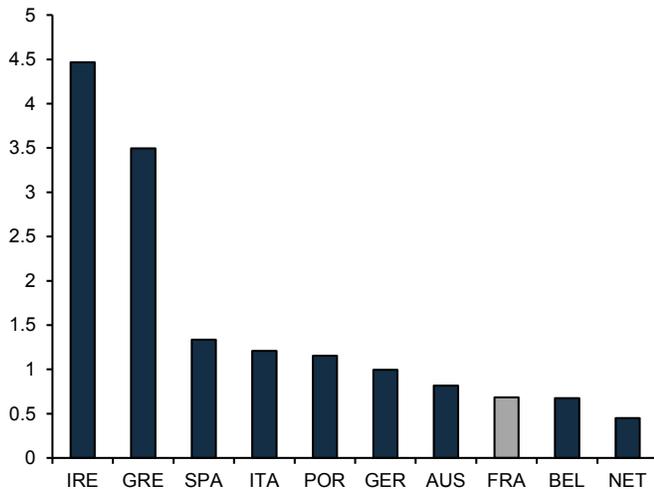
But beyond these – somewhat philosophical digressions – we want to make a key point that relates to our view of the French economy. For us, France is the euro area.

France is the real core of Europe, in our view, as it is the median country of the Union on most metrics (see charts overleaf), between the periphery and Germany. Policies targeting the median European – which is what the ECB does, are well suited for France, as a consequence: it is as if France had retained its “own” central bank – and as such its monetary sovereignty – while joining the euro.

This provides a key advantage to the country, we believe: area wide policies are most of the time “tailored” for France. In other words, a worsening economic situation in France will probably entail policy reactions at the euro area level that would suit the country. Risks to this view would be related to much weaker – and France-specific – negative GDP developments in the coming quarters, which we don’t see. Actually, our analysis of the cyclical and more structural developments of the French economy suggest that France is not only rebounding in line with the rest of the euro area – but also that the measures enacted in recent years have kept France well anchored in its “core” position within the euro area.

Figure 8: France=Euro area... GDP growth

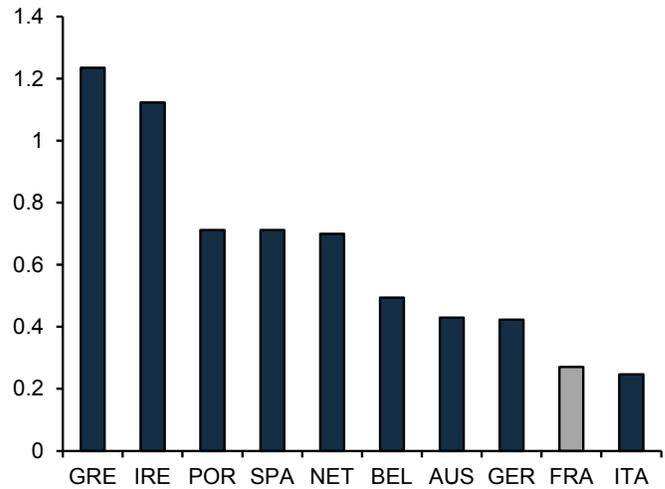
Absolute average distance from EA figures (2000-2016), pp



Source: Credit Suisse Economics Research, Datastream

Figure 9: France=Euro area... Inflation

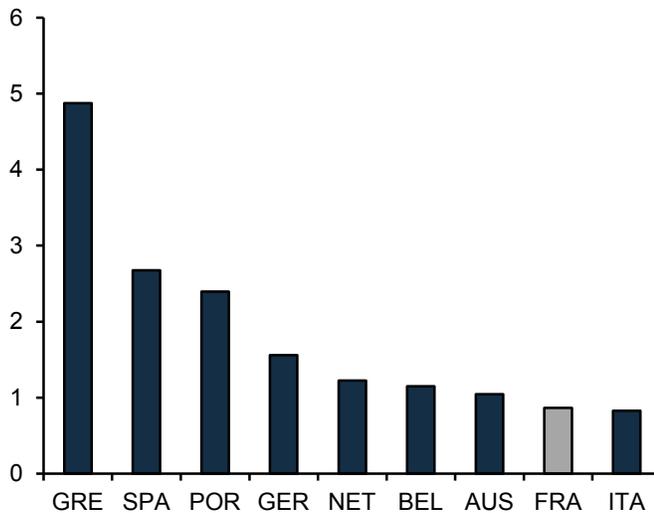
Absolute average distance from EA figures (2000-2016), pp



Source: Credit Suisse Economics Research, Datastream

Figure 10: France=Euro area... Government balance

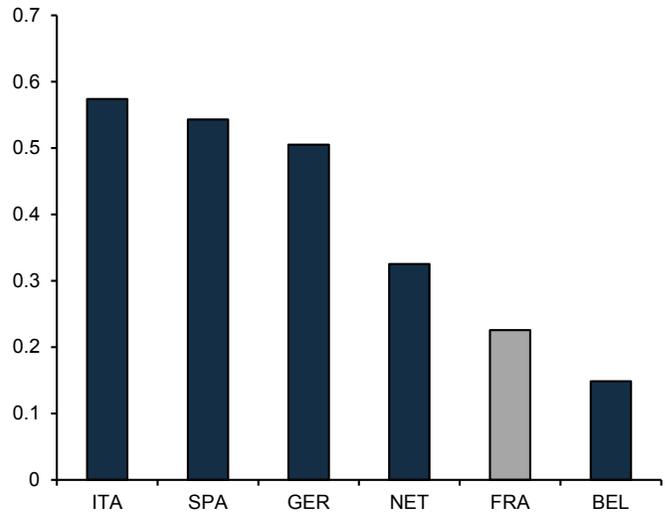
Absolute average distance from EA figures (2000-2016), pp



Source: Credit Suisse Economics Research, Datastream

Figure 11: France=Euro area... 10-year yield

Absolute average distance from EA figures (2000-2016), pp



Source: Credit Suisse Economics Research, Bloomberg

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Disclosure Appendix

Analyst Certification

Anais Bousie, Giovanni Zanni, Neville Hill, Peter Foley, Sonali Punhani and Veronika Roharova each certify, with respect to the companies or securities that the individual analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

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