HOUSE VIEW

DEFICIT, DEFICIT AND MORE DEFICIT

BancaMarch

DEFICIT, DEFICIT AND MORE DEFICIT

This Sunday we will see the final result of the French legislative elections. Polls suggest that, although Marine Le Pen's National Rally (RN) party will achieve a comfortable victory, it will not obtain an absolute majority in the National Assembly. This political group is committed, among other things, to "providing economic relief to the French", "the recovery of purchasing power" and "control of immigration", a set of measures that, if implemented in full, could amount to up to 3.5 p.p. of GDP.

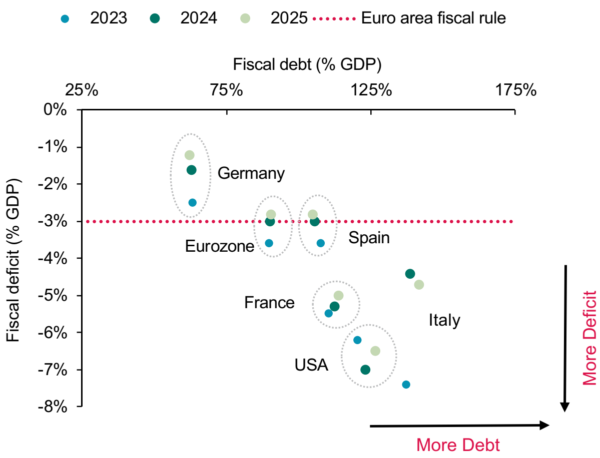
With Macron's party relegated to third place, the alternative to the RN would be the New Popular Front, a left-wing coalition led by Jean-Luc Mélenchon's France Insoumise, which proposes measures such as raising the minimum wage to 1,600 euros, reducing the retirement age to 60, as well as improving infrastructure and public services.

The eagerness to seek out new political directions is not an exclusively French phenomenon. Apart from right-wing extremism or the fierce struggle for control of the White House by two octogenarian presidential candidates, just yesterday in the United Kingdom the Labour Party won an overwhelming majority after 14 years out of government.

Above and beyond political considerations, in the economic sphere there is an underlying fact: a good number of voters are demanding, through one extreme or another, more income transfers through to tax cuts as well as more and better social services. A situation that would reduce public coffers to Swiss cheese, full of holes, making it difficult to reduce the deficit.

1. DEFICIT AND PUBLIC DEBT OVER GD

Sources: CE, CBO, FMI and Banca March



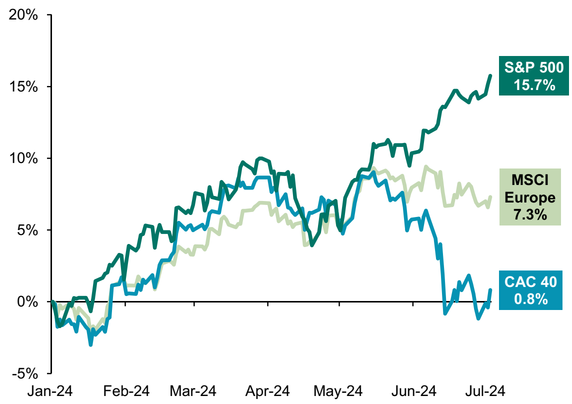
The lack of budgetary discipline is far from an isolated case. To give just one example, the EU, after several years of warnings and leniency with the spending that was used to tackle the pandemic, announced two weeks ago that it will initiate the excessive deficit procedure for seven of the 11 member states that have exceeded the 3% deficit target – including countries such as France, Italy, Belgium and Hungary.

The most likely scenario in France starting Sunday points to a divided National Assembly in which a fair amount of juggling will be needed to appoint a new prime minister. And the balance between the majority forces will determine the extent to which part of the laws enacted by Macron, such as the labour reform, will be reversed.

Despite the fact that the news is not good, we believe that the situation must be put into perspective: this is not the storming of the Bastille. First, a divided government would limit the ability of extremists to pass drastic programs. Moreover, some past experience shows that, once politicians come to power, they tend to moderate the implementation of their electoral programmes – and more so within the framework of the EU. At least that is what Meloni has done in Italy. Moreover, if leaders insist on moving away from orthodoxy, the markets will put pressure on them and ultimately prevent it – in the United Kingdom, Liz Truss was unable to pass the budget in 2022 and only lasted as Prime Minister for 44 days. Lastly, listed French companies have a very international dimension – only 16% of MSCI France's revenues come from the French domestic market. However, in recent days they have been heavily penalized with peak-to-trough drops of about -8% and a relative performance against the S&P 500 of -12% in the last month and a half.

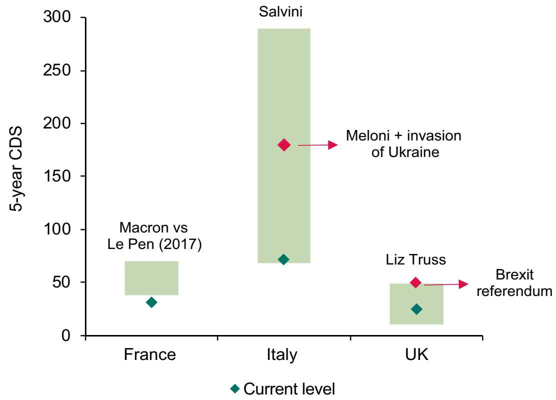
2. PERFORMANCE OF FRENCH STOCK MARKET VS. S&P 500

Sources: Bloomberg and Banca March



3. RESTRAINED REACTION IN CDS

Sources: Bloomberg and Banca March



In the fixed income market, stress has been quite contained. The French risk spread, despite being 10 bps above the Portuguese one, remains at levels similar to those recorded in the 2017 French legislative elections. Levels of default insurance used to insure debt (5-year CDS) are less aggressive: It is trading at 35 bps, exactly half of what it was then. As the chart shows, things usually return to normal over time, even if on this occasion tempers have not flared too much.

In short, although the absence of fiscal rigour is undoubtedly a threat to States and ends up hindering economic growth in the medium term, the French case is not too different to that of other countries. Despite the political uncertainty that is growing in France, we believe that we must capitalise on these episodes of volatility to continue positioning ourselves for a resilient global economic cycle that is heading towards a soft landing. Our intent is strictly opportunistic. We know what Napoleon said after his defeat at Waterloo by the British and Prussian armies: “All is not lost. I reckon that, once I regroup my forces, I will have 150,000 men.” A declaration of intent and an example that you have to seek out opportunities in the face of adversity.

Joan Bonet Majó
Head of Market Strategy and Advisory Services

IMPORTANT REMARK: