

France election: Macron wins big

Key views



We could see moderate gains in risk assets, with Macron's victory largely priced in after his first-round win



Legislative elections in June will be a key yardstick of Macron's ability to form a coalition to advance his reform agenda



We are positive on European shares, and see the reduction of political risk helping investors to refocus on the region's improving growth prospects

Independent centrist Emmanuel Macron has prevailed over the far-right Marine Le Pen in the final round of the French presidential election. Macron's comfortable win of about 65% of the vote marked a rebuke of Le Pen's *Front National* party, which ran on a nationalistic platform that included a referendum on leaving the European Union.

We expect the focus to shift to French legislative elections in June. These will be crucial for determining Macron's ability to implement his economic program, which includes labor market reforms that would make it easier for French businesses to hire and fire. We see scope for a mild risk-on reaction to the result, which looks mostly priced in after Macron clocked a first-round victory and polls consistently showed him ahead by a large margin.

We are positive on European shares and see potential for renewed investor inflows as focus returns to the region's improving growth. European purchasing managers' indexes point to the strongest economic activity in six years. Europe stands to benefit from global reflation, and we see attractive valuations in cyclical shares. We are underweight European fixed income. The region's improving economic outlook may spur higher bond yields and wider credit spreads – especially if markets sense the European Central Bank (ECB) is moving toward winding back its asset purchases.

Macron will form an interim government for the short period until the new National Assembly is in place in July. This government is not expected to make significant policy decisions, but appointments will be a gauge of Macron's ability to attract high-profile names from the two major parties to form a broad-based majority.

Our base case is that Macron will need to select a compromise prime minister and cobble together a working majority with supportive members of France's two major parties. This could lead to some watering down of his reform plans. Yet Macron's comfortable win means we now see some chance his *En Marche!* movement and its formal allies could win an outright majority, enabling him to choose his prime minister and government. A lower-probability scenario we see is the *Les Républicains* conservative party winning a majority. The last two scenarios would allow for business-friendly reforms – and would be welcomed by markets, we believe.

The French election result confirms our view that markets until recently had overstated European political risks. Italian political risk and the country's fragile banking system could move back into focus soon, however, particularly if the likelihood of early elections in late 2017 rises. These issues as well as Europe's still incomplete banking and fiscal union leave fault lines that could be exposed by eventual ECB normalization – and which bring into question the longer-term sustainability of the European Monetary Union.

Macron's win marks a sea change in French politics. He is not part of the mainstream left/right parties that have dominated since Charles de Gaulle formed the Fifth Republic nearly 60 years ago. Macron, a 39-year-old former investment banker, ran on a "change" platform that would favor business-friendly reforms and deeper European integration. He is committed to meeting the EU's 3% deficit target, combining spending cuts with targeted investments and freeing up the labor market.

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