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French Elections: C’est L’economie, Stupide

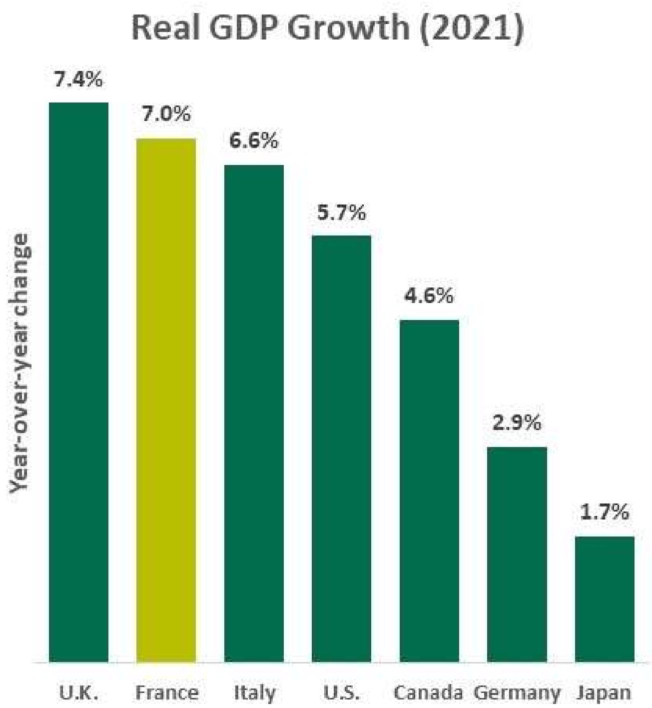
Inflation has complicated Macron's path to reelection.

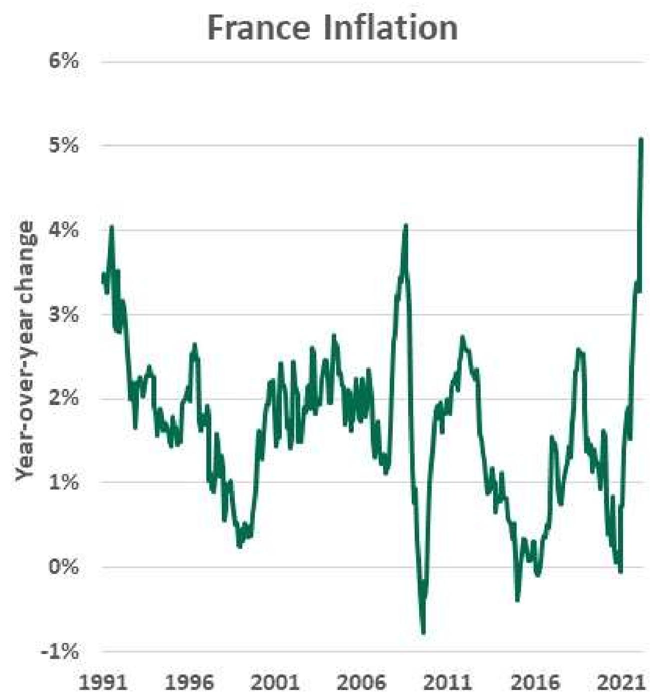
By Vaibhav Tandon

“It’s the economy, stupid” was the phrase coined by James Carville, strategist of U.S. President Bill Clinton’s 1992 campaign, reinforcing the importance of employment, inflation and markets to the public mood. The phrase went on to become a popular slogan, often repeated in political exhortations.

Thirty years later and an ocean apart, the economy is likely to determine the outcome as France goes to the polls this weekend.

During the 2009-12 European debt crisis, France was often grouped with the afflicted Southern European nations, but it has come a long way since then. The country has been a star performer during the pandemic. Recovery from COVID-19-induced lockdowns has been exemplary, as was the French vaccination drive. France's gross domestic product grew by 7% in 2021 after adjusting for inflation, the highest in nearly half a century and the second-best performance among G7 nations.





Sources: Oxford Economics, Haver Analytics

French labor markets have tightened considerably, with the unemployment rate falling to 7.4% in February 2022, well below the pre-pandemic level of 8.2%. Subsidies to employers to keep furloughed workers on the payroll have been a major factor in keeping unemployment in check. Joblessness among youth has also dropped to the lowest level in three decades.

In recent years, the French labor market has benefitted from deregulation reforms that were aimed at boosting job creation and making temporary positions more expensive for employers. Other reforms included tax cuts on businesses and replacing the wealth tax with a narrower property tax. The state is also better armed to cope with the headwinds from the war in Ukraine than other countries are, owing to relatively less reliance on Russian or Ukrainian imports.

With a positive economic backdrop, President Emmanuel Macron will be hoping to secure a second term. However, an alternative interpretation of James Carville's catch phrase encourages a focus on the lived well-being of people, not the broader macroeconomic statistics. By this standard, Macron's path to victory may not be that smooth.

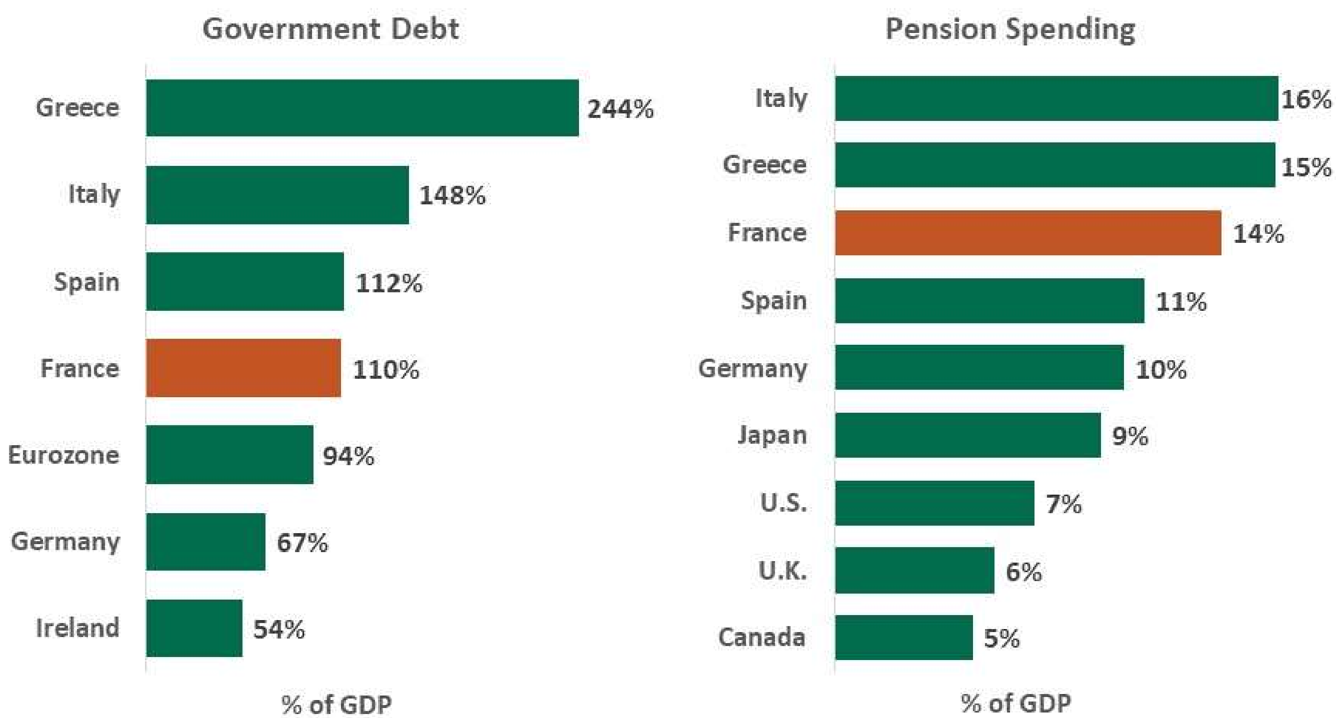
Erosion of purchasing power is emerging as a major headache for the French president.

Recent Ipsos polling shows that purchasing power is a top concern for French voters, supplanting the immigration and security issues that had long been at the forefront of political debates. Inflation in France is at a multi-decade high of 5.1% year-over-year. Energy costs are an issue that haunted the president not so long ago. The 2018 Gilets Jaunes (yellow vest) protests started off against a planned rise in the tax on diesel and petrol and spiraled out to a wider protest for employees' rights and against pension reforms.

The energy problem is far worse today. Retail fuel prices have soared well above the levels that kindled protest four years ago. Rent, house and food prices are increasing. And France is not a high-wage economy. Hence, with rising inflation, clamor for higher wages among low- and middle-income groups is growing, leading to demonstrations in several cities.

The government has taken some steps to cushion consumers. Recently, a 15 euro cents per liter rebate was announced on fuel, which will last for four months. This is likely to cost the state about €2 billion, on top of the €20 billion support provided for lowering heating and electricity bills.

As we wrote here, energy subsidies are not a remedy to broad inflation woes. The impressive economic recovery has already come at the cost of significant government spending, leaving the state saddled with more debt and a bigger deficit. France now ranks among the most indebted states and has one of the largest deficits. Simply put, both are well above the rules prescribed in the Stability and Growth Pact that underpins the common currency.



Sources: Haver Analytics, OECD

Macron's reformist credentials have taken a hit during his presidency. His efforts to overhaul the costly and complicated pension system, a plank of his 2017 campaign, are lying in cold storage. France has 42 different pension regimes, with variations in both retirement ages and calculation of benefits. Proposals to modify retirement ages have provoked mass protests and strikes.

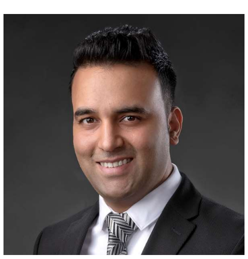
French leadership is important for the European project, including its fiscal rules. France is the bloc's largest military power and second largest economy. Following Angela Merkel's exit, the country has the opportunity to lead Europe's international efforts, a role that grew in prominence as Europe reacted in a coordinated and decisive manner against the Ukraine invasion.

President Macron seeks to strengthen European integration through greater energy autonomy, investments in the continent's tech corporations and boosting capabilities and cooperation of European armed forces. His leading opponent, Marine Le Pen, has a more nationalist vision of sovereignty, pledging to leave NATO and reform European treaties to regain independence.

The outcome of the French elections will have implications for European integration.

Past downturns have motivated French voters to change leadership. President Valéry Giscard d'Estaing lost elections in 1981 in the aftermath of oil price shocks that caused stagflation. More recently, Nicolas Sarkozy lost in 2012 on the back of the European debt crisis which led to a sharp increase in unemployment.

A good economic track record has put President Macron in the pole position, but current inflation challenges could be a worry for him. As James Carville might have observed, the road to the Elyseé Palace runs through the wallets of the people.



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Vaibhav Tandon is an Economist within the Global Risk Management division of Northern Trust. In this role, Vaibhav briefs clients and colleagues on the economy and business conditions, supports internal stress testing and capital allocation processes, and publishes the bank's formal economic viewpoint. He publishes weekly economic commentaries and monthly global outlooks.