

MACROCOSM

Our Fearless France Predictions

Friday, April 21, 2017

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Yesterday's attack is a wildcard, but Le Pen's euro threat remains only a *cygne noir*.

[Yesterday's terrorist attack in Paris](#) is a wild-card in France's 11-party presidential primary on Sunday. On the face of it, it should be a boost to the [anti-immigration anti-Muslim anti-Europe anti-euro Marine Le Pen](#), who has been contesting for a first- or second-place finish anyway. It could just as easily be a boost to the current third-place contender [François Fillon](#) – who has also taken a hard line against immigration but, as more of an establishment figure, might be seen as a steadier hand in dangerous times.

Le Pen will almost certainly make it into the two-way run-off on May 7, unless she is nosed out by Fillon on Sunday. If she does, we don't think she'll be elected the next president of France. But that doesn't mean this election isn't another example of the global movement of change-seeking and risk-embracing seen in the Brexit referendum and the Trump election (see ["2017: It's Bigger than The Donald"](#) December 30, 2016).

- The first-place candidate in the polls, [Emmanuel Macron](#), while a centrist, is [a young political near-novice](#) whose *En Marche!* party was founded barely a year ago. Though an outsider, his centrist positioning has [earned him the endorsement](#) of former US president Barack Obama (we will be snippy and point out that [his endorsement last year](#) didn't help the "remain" side in the Brexit referendum).
- Second-place [Le Pen's Front National](#) was founded 45 years ago by her father [Jean-Marie Le Pen](#), but has always been on the extreme populist right, embracing overt anti-Semitic narratives that the party [has been struggling to distance itself from](#). [She has been called](#) "the Trump of France," but that's surely unfair to Trump, [who refused to see her](#) when she showed up in January at Trump Tower.
- Third-place in the polls, only Fillon of [Les Républicains](#) represents a traditional mainstream French political party. But even he is revolutionary – at least for France: he is a [self-identified Thatcherite](#), calling for sweeping pro-growth reforms to France's labor and product markets.
- The fourth-place candidate in the polls, extreme Leftist [Jean-Luc Mélenchon](#), who identifies with the Spanish *Podemos* party and with Venezuela's Hugo Chavez, is running for the [La France](#)

Update to strategic view

EUROPE MACRO, EUROPE BONDS, EUROPE STOCKS, FX:
Thursday's terrorist attack is a wild-card that favors Le Pen and Fillon in Sunday's French presidential primary. Our base case, based on the level and direction of polls, is that Macron and Le Pen will come in first and second, respectively. We caution against the automatic assumption that polls undercount populists, which really hasn't borne out other than in the Brexit case. The most likely surprise would be Fillon nosing out Le Pen. If Le Pen advances to the May 7 run-off, we see her losing to any opponent. Her anti-euro position presents global systemic risk, but because Maastricht is incorporated into the French constitution, leaving the euro would require parliamentary action and a referendum. Except for the France-Germany 10-year spread, markets seem unprepared for a Le Pen win. So if she loses, there won't be much reaction. If she wins, we would expect a risk-off reaction that would likely be a buying opportunity.

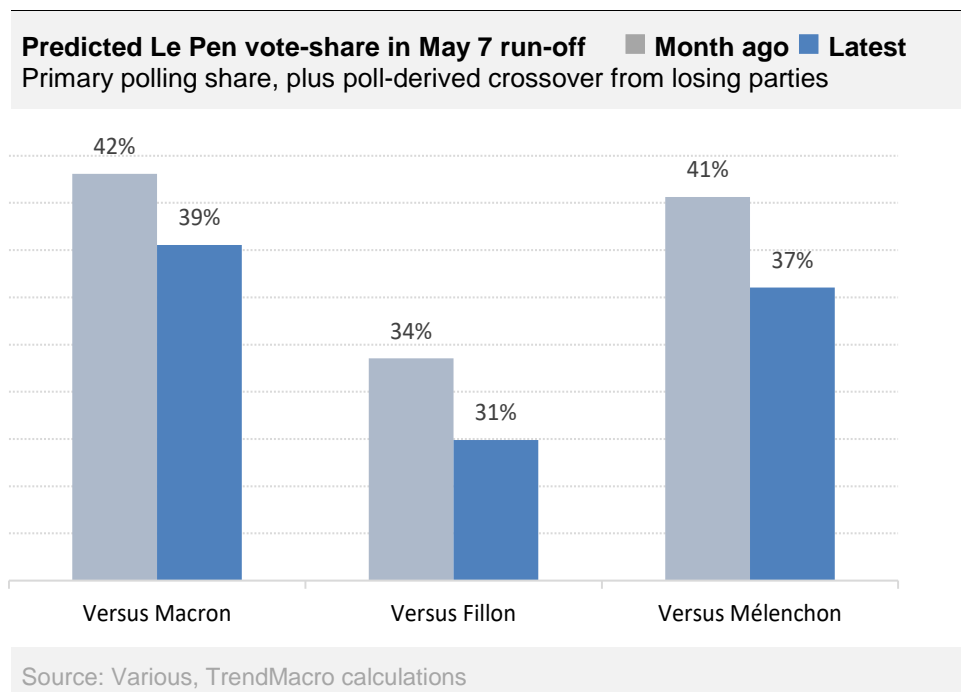
[\[Strategy dashboard\]](#)

[Insoumise](#) party (“Unsubmissive France”), founded just 14 months ago.

- These top four are clustered closely in the polls, with [Benoît Hamon](#) of the mainstream ruling [Parti Socialiste](#) pulling a very distant fifth. Current president [François Hollande](#) decided not to run.
- *The stakes here are very high. The issue is not that Le Pen, if she wins, would drive France out of the European Union. Like Brexit, that might be exactly the kick in the pants that sclerotic Europe needs* (see [“On the Brexit Referendum”](#) June 24, 2016).
- *The issue is that unlike even the Eurosceptic Mélenchon, Le Pen wants to withdraw France from the euro currency. We think such a move would trigger a globally systemic currency crisis – so even small increases in political risk here have leverage* (see [“Make My Inauguration Day”](#) January 23, 2017).

Yesterday’s attack aside – and admittedly, it really is a wild-card – Le Pen has been falling in the polls over the last month, slipping into second-place after many months of leading the pack. But second-place is enough to put her in the run-off.

- *We think polling makes it pretty clear that Le Pen could not win in the May run-off, no matter who opposes her* (please see the chart below).



- With many voters undecided, and many saying they won’t vote at all, the polls are admittedly tricky. And yes, we know... polls have been notoriously wrong when it comes to populist movements, conspicuously with respect to the [UK Brexit referendum](#) and the [US presidential election](#).
- *But we caution against casually assuming that the polls will necessarily be wrong again, or wrong in any particular direction.*

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Recommended Reading

[Why Are Republicans Making Tax Reform So Hard?](#)

Steve Forbes, Larry Kudlow, Arthur B. Laffer and Stephen Moore
New York Times
April 19, 2017

[Has Trump Stolen Philosophy’s Critical Tools?](#)

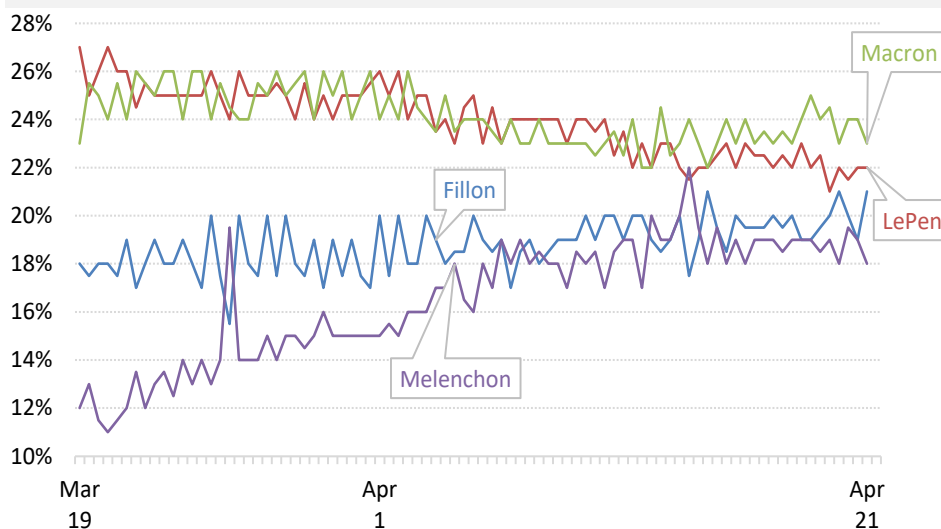
Casey Williams
New York Times
April 18, 2017

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We think polling errors are falsely remembered to be greater than they have actually been, and the errors aren't always in the same direction.

- In the two-way Brexit referendum, the polls were indeed wrong by a considerable 4%. Even if that magnitude of error recurs in France on Sunday, how should we expect it to impact an 11-party ballot?
- In the US election, it's not clear the polls were wrong at all. They almost perfectly predicted the popular vote – just not the Electoral College vote, which they weren't measuring in the first place.
- The polls were wrong in the [March legislative elections in the Netherlands](#), too – but they were wrong in an unexpected direction. They far over-estimated the gains that would be made by the populist party of Geert Wilders. Applied to France, that would suggest that Le Pen will do worse than expected, not better.

Polling for French presidential primary



Source: Various, TrendMacro calculations

- In all three cases, the trend-direction in the polls in the final days leading up to the election was correctly predictive, even when the final magnitudes were wrong. This doesn't speak well for Le Pen, but then again we aren't seeing polls that take yesterday's attacks into account.
- The base case has to be that Macron and Le Pen will come in first and second, respectively.

In the spirit of war-gaming unlikely worse-case scenarios, even if Le Pen is elected – which we think she will not be – it would be quite difficult for her to withdraw France from the euro currency.

- [The Treaty of Maastricht](#), the founding document of the European Union, has been formally adopted as a part of the French constitution. So leaving the euro would require a constitutional amendment, itself requiring either bicameral parliamentary approval

and a national referendum, or a bicameral parliamentary super-majority vote.

- These are probably insuperable hurdles. Le Pen's *Front National* lacks sufficient seats in the parliament – now, and in the foreseeable future – and the euro currency is favored by a large majority of French voters (as it is favored everywhere in Europe).
- All that said, if Le Pen is elected and there is sufficient popular support for France to exit the European Union, then by treaty that would perforce also pull France out of the euro currency – which while not preferred by voters on its own, might be seen as an acceptable side-effect in a package-deal.

It's a bit of a mystery to us how markets have behaved in the run-up to the primary. While the [elite establishment narrative has been apocalyptic](#) and the French-German 10-year spread has widened out considerably, the euro has fluctuated almost randomly within a narrow range, and the French stock market has performed quite well.

- So signals from markets are mixed. It's not obvious just what is being discounted here.
- We are going to assume that, approximately, markets are priced for the kinds of outcomes we are expecting – so if we get them, the most we would expect would be a narrowing of the France-Germany 10-year spread.
- Conversely, if we are wrong, then markets are probably mostly unprepared for a Le Pen win. As with Brexit, it would be seen as a black swan event, and there would probably be a risk-off reaction. But because there is so little Le Pen will be able to actually do that would affect the global economy, our going-in proposition would be to buy the dip.
- Here's the greatest uncertainty: *even though there would be very high hurdles to pulling France out of the euro or the EU, there is some chance that Le Pen's election would trigger a speculative run on the euro and on European banks, which would turn into a self-fulfilling systemic catastrophe.* That's the real *cygne noir* here.

Bottom line

Thursday's terrorist attack is a wild-card that favors Le Pen and Fillon in Sunday's French presidential primary. Our base case, based on the level and direction of polls, is that Macron and Le Pen will come in first and second, respectively. We caution against the automatic assumption that polls undercount populists, which really hasn't borne out other than in the Brexit case. The most likely surprise would be Fillon nosing out Le Pen. If Le Pen advances to the May 7 run-off, we see her losing to any opponent. Her anti-euro position presents global systemic risk, but because Maastricht is incorporated into the French constitution, leaving the euro would require parliamentary action and a referendum. Except for the France-Germany 10-year spread, markets seem unprepared for a Le Pen win. So if she loses, there won't be much reaction. If she wins, we would expect a risk-off reaction that would likely be a buying opportunity. ▶