MyStratWeekly
Market views and strategy

Ostrum ASSET MANAGEMENT

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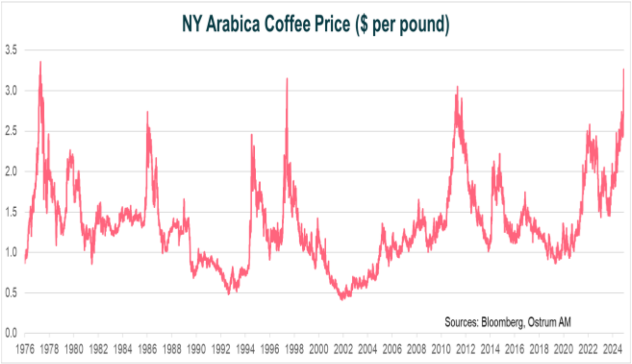
Topic of the week: The French spread under threat of the adoption of a no-confidence vote
by Aline Goupil-Raguénès

- Political uncertainty in France has significantly increased in recent days with the risk of the adoption of a no-confidence vote against the government, which could occur as soon as Wednesday, December 4th;
- This generates concerns about the government's ability to reduce its public deficit, which is set to be the highest among Eurozone countries (projected at 6.1% in 2024);
- The French spread has thus reached its highest level since 2012, during the sovereign debt crisis, and the 10-year yield is at the same level as the Greek 10-year yield;
- If a no-confidence vote is adopted, either this week or later, the French spread is expected to reach 100 basis points, and French stocks are likely to underperform more compared to the rest of the Eurozone;
- The floor level of the spread should now be closer to 80 basis points, given the prolonged risk of political instability, as long as the National Assembly remains deeply divided, limiting the government's ability to reduce its public deficit.

Market review: Risk-free rates plunge
by Axel Botte

- U.S. growth confirmed at 2.8 % in Q3 2024;
- OAT spreads briefly hit 90 bp as risk-free bond yields plunge;
- Credit spreads broadly stable whilst high yield spreads widen;
- The yen strengthens as BoJ rate hike looms.

Chart of the week



The price of arabica coffee, quoted in New York, has reached its highest level since 1977. It has increased by 70% since the beginning of the year, reaching $3.20. This dramatic rise is mainly linked to weather conditions in Brazil. After experiencing an unprecedented drought between August and September, Brazil was hit by heavy rains in October. These weather conditions have raised concerns about coffee supply and have heavily impacted arabica prices. The uncertainty regarding the implementation date of the EU's deforestation regulation has also contributed to the significant price increase. This regulation will ban imports of agricultural products sourced from deforested plantations.

Figure of the week

4

Debt-for-nature swaps could reach a record amount of $4 billion in 2024. This process allows emerging economies to cancel a portion of their external debt in exchange for national investments in nature conservation.
Source: Bloomberg

Topic of the week

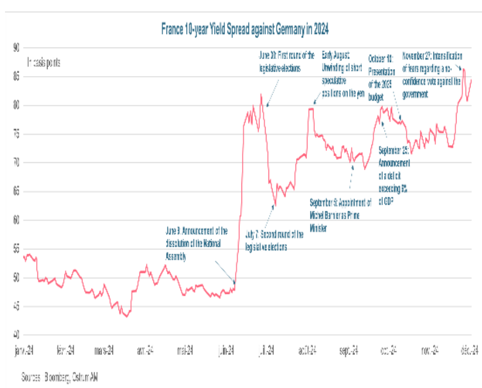
The French spread under threat of the adoption of a no-confidence vote

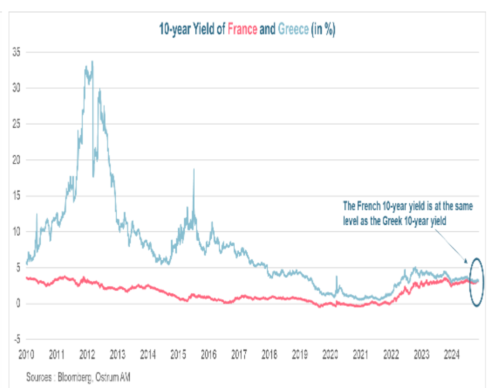
Political uncertainty has significantly increased in recent days with the risk of a no-confidence vote being adopted against the government as early as Wednesday, during the vote on the social security finance bill. This generates concerns about the government's ability to reduce the deficit, which is the highest in the Eurozone. The French spread is thus at its highest level since 2012, during the sovereign debt crisis, and the 10-year yield has reached the same level as the Greek 10-year yield. This uncertainty is also weighing on the confidence of households and businesses, risking a limitation on investment and hiring. Regardless of the outcome, as long as the National Assembly remains deeply divided, the risk of political instability will persist, along with the associated tensions on the French spread, with a high likelihood of a new early legislative elections in July.

The French spread is at its highest level since 2012 and the CAC is significantly underperforming compared to European indices

The increase in political risk weighs on the French spread

The growing risk of a no-confidence vote against the government is heightening concerns about the evolution of French public finances and generating an increase in risk aversion among investors. The interest rate spread between the French 10-year yield and the German 10-year yield (the benchmark bond in the Eurozone, considered risk-free by the markets) has thus risen sharply since last week, reaching its highest level since 2012, during the sovereign debt crisis. It even hit 90 basis points during trading on Wednesday, November 27, shortly after the market opened. Although the spread slightly decreased at the end of the week, it remains well above the level that prevailed at the beginning of June (48 basis points), prior to Emmanuel Macron's announcement of the dissolution of the National Assembly.



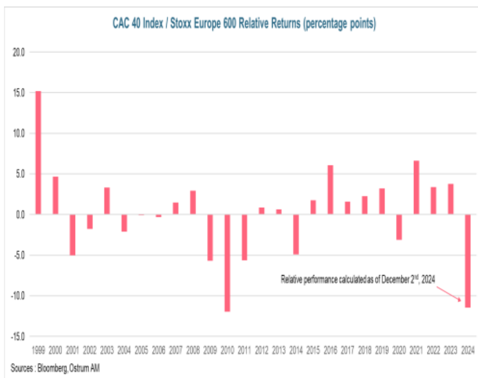


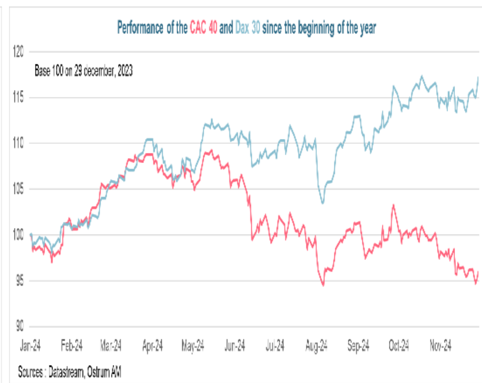
The French 10-year yield has reached the same level as the Greek 10-year yield

The French 10-year yield is now at the same level as the Greek 10-year yield, at 2.9% on Friday, November 29, whereas Greece has the highest public debt-to-GDP ratio in the eurozone: 153.1% of GDP in 2024, according to the European Commission, compared to 112.7% for France. Unlike France, Greece's public finances have significantly improved, since 2020, at a much faster pace than other Eurozone countries. The Greek debt-to-GDP ratio has indeed decreased by 56 percentage points between 2020 and 2024, compared to a decline of 9 percentage points for the Eurozone and 2 percentage points for France. Additionally, Greece is expected to achieve a primary surplus of 2.9% of GDP in 2024 (budget balance excluding interest charges), whereas France is projected to have a primary deficit of 4.1% of GDP.

The French stock market is recording its worst performance of the year since 2010 compared to European stocks.

This investor distrust is also reflected in the French stock market. The CAC 40 is indeed on track to have its worst year since 2010 compared to European stocks, as shown in the chart on the left below. Furthermore, the CAC 40 index has underperformed the German DAX 30 index since last spring, even though Germany has yet to emerge from recession due to a challenging economic environment and significant structural issues, particularly its past heavy reliance on Russian energy and chronic underinvestment. The DAX 30 index, however, has risen by 17% since the beginning of the year, while the CAC 40 index has declined by just over 4% (as shown in the chart on the right below). Banking stocks, in particular, have weighed on the French index.





The government is under threat of a no-confidence vote as early as December 4th

The concessions made by the government on certain budget measures are not considered sufficient

The risk of political instability is not new; it has been weighing on the French spread since the announcement of the dissolution of the National Assembly on June 9, leading to early legislative elections that resulted in a lack of majority and a deeply divided National Assembly. What is new is that the risk of political instability has significantly increased in recent days due to the threat from the National Rally (RN) to vote for a no-confidence motion against the government if it does not reverse certain measures in the 2025 budget. On November 28, the government, led by Michel Barnier, made two concessions by abandoning the increase in the electricity tax and the end of exemptions for employer contributions for low wages. However, this was deemed insufficient by RN leader Marine Le Pen, who set an ultimatum for the government on December 2 to obtain further concessions. These concessions include the abandonment of the minimum pension increase and the reduction in the reimbursement of medications.

Discussions in Parliament regarding the budget have not yielded results, increasing the likelihood that the government will resort to Article 49.3 to pass it. This constitutional provision allows for the adoption of a law without a vote from the National Assembly. The New Popular Front (a left-wing coalition) has indicated that it would file a no-confidence vote against the government if Article 49.3 is invoked. Lacking a majority, the NFP needs the support of other parties to get the motion passed. This would be feasible if the National Rally also votes in favor of the no-confidence motion.

What are the dates for a potential no-confidence vote?

A no-confidence motion against the government could be voted on December 4, December 6, or around December 20

The vote on a no-confidence motion against the government could take place as early as December 4, if the government uses Article 49.3 to pass the social security finance bill (PLFSS) in the National Assembly (which will be held on December 2). This part of the budget includes measures regarding the minimum pension increase and the reduction of medication reimbursements that the National Rally (RN) wishes to see abandoned.

A second date is December 6, in the event that Article 49.3 is used for the vote on the management finance bill, which will take place on December 4. This is a more technical law aimed at making year-end budget adjustments to "contain" the deficit at 6.1% of GDP in 2024 and to finance unforeseen expenses from the last few months.

The final date concerns the vote on the 2025 finance bill (PLF). The Senate vote will take place on December 12, followed by the vote of the joint committee around December 16. If an agreement is reached, the vote on the PLF in the National Assembly is expected to occur around December 18. If the government uses Article 49.3 to pass it, there is a risk of a no-confidence motion being adopted around December 20.

What happens in the event of a no-confidence vote?

If the no-confidence motion is adopted by an absolute majority, the budget is rejected and the government resigns.

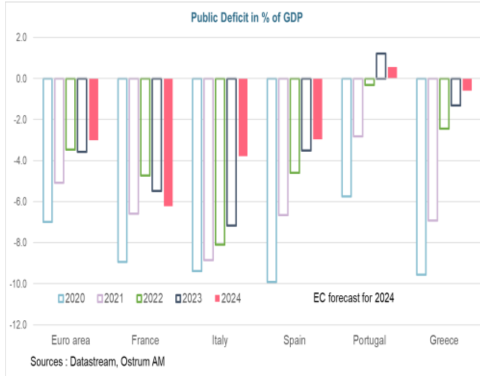
A new Prime Minister will need to be appointed, whose task will be to urgently prepare the 2025 budget

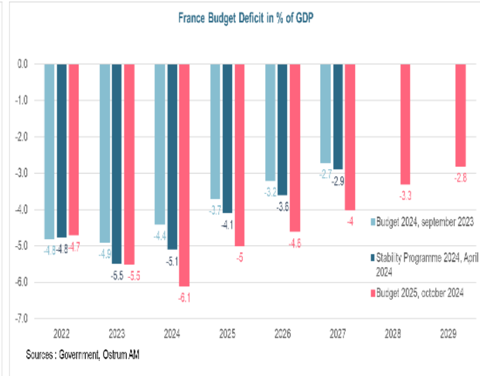
To be submitted, a no-confidence motion must be signed by one-tenth of the deputies. To be adopted, it must receive an absolute majority of deputies. Thus, if the National Rally (RN) does not join the New Popular Front (NFP), the no-confidence vote will not receive the absolute majority and the 2025 budget will be adopted.

On the other hand, if the RN joins the NFP, the absolute majority will be reached, and the no-confidence motion will be adopted. Consequently, the budget will be rejected, and the government will have to resign. The 2024 budget will be extended, and the President will need to appoint a new Prime Minister whose task will be to urgently prepare the 2025 budget. Given that new early legislative elections cannot be held before July 2025, according to the Constitution, the Prime Minister will continue to face a deeply divided Assembly with ongoing risks to political stability.

A significant budgetary effort is planned for 2025 in light of the substantial budgetary slippage

In 2024, France recorded a significant budgetary slippage. The government announced that the deficit would reach 6.1% of GDP, compared to the 4.4% initially projected in the finance bill. This is primarily due to lower-than-expected tax revenues (amounting to €40 billion). The European Commission has thus placed France under an excessive deficit procedure, similar to Italy and Belgium. In 2024, France will have the highest budget deficit among Eurozone countries by far. Only Slovakia is close, with a projected deficit of 5.8% in 2024, according to European Commission forecasts.



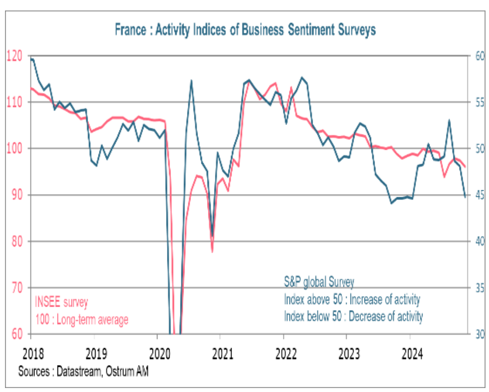


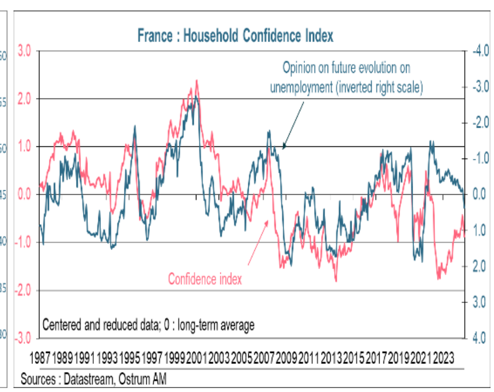
The government aims to achieve €60 billion in savings by 2025. This is a significant effort…

…especially since growth is expected to be lower than anticipated.

The political crisis is also weighing on the confidence of households and businesses.

The French government aims to achieve €60 billion in savings by 2025 to reduce the deficit to 5% of GDP. It has also postponed the return of the public deficit below the 3% of GDP threshold by two years, to 2029. The government is targeting a reduction in public spending of €40 billion and an increase in taxes of €20 billion. This represents a significant effort. It is based, in part, on the assumption of 1.1% growth in 2025, which now seems quite optimistic. Surveys conducted among business leaders and households have significantly deteriorated in November due to the rising political risk and uncertainties regarding the evolution of fiscal policy. The election of Donald Trump and the threat of a rise in tariffs, from 10% to 20% on imports from the EU, have likely also weighed on confidence. This could lead business leaders to adopt a wait-and-see approach regarding investments and hiring, thereby impacting domestic demand. Households are also expected to be more cautious and limit their spending in light of concerns about a potential rise in the unemployment rate, as revealed in the latest INSEE survey. Recent announcements of layoff plans have also contributed to this sentiment.





Prolonged political uncertainty poses the risk of lower growth and a public deficit and debt that are higher than expected.

In addition to this lower-than-expected growth, the concessions made by the government to avoid a no-confidence vote will also come into play. If the motion is unanimously adopted and the government resigns, the deficit will be larger than anticipated due to the extension of the 2024 budget, which does not include any measures to reduce the public deficit, as well as the time lost before adopting a budget for 2025 that could address the imbalances.

In summary, political uncertainty poses the risk of a public deficit higher than the projected 5% of GDP for 2025, as well as a larger public debt due to the increased deficit and the resulting rise in interest rates.

Risk of a downgrade of France's sovereign debt rating

The S&P agency surprises by keeping the outlook for France's sovereign debt rating unchanged at stable.

The increase in political uncertainty and the risks it poses to the evolution of the budget deficit heighten the likelihood of a downgrade of France's sovereign debt rating by agencies during the spring. The S&P agency issued a statement on Friday evening. After downgrading France's rating from AA to AA- in April, it left the rating unchanged. Surprisingly, it maintained a stable outlook attached to this rating, despite France experiencing a significant budgetary slippage in 2024, which could be impacted by political instability. Rating agencies Moody's and Fitch had previously kept their ratings unchanged, at Ba2 and AA-, respectively but revised their outlook from stable to negative, suggesting a possible downgrade in the future.

High risk of a downgrade of France's rating to A in the spring.

Despite the political uncertainty, S&P expects France to eventually meet its budget deficit reduction targets, with a baseline scenario projecting a reduction of just under 1% of GDP in the deficit for 2025. The agency also highlights that France has a balanced economy (with a deficit of 6.1% of GDP), which is open, diversified, and wealthy, with significant domestic private savings. It may downgrade the rating if the government fails to reduce the deficit or if growth remains consistently below its forecasts (1% expected in 2025 and 1.2% in 2026).

Conclusion

If the no-confidence vote against the government is adopted on either December 4 or December 20, the French spread is expected to reach 100 basis points. Subsequently, the new floor is likely to be around 80 basis points, given the prolonged political uncertainty, as long as the National Assembly remains deeply divided, which limits the government's ability to reduce its budgetary imbalances. The risk of a downgrade of France's rating to A+ in 2025 is high, as is the risk of new early legislative elections, which would undoubtedly drive the spread back to 100 basis points. France's situation contrasts with that of peripheral countries such as Spain, Greece, and Portugal, which have significantly improved their public finances, benefiting from strong growth and implementing structural reforms. Even Italy is seen as a model student compared to France due to its political stability and its plan to reduce the deficit below the 3% of GDP threshold by 2026, particularly benefiting from disbursements from the Next Generation EU funds.

Aline Goupil-Raguénès

Market review

Risk-free rates plunge

French political risk dominates market headlines in Europe. Safe-haven yields are plunging, and the yen has strengthened by 3% against the dollar.

In this shortened week due to Thanksgiving in the United States, market participants have focused primarily on the political situation in France. The French spread has approached the 90-bp threshold. German Bunds (2.11% on Friday) benefit from the woes of the OAT, while the T-note, along with Australian and Canadian bonds, has outperformed with weekly declines of approximately 20 basis points. Inflation breakevens are being compressed by the flight to safe assets. European equities are slightly lower, with the CAC 40 underperforming. The yen continues its rebound (trading at 150 against the dollar), with elevated inflation validating expectations for another rate hike in December. Some profit-taking is observed on the dollar, which has lost 1% over the past five sessions. The Brazilian real has hit a historic low (beyond 6) following the release of an overly expansionary budget. The rouble has collapsed in the wake of sanctions on Russian banks, even as Russian aggression intensifies.

US growth was confirmed at 2.8% for the third quarter, despite a slight downward revision of consumer spending. Preliminary data for October indicate a moderation in private consumption (+0.1% in real terms). Housing investment is expected to decline in the final quarter. New home sales plummeted to 610,000 in October, the lowest level in two years, due to rising mortgage rates (up 60 basis points on the 30-year fixed in October). Housing prices have somewhat slowed to 4.7% year-on-year. Orders for capital goods are also moderating. In the Eurozone, inflation is reported at 2.3% for November according to the preliminary estimate, while the core index remains stable at 2.7%, a level nearly unchanged since the spring.

Positions in the rates markets have been scaled back ahead of the Thanksgiving weekend. According to the latest statements from central bankers, both the Fed and the ECB seem to agree on a 25 basis point cut in December. The ECB will allow itself to adjust the pace of its interventions based on decisions from the Trump administration. The German curve is flattening, with the Bund regaining its status as a safe haven amid tensions surrounding the OAT. Consequently, swap spreads have moved back into positive territory, nearing 10 basis points on the 10-year maturity. A vote of no confidence threatens the Barnier government, while the French sovereign rating is already under pressure. The 10-year French spread has approached 90 basis points at the week’s peak. The credit market continues to detach itself from the volatility environment characterizing rates. Demand for the credit asset class remains robust, with the credit spread against swaps trading at 92 basis points. However, high yield has erased the tightening observed since the beginning of the month, despite positive inflows into specialized funds over the week.

The equity market is showing a slight decline in Europe, driven by underperformance in consumer and energy stocks. Third-quarter earnings reports reveal stagnant revenues and a 9% year-on-year drop in profits. Earnings have collapsed in the discretionary consumer sector, particularly in automotive and media.

Axel Botte

Main market indicators

G4 Government Bonds	02-Dec-24	1wk (bp)	1m (bp)	2024 (bp)
EUR Bunds 2y	1.93%	-10	-32	-48
EUR Bunds 10y	2.06%	-15	-35	+4
EUR Bunds 2s10s	13.2bp	-5	-2	+52
USD Treasuries 2y	4.2%	-7	-1	-5
USD Treasuries 10y	4.21%	-6	-17	+33
USD Treasuries 2s10s	1.3bp	+1	-16	+39
GBP Gilt 10y	4.25%	-9	-19	+72
JPY JGB 10y	1.08%	+0	-15	-57
€ Sovereign Spreads (10y)	02-Dec-24	1wk (bp)	1m (bp)	2024 (bp)
France	84bp	+2	+3	+30
Italy	115bp	-11	-4	-52
Spain	71bp	-2	+1	-25
Inflation Break-evens (10y)	02-Dec-24	1wk (bp)	1m (bp)	2024 (bp)
EUR 10y Inflation Swap	1.91%	0	-10	-22
USD 10y Inflation Swap	2.45%	-9	-3	+4
GBP 10y Inflation Swap	3.53%	-7	-15	-1
EUR Credit Indices	02-Dec-24	1wk (bp)	1m (bp)	2024 (bp)
EUR Corporate Credit OAS	108bp	+1	+5	-30
EUR Agencies OAS	66bp	+1	+6	-4
EUR Securitized - Covered OAS	60bp	+3	+10	-18
EUR Pan-European High Yield OAS	339bp	+11	+2	-60
EUR/USD CDS Indices 5y	02-Dec-24	1wk (bp)	1m (bp)	2024 (bp)
iTraxx IG	56bp	-1	-2	-2
iTraxx Crossover	301bp	-6	-13	-13
CDX IG	48bp	-1	-6	-9
CDX High Yield	295bp	-4	-39	-61
Emerging Markets	02-Dec-24	1wk (bp)	1m (bp)	2024 (bp)
JPM EMBI Global Div. Spread	336bp	+7	-3	-48
Currencies	02-Dec-24	1wk (%)	1m (%)	2024 (%)
EUR/USD	$1.052	0.200	-3.328	-4.7
GBP/USD	$1.270	1.074	-1.960	-0.2
USD/JPY	JPY 150	2.601	1.204	-6.2
Commodity Futures	02-Dec-24	-1wk ($)	-1m ($)	2024 (%)
Crude Brent	$72.6	$0.1	-$0.2	-2.5
Gold	$2 635.9	$10.9	-$100.9	27.8
Equity Market Indices	02-Dec-24	-1wk (%)	-1m (%)	2024 (%)
S&P 500	6 032	1.41	5.30	26.5
EuroStoxx 50	4 787	-0.27	-1.86	5.9
CAC 40	7 189	-0.95	-2.98	-4.7
Nikkei 225	38 513	-0.69	1.21	15.1
Shanghai Composite	3 364	3.07	2.81	13.1
VIX - Implied Volatility Index	14.07	-7.68	-35.69	13.0

Source: Bloomberg, Ostrum AM

Additional notes

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