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Market View
ECB lowers rates in a week marked by political upheaval in France and Germany

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At a glance

- President Emmanuel Macron names François Bayrou as the new French PM amid political turmoil in France and Germany.

- Despite political instability, French equities have risen, with the CAC 40 Index rising.
- ECB cuts rates amid economic sluggishness and uncertainty over US tariffs.

In what has been a remarkable year for geopolitics, the final few weeks of 2024 have been truly extraordinary. In the past two weeks alone, we have seen the French government voted down, the declaration of martial law in South Korea, the collapse of the Assad regime in Syria and a confidence vote in Germany.

French Prime Minister dismissed

Earlier this month, former French Prime Minister, Michel Barnier forced through a budget without a vote in parliament. As a result, French lawmakers passed a no-confidence vote on 4 December, the first successful no-confidence vote in France in over 60 years, making Barnier's three-month-old government the shortest tenure of France's Fifth Republic.[1] This leaves the country, which continues to struggle with substantial debt and a widening deficit, without a clear path towards a new budget. On Friday, President Emmanuel Macron named centrist leader François Bayrou as the new prime minister. Bayrou is an ally of Macron, but Macron's authority remains shaky, and his party and its allies lost many seats to both the far right and the far left during the parliamentary elections earlier this year.

Barnier's attempts to force through the budget without support led to French and German 10-year bond yields widening significantly, reaching levels not seen since 2012.[2] Germany is seen as one of the safest economies in Europe so historically, French bond yields are typically higher than German counterparts—higher yields mean investors demand more return for their money, as the investment is riskier. The gap widening last week demonstrates that investors were worried about France's financial stability; however, Franco-German bond yields have since tightened, indicating investors are now less nervous about the recent political upheaval in France.

Despite the political turmoil, French equities meanwhile have performed well, with the CAC 40 Index rising almost 3% so far this month, benefiting from China's most recent stimulus announcement. The CAC 40 is largely made up of luxury goods firms, which are poised to benefit from increased Chinese demand.

Given how fractured parliament remains, Bayrou's job will be difficult, with his first challenge forming a government that will not be brought down in the same way as his predecessor's in the National Assembly. Additionally, tax brackets in France are not planned to be adjusted for inflation, which ultimately means the tax burden will increase for civilians. Until Bayrou's government is officially formed, the existing French government remains in place and, if needed, they can use emergency legislation to continue to operate, and for taxation and expenditure.

German political upheaval

The political upheaval is not exclusive to France. In Germany, Chancellor Olaf Scholz called for a confidence vote on Wednesday, the first step towards disbanding the German government, which could lead to snap elections early next year that will likely remove him from office.[3] This move had been expected since the chancellor fired his finance minister in November, accelerating the breakup of his three-party coalition. This political turbulence is significant in a country traditionally known for stable governments.

ECB

On Thursday, the European Central Bank (ECB) cut rates by 0.25%, to bring rates to 3%.[4] It is the fourth cut since the ECB began their easing cycle, and given how sluggish the European economy remains, markets expect the ECB to cut rates at every meeting until mid-2025. ECB President Christine Lagarde remained ambiguous about future rate cuts despite these market expectations. The ECB faces a considerable amount of uncertainty going forward, particularly concerning the timing, extent and impact of potential US tariffs under President-elect Trump. ECB members will undoubtedly want to keep policy options open going into 2025.

Conclusion

As noted previously, it has unquestionably been a noteworthy year for geopolitics. Europe in particular faces much uncertainty. Political turbulence in Germany, and the fall of the French government, leave the European Union in a precarious position at a critical time: it faces ongoing challenges with Russia's war with Ukraine, Donald Trump's imminent return to the White House, and increasing anti-EU sentiment amongst a growing number of far-right political parties throughout Europe. Ultimately, the stable businesses able to future-proof, forecast for the long-term and deftly adapt to geopolitical changes will weather the political storm, and continue to grow earnings. We continuously monitor geopolitical risk when constructing portfolios, focusing on quality companies well positioned to withstand political turbulence.

[1] New York Times: https://www.nytimes.com/2024/12/04/world/europe/france-no-confidence-barnier.html?

[2] Bloomberg, Deutsche Bank

[3] New York Times: https://www.nytimes.com/2024/12/11/world/europe/germany-scholz-no-confidence-vote.html

[4] ECB: https://www.ecb.europa.eu/press/pr/date/2024/html/ecb.mp241212~2acab6e51e.en.html