
Economy Macro Update

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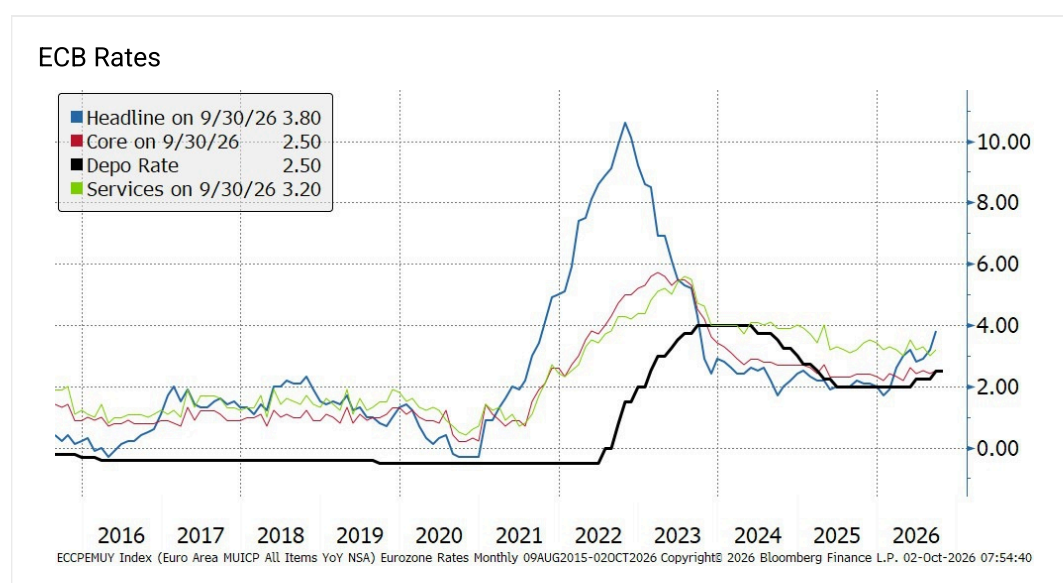
“How can you govern a country which has 246 varieties of cheese?”

Charles de Gaulle

With France in the spotlight, Marine Le Pen called on the European Central Bank to use its Transmission Protection Instrument to help push French yields lower. Here, we explain what the TPI is and why it's unlikely to be used to help France.

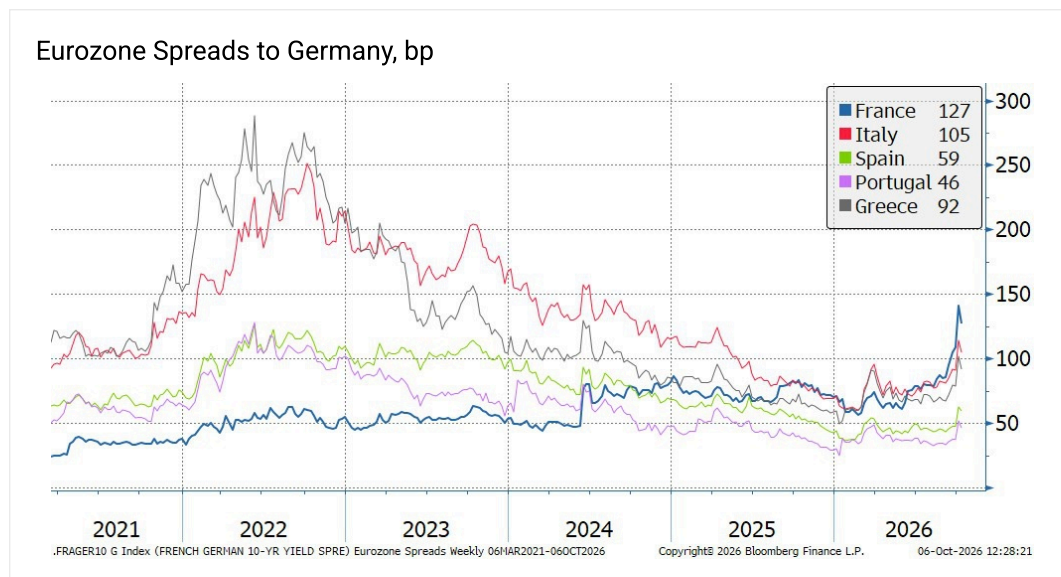
How It Started

The ECB introduced its TPI at the July 21 2022 meeting, when it began a tightening cycle from the pandemic era of zero rates. The bank stressed that “In particular, as the Governing Council continues normalizing monetary policy, the TPI will ensure that the monetary policy stance is transmitted smoothly across all euro area countries.” It added that “The TPI will be an addition to our toolkit and can be activated to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across the euro area. By safeguarding the transmission mechanism, the TPI will allow the Governing Council to more effectively deliver on its price stability mandate.”



Basically, the TPI was created to help prevent a bond market meltdown in the weaker eurozone credits as the ECB hiked rates and normalized policy. However, the criteria for activating TPI are pretty rigorous and can be found [here](#).

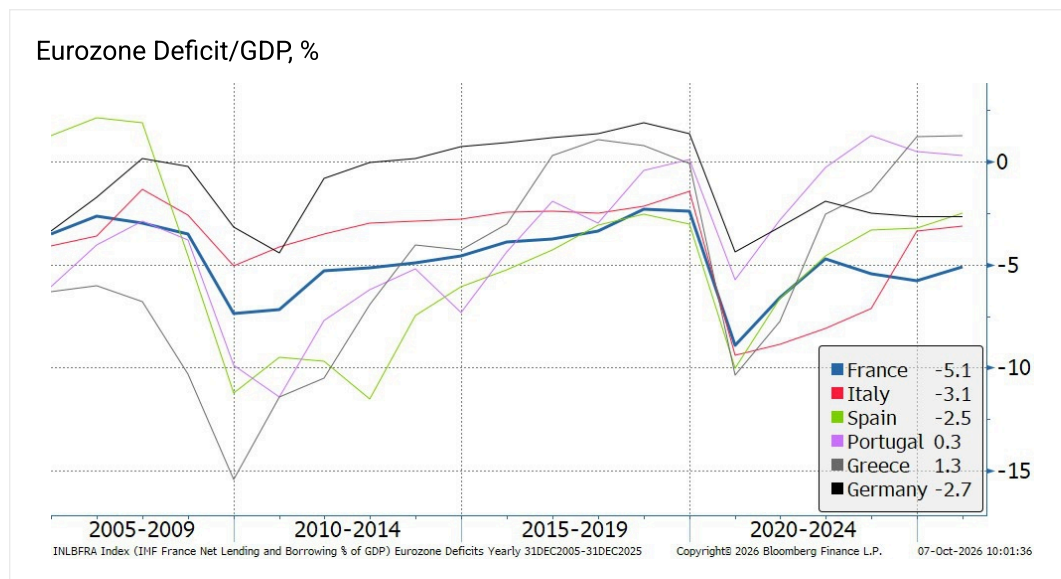
While we did get some spread widening during Q3 2022 in the weakest eurozone credits (at that time, Italy and Greece), no country needed the TPI assistance and those spreads eventually tightened over the course of Q4 2022 and beyond.



How It's Going

Concerns about French fiscal largesse are nothing new. Indeed, one can point to years of fiscal mismanagement and political paralysis as the root causes of the current crisis. How bad has France been? The country has routinely run budget deficits in excess of -3% of GDP since 2020, when the pandemic hit. For the two years prior to that, France ran deficits of slightly more than -2% of GDP but those were anomalies, coming off a full decade of excessive deficits. What's really changed? In a world awash with debt, markets finally ran out of patience.

The ECB started this current tightening cycle back at the June 10-11 meeting. Spreads held in relatively well but have spiked sharply since late summer. This move higher has been led by France, which became the weakest eurozone credit in August by trading wide of Italy. As we moved into September, spreads of the next weakest credits (Italy and Greece) have been dragged higher, bringing forth fears of contagion. Indeed, even Spain and Portugal spreads have moved higher in recent weeks.



How It's Likely to End

We must stress that peripheral fundamentals have improved significantly since the eurozone crisis. Greece and Portugal have both run budget surpluses over the last several years, while Spain got its deficit below -3% of GDP in 2025 while Italy got its deficit to -3.1%, within a whisker of the -3% limit.

As a result of these improved fundamentals, we believe the contagion risks are limited. Simply put, France clearly stands out as being in a much worse fiscal position than all the peripheral countries. If markets were able to force those nations into belt-tightening over the past decade, then we should expect the same from France. It won't be easy or quick.

Things are complicated by the upcoming French presidential election in 2027. If no candidate wins a majority in the first round April 18, the top two candidates will go to a runoff May 2. The most recent Toluna Harris poll from late September shows far-right candidate Marine Le Pen leading with 35-36% of the vote in the first round vs. 17-18% for far-left candidate Jean-Luc Melenchon and 13-16% for center-right candidate Edouard Philippe. The same poll shows Le Pen beating both Melenchon and Philippe in the runoff with 69% and 57% support, respectively.

We suspect that Le Pen's support may drop in October after she pledged to follow a policy path that is loaded with even more austerity than the 2027 budget that was just proposed by the government. However, given her huge lead, we still expect Le Pen to emerge as the victor.

Whether she can implement her austerity plans remains to be seen, as the current parliament is fragmented with no bloc holding a majority. This is a big reason why the current fiscal situation has festered despite the political crisis that led President Emmanuel Macron to call snap elections in 2024. The next parliamentary elections don't have to be held until June 2029. If Le Pen has a strong showing this spring, we believe that she may call snap elections in an effort to break the parliamentary deadlock. If she succeeds in winning a majority for her National Rally party, then Le Pen may actually be able to implement much-needed fiscal tightening. The current wave of protests against austerity suggest that this adjustment process will be a long and painful one.

We do not expect the ECB to implement its TPI as France does not meet the first and most important criteria of being in "compliance with the EU fiscal framework" and "not being subject to an excessive deficit procedure (EDP)." We note that the EU Council officially launched an EDP on France back in July 2024 and later adopted a recommendation requiring France to correct its excessive deficit by 2029. While the EU may give France a little more flexibility to correct the situation, we believe the ECB will not be riding to France's rescue with the TPI. It will really be up to the French politicians.

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