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In a famous speech in 1953, Thomas Mann, a towering figure of German and world literature, called on the Germans to resist the temptations of aggressive nationalism. The novelist appealed to an audience of students in Hamburg, urging them to strive not for a German Europe, but a European Germany.

In a paradox of history, Mann's appeal could be undermined by the decisions of the French electorate.

In this brief analysis, we will consider the potential consequences of the upcoming French national elections. We focus specifically on the fiscal and financial repercussions of French political instability. We observe that political instability or anti-European stances in France could weaken the traditional "core Europe" formed around Franco-German cooperation. Even if France manages to avoid a devastating fiscal-financial crisis (which would bring havoc to Italy), its days as a pillar of the European "core" may be counted. Traumatic changes in France have the potential to damage the whole European project.

A new "core" would need to be restored. This could lead to an unprecedented alignment of a new German government after September 2025 and a (likely) renewed presidency of the EU Commission. According to current polls, members of the *Christliche-Demokratische Union* (CDU) could control the main levers in Brussels and Berlin. Fortunately, the type of German-led Europe that would emerge is likely to be entirely different from the one feared by Thomas Mann.

After a significant win for the far-right *Ressemblement National* in the European elections, President Macron dissolved the National Assembly, the lower chamber of the French Parliament, and announced legislative elections on June 30 and July 7. Macron's actions caused concern in other European capitals and led to a sell-off in French assets, signaling a new phase of political and financial instability in the euro area.

The final results of the European Parliament elections[1] in France revealed a major victory for Jordan Bardella and Marine Le Pen, the far-right National Rally's (RN) president and parliamentary group leader. The RN secured about 31.4% of the vote, which, combined with the vote share of the extreme right Reconquête, amounted to nearly 40% of the vote in France. In contrast, French President Emmanuel Macron's Renaissance

[1] https://results.elections.europa.eu/en/france/

party obtained only 14.6% of the vote. Despite Macron's focus on the battle between pro- and anti-European forces, as noted by Brookings analysts,[2] the strategy that worked for him in previous elections did not succeed this time. The vote in favor of Le Pen and Bardella is no longer considered solely a protest vote, and the RN is now the premier political force in France.[3]

Macron's decision to bet on the RN's incompetence and incapacity to govern the country is widely considered a risky move. He hopes that this will decrease the party's prospects for the 2027 presidential election. The risk is significant because future French political choices have vast implications for foreign policy and the financial stability of the euro area. Additionally, a political deadlock in France or a far-right majority could prevent important institutional steps at the European level from being approved, as they require parliamentary approval and could be hindered by a blocking majority. This is especially concerning at a time when common initiatives can be vital for the continent.

Foreign policy remains a French president's prerogative, however. A National Assembly controlled by the far-right could present several opportunities to influence the foreign policy decision-making process. Leaders of the RN have recently stated that they would not withdraw from NATO while the war in Ukraine continues. However, some analysts believe they might change their stance once in power, depending on developments on the ground. The party has been receiving loans from Russian banks for years and its two leaders have expressed a close relationship with Russian president Vladimir Putin. Without making drastic decisions, Bardella's government might make superficial statements supporting NATO membership and EU cooperation while weakening both entities from within. The first major test would be the decision to admit Ukraine into the European Union, a plan that faces strong opposition in the RN constituency.

The main challenges for Europe's foreign policy may become apparent over time. Le Pen's ambiguity on foreign policy arises from the fact that even RN is aware that France has always been at the core of Europe and a crucial pillar of Europe's political structure. In the past, Paris gained significant political clout by aligning with Berlin. Since the EU's early days, the Franco-German partnership has been aligned on most major issues before consulting with other EU member states' governments, often imposing their opinions. A drastic change in France's political direction might make it difficult for mainstream German political parties to further cooperate with Paris.

A constitutive element of the Franco-German cooperation was the need for Paris to be acknowledged as having the same level of financial credibility as Berlin. This factor was behind the tight coordination between Angela Merkel and Francois Hollande (later replaced by Nicolas Sarkozy) during the euro-area crisis. This coordination essentially represented France's submission disguised as *éntente*, aimed at demonstrating that the two countries were on the same wavelength and essentially inseparable.

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[2] https://www.brookings.edu/articles/the-european-parliament-elections-have-upended-french-politics/

[3] In the first European elections held in 1979, the vote share garnered by the RN—then the FN (Front National)—was 1.31%

Fig 1

France's critical juncture is such that a significant political shift could have major financial implications and disrupt the country's alignment with others, Germany first of all. This would impact the future of the eurozone and the European Union.

On June 19, the EU Commission opened an Excessive Deficit Procedure in consideration of France's fiscal situation. The sustainability of France's debt largely hinges on favorable borrowing conditions, particularly interest rates akin to those in Germany (Fig 1). Given the subdued economic growth prospects, maintaining low interest rates is crucial to prevent the debt from spiraling. France needs to ensure that its borrowing costs remain as close to the German levels as possible, especially with little room for potential growth and inflation already hovering around 2%. The current political uncertainty has already complicated France's fiscal outlook and this situation could worsen if borrowing costs start incorporating the likelihood of further political instability (Fig 2 shows the spread increase in the last months).

Fig 2

France's current financial vulnerability should not be exaggerated. The current increase in the "spread" is similar to the levels seen during other periods of political instability in 2017 and 2022. At the start of the Covid-19 crisis in 2020, the spread also began to widen but was brought under control, coinciding with the Merkel-Macron agreement on debt mutualization in the euro area. France's fiscal vulnerability, however, is greater than in other countries because of the high share of the French public debt (almost half of the total €3trillion) held by foreign investors.

Fig 3

Recent history tells us that France's fiscal stability is exposed to political uncertainty and benefits from the country's stable cooperation with Europe. A financial crisis in France has the power to bring havoc to the euro area via the banking channel. According to Bloomberg calculations, French banks are the fourth biggest international lenders after Japan, the US, and the UK, with $2.4 trillion of foreign loans on their balance sheets. Italy is the second biggest borrower from banks in France after the US. Euro basis swaps have shown signs of stress, indicating an increased demand for dollar funding. Based on BIS data, French banks have lent almost $400bn to Italian counterparts. A decline in credit availability in France would increase credit costs and hit the Italian economy, likely spreading the financial contagion across the Alps.

France's public finances have been worsening with its debt-to-GDP ratio climbing to 111% and growing. While other high-debt countries have been on a declining path, France's debt has risen more than other major euro-area economy. Between 2019 and today, France's debt-to-GDP ratio has grown by around 13%, while in Greece and Portugal it has declined by more than 20%. All the periphery countries subject to EU programs during the euro-crisis have a substantial primary surplus while France has recorded the highest primary deficit together with Italy.

The whole social model in France hinges on state intervention. Government expenditures total 58% of GDP and opposition parties converge on proposals that would increase the state's intervention in the economy. Even the private economy has increased the level of indebtedness. Private debt has increased by more than 40% in the last 10 years, more than in any other European economy. According to Bloomberg, France's debt service ratio – the ratio of servicing private, non-financial debt repayments to disposable income – is just under the 20% level that has been the harbinger of financial crises in other countries. The situation is aggravated by the fact that France has the second highest current account deficit in the euro area, after Greece. France's stability is necessary to maintain the flow of foreign capital, compensating for the excessive domestic debt. Political stability is critical in this regard, as the UK has experienced a violent rise in yields provoked by former prime minister Liz Truss's irresponsible fiscal policy plans.

At the current stage, it is far from clear how the French political situation will play out. It is only possible to envisage different scenarios bringing different degrees of tension in the government bond market. The two most likely scenarios are a hung Parliament or a relative majority for the far-right coalition. On the one hand, a hung parliament would probably prevent financial markets from drawing dramatic conclusions about France's future, leaving the spread at the current levels. On the other hand, it would make it very hard to govern the country effectively. It would leave decision-making to the challenging coordination between President Macron and a prime minister representing an informal coalition, which may or may not include the president's party. If the president is forced to work with a non-cooperative government coalition, or if no stable coalition can be formed at all, the situation could become intolerable. However, the French constitution prohibits the president from dissolving the parliament and calling for new general elections until a year has passed since the last snap elections.

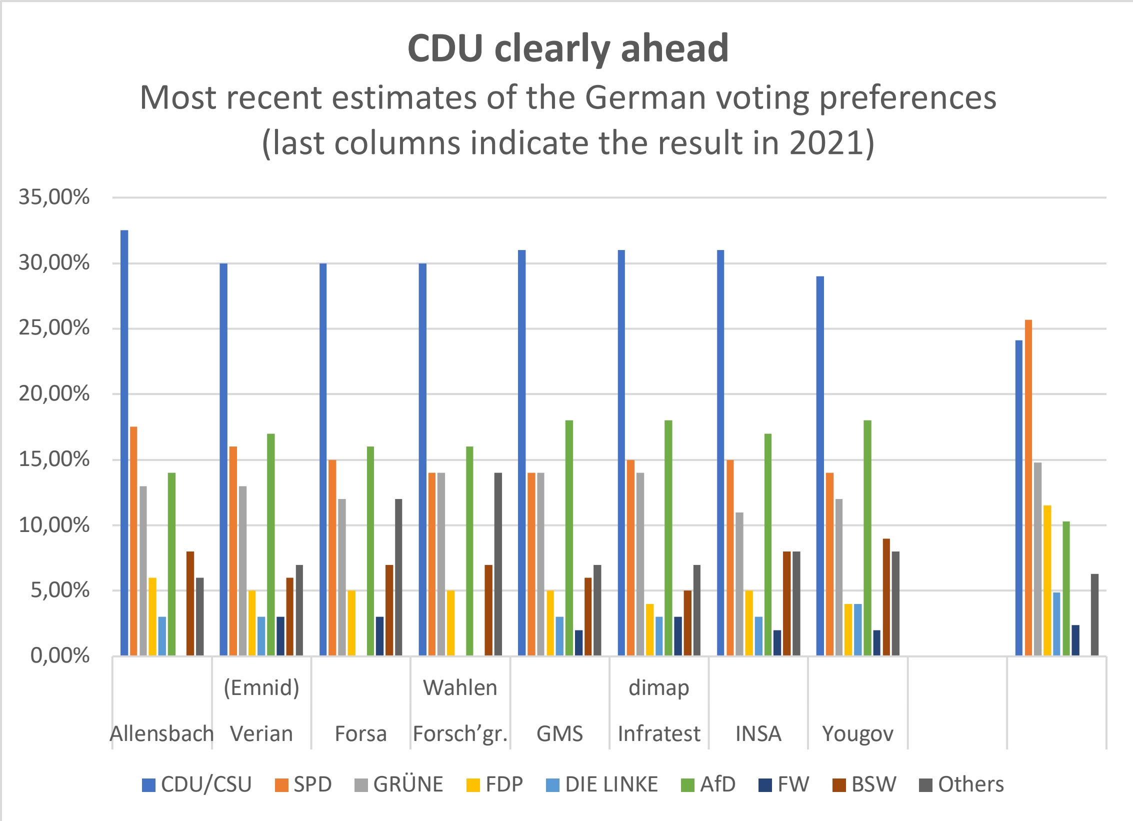
The country would be paralyzed, and no Franco-German common decision would be possible on European topics of common interest. Political economy would be left to the necessity of abiding by the new reinstated rules of European economic governance. The European Commission placed France under the Excessive Debt Procedure on June 19, considering the deterioration of its fiscal outlook. France has committed to reducing its deficit to around 4% in the next year. How this is manageable without a strong government in office is unclear. A deadlock scenario in which no political party can pass meaningful tax or spending measures could still allow the primary balance to improve slightly due to the recovery underway, but borrowing spreads would remain at their current levels.

France will need to remain eligible under the ECB's Transmission Protection Instrument in case of the non-fundamental fragmentation risk, which can be applied with significant discretion by the ECB Governing Council, whose president, incidentally, is French. New general elections would be held after at least one year, likely before investor confidence in the financial alignment between France and Germany begins to deteriorate.

If the rightwing coalition wins the relative majority, cohabitation would be even more awkward because the government would feel more legitimated by the popular vote and claim its mandate is stronger than the president's. In that case, Bardella might try to force the hand and disregard the European fiscal rules. His government would need more maneuvering room to accomplish at least part of its expensive fiscal program before 2027 when new presidential elections will take place. The use of too much fiscal headroom would be sanctioned by the European Commission, and the political confrontation might become very heated. This is the scenario that investors are mostly frightened of. The spread might rapidly climb over 100 basis points and de facto open a new era in the history of the euro area, splitting its inner-core.

The splitting of the core will not necessarily provoke a nuclear chain reaction. If Ursula von der Leyen becomes President of the EU Commission for a second term, "core Europe" is likely to morph into something different from the Franco-German axis that we have known so far. In September 2025 a new German government is expected to take office and, according to the polls, it will be led by a CDU *Kanzler*.

Fig 4



The new European "core" will thus be constituted by the new German Chancellor, playing a critical role in the European Council, and the German President of the European Commission, who comes from the chancellor's party. Luckily, the fact that German influence on Europe would pass through the European Commission would prevent the German Europe scenario dreaded by the European Germans.