In June 2024, increased uncertainty on the financial markets is specific to France and a significant shock, but not a major one

Whether caused by political, geopolitical or macroeconomic factors, uncertainty shocks are liable to affect the real economy. Decisions made by economic agents depend on their assessment of the future situation of the economy as a whole. Thus a situation that suddenly becomes more uncertain, following on from exceptional events (e.g. political or geopolitical crises), can give rise to an "uncertainty shock". Such a shock can take the form of a series of financial fluctuations: stock market volatility in particular is a macroeconomic measurement that correlates with uncertainty at the individual level. However, such events are likely to confuse the expectations of economic agents and be passed on to the real economy. In the case of France, an uncertainty shock, defined by selecting the main episodes of financial volatility over a long period (a threshold corresponding to the highest 5% of monthly values was selected), has a significant impact on activity: the Industrial Production Index (IPI) falls during the year following the shock and temporarily reaches a level 1% lower than it would have been in the absence of the shock.

The announcement of the dissolution of the National Assembly led to strong volatility in the French financial markets in June 2024. However, an indicator must be constructed over a long period in order to determine the importance of this increase in volatility compared to the last episodes of recorded "shocks". The method used in this *Focus study* is able to quantify the extent of the volatility and hence identify the main uncertainty shocks over the recent period: while the different phases of the Covid pandemic and the invasion of Ukraine did cause a major increase in volatility, this was not the case for the dissolution of the National Assembly. The volatility observed in June 2024 on the CAC 40 certainly increased, but it remained contained: thus at the macroeconomic level it was a large uncertainty shock, but not a major one. The event is unusual nonetheless as it is a shock specific to France, whereas previous uncertainty shocks were caused rather by global or European events.

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An increase in uncertainty is likely to generate a wait-and-see attitude, particularly with regard to corporate investment

Uncertainty shocks affect the decisions made by economic agents, decisions which are based on the agents' assessment of the future of the economy as a whole. Such wait-and-see behaviour can affect households as they decide between consumption and savings, but it is particularly relevant for corporate investment decisions. Indeed, in an uncertain environment, companies are more likely to decide to postpone or reduce the scale of their projects so as to limit the risks of overproduction and problems with cash flow, as investment decisions are difficult to reverse. Thus an increase in uncertainty is likely to slow down economic activity.

Uncertainty is not observable directly but can be approached by studying the volatility of financial markets

The uncertainty faced by economic actors cannot be observed directly. However, ▶ **Bloom (2009)** has shown that stock market volatility is a macroeconomic measurement that correlates with uncertainty at the individual level and that it also has an impact on real macroeconomic variables. Thus, most studies on uncertainty shocks use the volatility of the financial markets as an indicator of the uncertainty perceived by economic actors. In particular, the ECB publishes an index of financial uncertainty every month and for every European country (CLIFS, Country-level index of financial stress), constructed from financial data from three different types of market: stocks, bonds and foreign exchange (▶ **Duprey and Klaus 2015**).

However, it is not possible to identify the source of this uncertainty (natural events, internal political crises, international situation, etc.) using such an approach. To assess the political origin of any uncertainty, ▶ **Baker, Bloom and Davis (2016)** created a composite indicator based in part on the frequency with which political uncertainty is mentioned in the major American daily papers, using certain key words (such as "economy" associated with "uncertainty"). They show that an increase in uncertainty, when measured in this way, is accompanied by a significant contraction in investment, GDP and employment. This indicator is updated every month by the authors and replicated for most major economies. For France, the authors have used the websites of two major dailies (*Le Monde* and *Le Figaro*) to construct their indicator of political uncertainty since 1987. In a recent article using a similar method, ▶ **Hee Hong, Ke and Nguyen (2024)** show that a budgetary uncertainty shock leads to a contraction in industrial output and an increase in the cost of borrowing for several advanced countries, including France.

Economic outlook

In France, uncertainty shocks usually slow down industrial activity for several months

In the case of France, ▶**Zakhartchouk (2012)** has constructed an uncertainty indicator based on episodes of sudden increases in the volatility of stock market prices. He shows that an uncertainty shock, defined by selecting the main episodes of financial volatility over a long period (a threshold was chosen corresponding to the highest 5% of monthly values), has a significant impact on activity, and especially industrial activity. In fact, the Industrial Production Index (IPI) falls during the ten months following the shock. At the height of this period of "uncertainty crisis", the IPI is 1% below the level it would have had in the absence of the shock. From the eleventh month, the IPI increases once again, getting closer to its long-term level, which it reaches in around the twentieth month. In a more recent analysis covering the entire Eurozone, ▶**Bobasu and al. (2021)** use a more complex uncertainty indicator which reflects the difficulty in forecasting a set of real and financial variables (GDP, employment, industrial production, retail sales, household consumption, price indices, interest rates, etc.). They show that industrial production reacts negatively to such a shock, which dissipates after about a year. They also highlight a rise in unemployment following these shocks, with a return to the original situation after two years.

Financial volatility in France increased significantly in June faced with the surprise of early legislative elections

The announcement of the dissolution of the National Assembly on Sunday 9 June 2024 was an exogenous event, not anticipated by the financial markets. In the week of 10 June 2024, this surprise led to a sharp decline in the CAC 40 stock market index, which measures the listings of the 40 most actively traded stocks on the Euronext Paris financial market: the index fell by an average of 3% over the week compared to the previous week (▶**Figure 1**).

In contrast to the CAC 40, the American S&P 500 Index, which is based on 500 large listed companies in the United States, did not see a downturn in the week of 10 June 2024 and continued its upward trend. The German DAX 30 index, based on 30 large companies listed on the Frankfurt stock exchange fell by 1.2% in the week following the announcement of the dissolution. Over the same week, the yield on the 10-year Bund (considered to be the Eurozone's risk-free bond) lost 26 basis points (▶**Figure 2**) and the interest rate gap between France and Germany increased. Thus, faced with increased uncertainty fuelled by the French political situation, investors were able to seek a safe investment, which probably led to the fall in German sovereign yields.

The political origin of uncertainty can be highlighted by bringing in the indicator calculated from press cuttings by ▶**Baker and al (2016)**. In France, this indicator of political uncertainty increased sharply in June 2024, returning to a level close to the maximum reached in April 2017, the time of the presidential election.[1] However, this indicator remained lower in France in June than the level in Germany since the invasion of Ukraine, or in the United Kingdom at the time of Brexit (▶**Figure 3**).

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[1] However, this episode did not result in a particular increase in volatility on the French markets. Thus not all political uncertainty shocks turn into financial uncertainty shocks.

▶1. Stock index levels since January 2024
(level: in points)
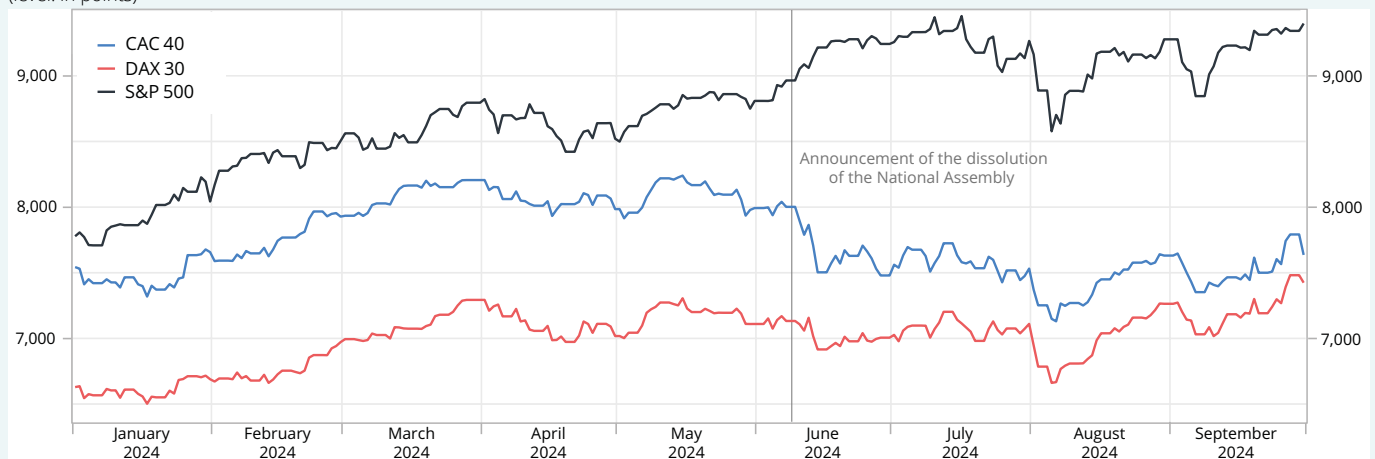
Last point: 30 September 2024.
How to read it: the CAC 40 stood at 7635 points on 30 September 2024.
Source: S&P, INSEE calculations.

The increase in financial volatility in the financial markets in June 2024 was substantial but not major

In order to quantify this increase in financial volatility and compare it to previous times of shock, an uncertainty indicator was constructed, based on the work of ►**Zakhartchouk (2012)**. It is calculated by correlating the monthly variance[2] of the CAC 40 with its average for the month (►**Figure 4**), and it does indeed show a marked increase in June 2024. It is well correlated with the ECB's index of financial uncertainty (CLIFS) for France, although it is more volatile (►**Figure 5**): in fact, this indicator is able to capture one-off uncertainty shocks, whereas the CLIFS is rather able to identify prolonged periods of uncertainty.

This uncertainty indicator can then be transformed into a binary "shock" signal. Two conditions are defined for a high volatility episode to be considered as an uncertainty shock:

• It must exceed a significance threshold, which can define the exceptional nature of the shock quantitatively. The threshold chosen here corresponds to the level where the highest 5% of values are selected. This is the conventional threshold and another value, 10% for example, could have been chosen.

• There must not have been a similar shock in the previous three months. This condition ensures that a unique shock is identified with exceptionally high volatility for several months.

2 Monthly variance is calculated from daily data. For each day, the closing value of the index for the session is used.
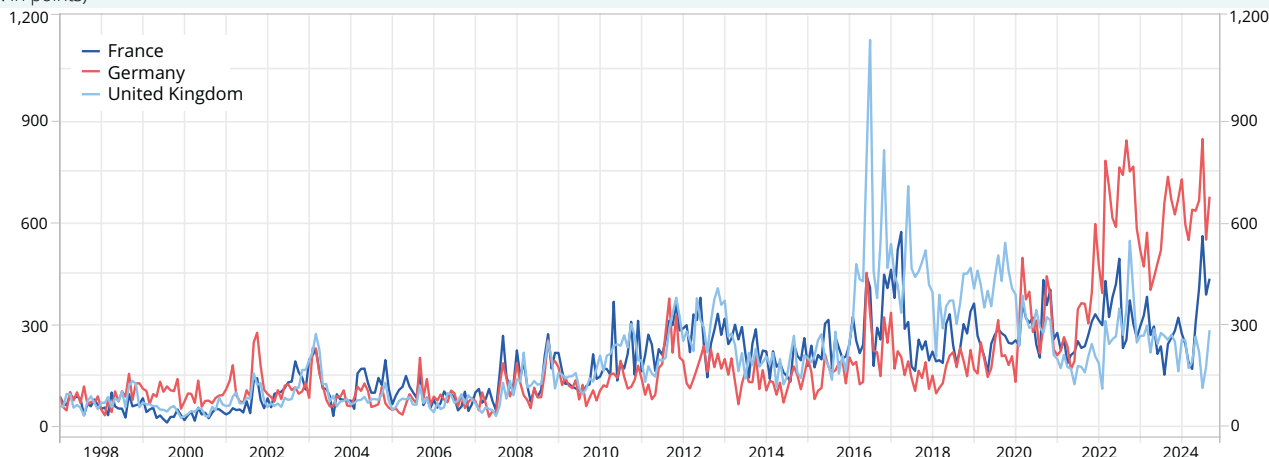
►2. Borrowing interest rates
(in %)
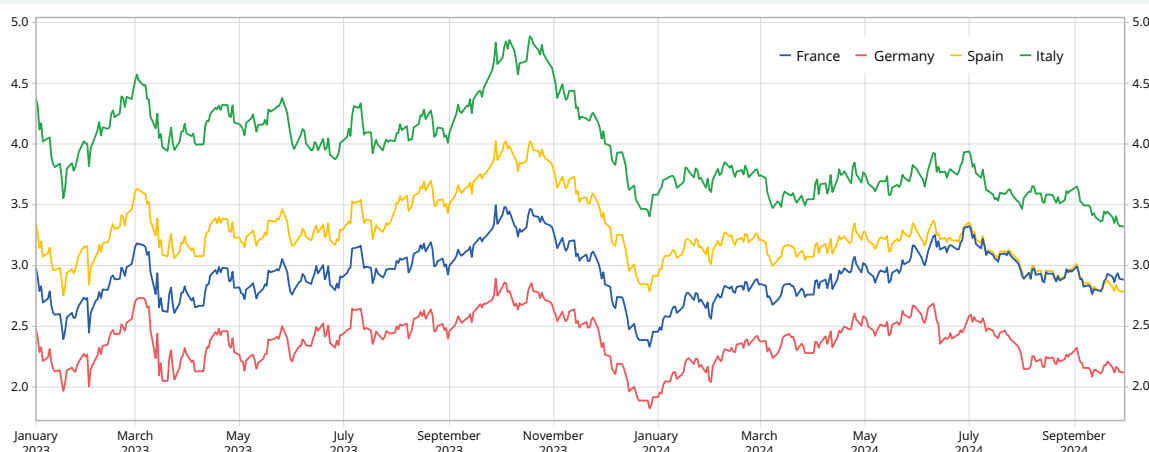
Last point: 30 September 2024.
How to read it: the borrowing interest rate on a 10-year loan in France was 2.9% on 30 September 2024.
Source: S&P, INSEE calculations.

►3. Political uncertainty index
(level: in points)

Last point: September 2024.
Source: Economic Policy Uncertainty Index, Baker et al.

Economic outlook

Thus the resulting indicator does not quantify the level of uncertainty in the economy, but identifies a sudden increase in uncertainty: if the volatility indicator rises above the chosen threshold, this is interpreted as the occurrence of an uncertainty shock.

This method identifies about twenty uncertainty shocks over the period 1987-2024. Most recently, the following episodes are identified (shocks prior to 2012 are listed in ►**Zakhartchouk, 2012**):

• January 2015: the CAC 40 experienced a sharp rise due to the start of the quantitative easing programme by the European Central Bank (ECB), in a context of fears of a deflationary spiral in the Eurozone.

• August 2015: concerns over a slowing Chinese economy caused Asian stock indices to fall, which then spread to western indices.

• October 2018: the escalation of trade tensions between China and the United States, the successive increases in the US Federal Reserve's key interest rate, as well as a resurgence of tension in the Eurozone between the European Commission and the Italian government regarding the preparation of the 2019 budget are all factors that affected the CAC 40 towards the end of 2018.

• February 2020: the spread of the Covid pandemic across the world caused a sharp increase in the volatility of the CAC 40 from February 2020. It reached its highest level ever in March.

• November 2020: during the second wave of the pandemic, the CAC 40 increased suddenly on 9 November 2020, following the announcement of the interim results of the final phase of the Pfizer BioNTech Covid vaccine trials.

• March 2022: this uncertainty shock was caused by the Russian army's invasion of Ukraine.

• June-September 2022: fears of recession emerged in the face of the rapid rise in inflation and the first decisions of the central banks to tighten their monetary policy.

The increase in volatility observable in June 2024 following the dissolution of the National Assembly falls just below the chosen threshold. However, the 5% threshold remains the convention, and the volatility in June 2024 is easily within the highest 10% since 1987.

►**4. Volatility of the CAC 40 compared to the index average**
(level: in points)
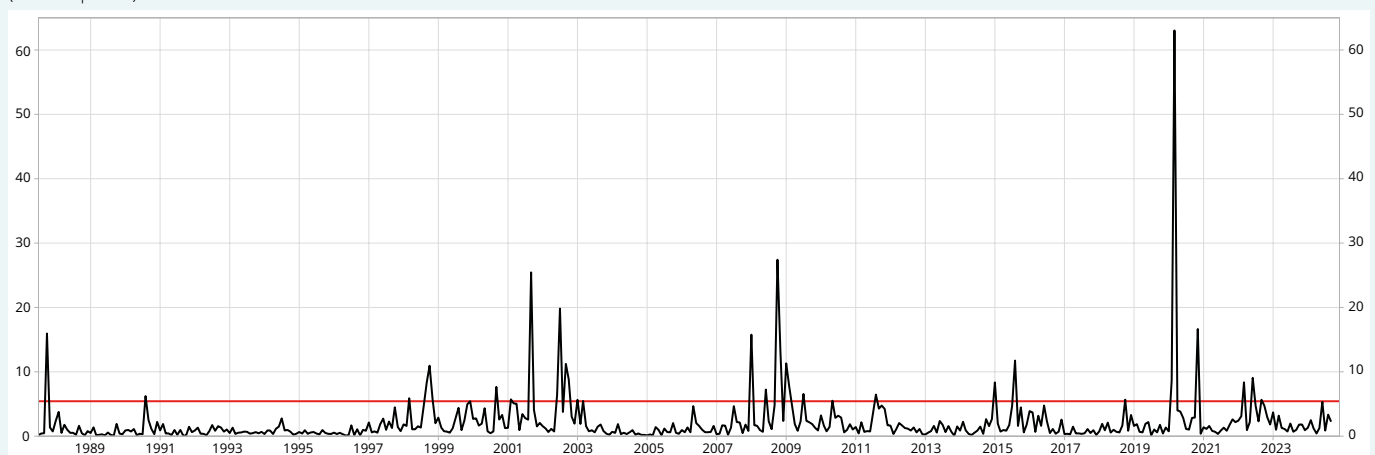
Last point: September 2024.
How to read it: the monthly variance of the CAC 40 compared to the index average was at 2.2 in September 2024, i.e. below the threshold selected to define a shock (horizontal red line).
Source: S&P, INSEE calculations.

In addition, the proposed indicator is constructed only from stock markets, whereas part of the shock may have passed through the bond markets too. However, the CLIFS indicator for France, which combines volatility in three markets (bonds, stocks and foreign exchange) does not show a very pronounced increase in June 2024 either. Consequently, while there were many mentions in the press of political uncertainty (▶ Figure 3), in terms of financial volatility, the June 2024 episode is not a major uncertainty shock, although it can still be described as a substantial shock. The event is nonetheless unique in that this shock is specific to France, where previous uncertainty shocks were usually caused by global events. ●

▶5. CAC 40 volatility index and CLIFS
(standardized and scaled levels)
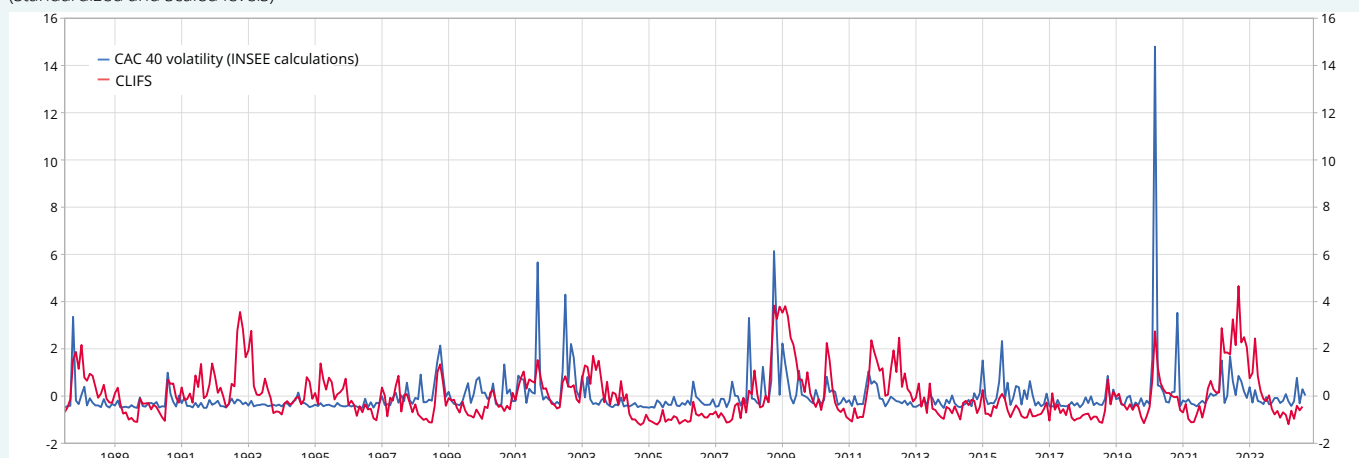
Last point: September 2024 for the CAC 40; August 2024 for the CLIFS.
Note: the indices have been standardized and scaled for comparison.
Source: S&P, ECB, INSEE calculations.

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