



The Drill

with Mikkel Rosenvold

Steno Research

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Decision Time in Israel and Paris on Fire

Washington has turned on Kyiv in two weeks, and diesel is only one of three reasons why. Next Tuesday is a double date: Israel elects its 26th Knesset, and the French Assembly holds its postponed vote on the revenue half of the 2027 budget. Both markets have already priced the bad outcome: a deadlocked Knesset in Tel Aviv and a spread back at euro-crisis levels in Paris. Below: the Ukraine/Russia/US update, why the Israeli deadlock is priced, but the upside is not, and the French escalation ladder with its mechanical floor.

Ukraine, Russia and the US

We've seen an incredible shift in tone and messaging from the Trump administration on Ukraine and Russia over the past two weeks. I covered the diesel deal and situation last week, but now that we understand the situation even better, let me conclude the three reasons for this.

First off, diesel. It has been correctly identified by the Trump administration as the main culprit behind the recent hot inflation prints, which led to the rate hike in September, which contributed massively to the AI selloff.

So it's not unfair to paint a direct line between the Iran war and the AI selloff. But obviously there's more to the story. Ukraine's attacks on Russian refineries have contributed heavily to the diesel supply crisis. Yesterday, I interviewed Rory Johnston, who put 1/3 of the blame on Ukraine and 2/3 on the Iran war. Just to put things into perspective.

So, can Trump save the diesel supply situation by cooperating with Russia? No. By no means. Even a complete halt to Ukrainian attacks on Russian refineries would only see meaningful effects on Russian diesel exports over the next quarters, as refineries and pumping stations are rebuilt. Meanwhile, Russia might (!) be able to double its current export levels from 100,000 b/d to 200,000 b/d within 1-2 months, but that's far from its usual level of 900,000 b/d.

In short: the diesel deal will do nothing to reduce the price at the pump before the midterms or even in 2026. So what's Trump's point?

Very clearly, to paint Ukraine as the culprit of the diesel supply crisis and the wider inflation issues. By focusing on this part of the problem, Trump is shifting focus away from the Iran war and giving Republican candidates across the country a boogeyman to blame for the inflation. And again, it's not incorrect. Ukraine's attacks on Russian refineries have led to energy inflation globally. But so has the Iran war.

Secondly, I think Trump has identified Ukraine as the path of least resistance to a peace deal. If you truly don't care what a peace deal looks like, it's logical to put the screws on the party that's most likely to give in. And that is Ukraine. Getting Ukraine to surrender still counts as having ended the war, after all.

Finally, the big game. I don't know if this is an articulated strategy, but the long-term vision is hopefully part of the discussions in the West Wing. That is: Russia needs to be pulled out of China's tentacles. When the war is over (or even before that), it's absolutely in the national interest of the US to build a new partnership with Russia that limits its dependence on China. The same goes for Russia. Moscow still views itself as a peer to the US and China, or at least a country that neither can subdue. Therefore, Russia needs to break free from its dependence on China and re-establish itself on the global stage. It's a win/win between Moscow and Washington, but obviously a seriously tough pill to swallow for Europe.

Israel: The Deadlock Is Priced, the Upside Is Not

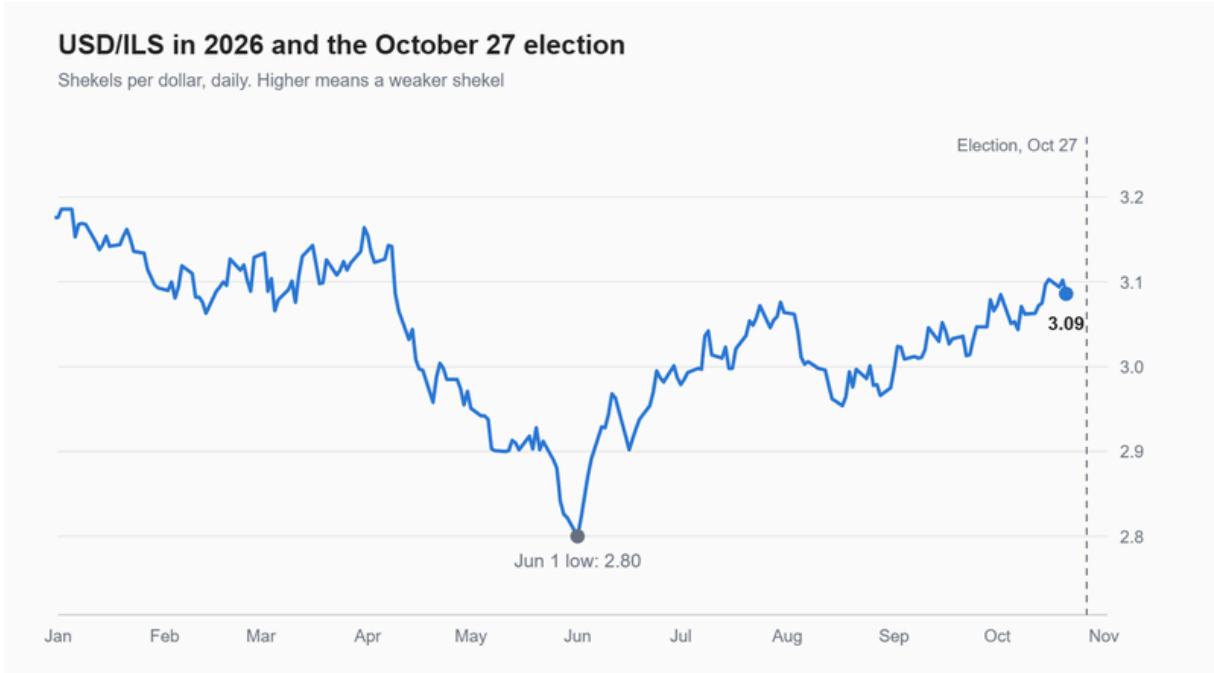
Israel votes on October 27 with the two blocs dead level. Four recent polls compiled by the Jerusalem Post put the Zionist opposition at 51.25 seats on average and Netanyahu's bloc at 51, ten short of the 61 needed. Gadi Eisenkot's Yashar now leads Likud in most surveys, while Bennett's list keeps bleeding seats.

The consensus read is simple: no majority, months of coalition haggling, possibly a sixth election in eight years.

The market agrees, and it has positioned for it. Tel Aviv Stock Exchange research on the last ten elections shows stocks sag in the run-up to votes that end in stalemate, and the early-October slide fits that pattern. Foreign investors made just NIS 2.7bn of net share purchases in the first nine months of 2026, down almost 70% on last year, and bank stocks flipped from the main source of inflows to the main source of outflows.

Run the numbers on the shekel. USD/ILS hit 2.80 on June 1, the strongest shekel since 1993, and has since climbed about 10% to 3.09, a nine-month low for the currency. The Bank of Israel was expected to pause this week after three straight cuts, with analysts pointing to the election.

Chart 1: USD/ILS in 2026 and the October 27 election



My take: the downside scenario is in the price, and the market is underpricing two other outcomes.

The first is a decisive opposition win. The parties around Eisenkot and Bennett would not change fiscal policy much, but they would change the relationship with Washington, Brussels, and the ratings agencies, and that is what foreign money has been waiting on. JPMorgan sized the election swing in the shekel at up to 3% in either direction while FX options priced roughly 1%.

The second is the one nobody trades: a unity government. Asked what should happen after a deadlock, close to 40% of Israelis prefer a Netanyahu-led unity government and 32% prefer another election. Note also that Netanyahu still leads every preferred-PM question (38% against 24% for Eisenkot in Maariv), so a broad coalition with him at the top and a centrist partner is a plausible landing, and markets would read it as stability.

Do not expect a dovish Israel. Eisenkot calls the two-state solution a grave mistake, has pledged to destroy Hamas's military wing within 18 months, and wants Iran's nuclear capability destroyed by any means. On Gaza and Iran, the gap to Netanyahu is close to zero.

The change sits in the West Bank and in the institutions. Eisenkot opposes formal annexation and the E1 plan, would dismantle unauthorised outposts, and blames Ben-Gvir and Smotrich for the settler violence. The bloc also wants the judicial overhaul reversed and a state inquiry into October 7. That is the list Brussels, Amman and the ratings agencies watch, and it is where the risk premium comes from.

Note also the coalition math. Bennett and Liberman rule out any Arab party, and Eisenkot's conditions exclude both the Arab and Haredi parties. On 51 seats with both flanks closed, the opposition's realistic road to 61 runs through Likud.

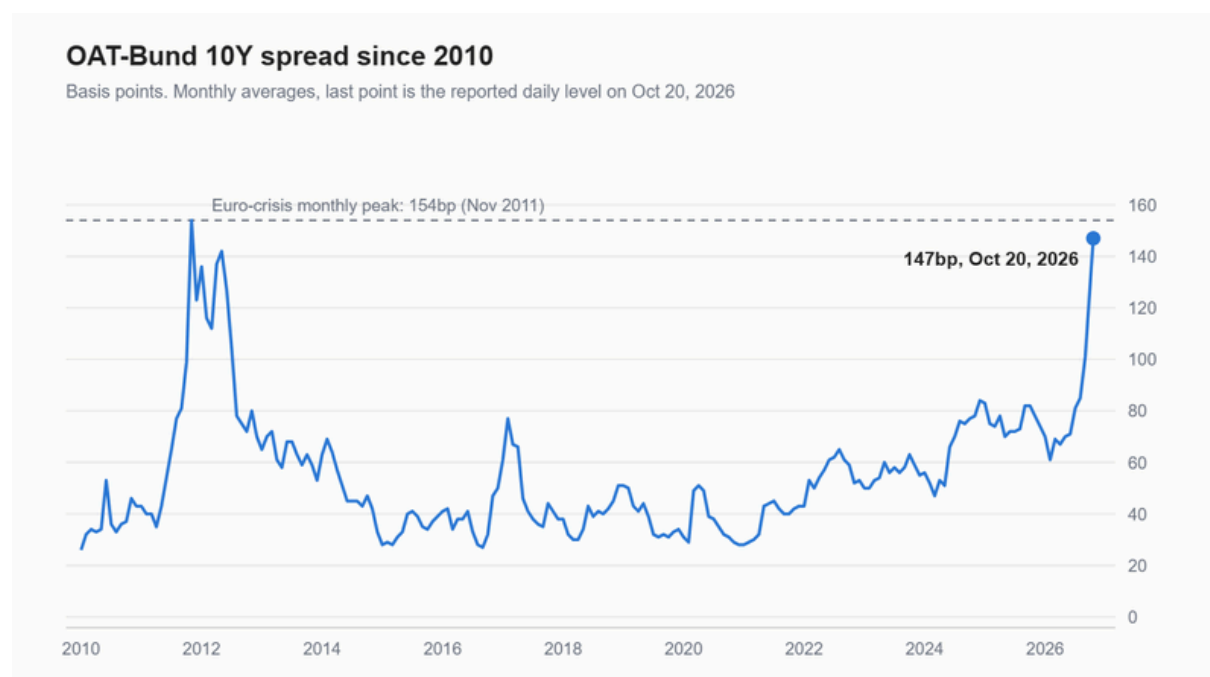
The tail that hurts is a narrow Netanyahu majority with Ben-Gvir and Smotrich back in key ministries. On these polls, that needs the bloc to find around ten seats in a week.

The trade: a 1-3 month long in Israeli banks (Bank Leumi, Bank Hapoalim) or the broad iShares MSCI Israel ETF (EIS), which carries the shekel exposure for a dollar-based reader. The banks are 6-7% below their February highs while the TA-35 is up about 17% this year, so the election discount sits where the foreign selling was. The trigger is the first coalition signal after the 27th; the stop is a 61-seat result for the current bloc.

France: An Escalation Ladder With a Floor

The French 10Y closed at 4.93% on Monday, its highest close since 2002, and the OAT-Bund spread touched 156bp on Tuesday. On monthly averages, the spread peaked at 154bp in November 2011, so France is now paying a euro-crisis premium with no euro crisis. It has also traded wider than Italy since the summer.

Chart 2: OAT-Bund 10Y spread since 2010



The trigger is the street meeting the budget. Around 550,000 people marched on the weekend of October 17, the Limoges town hall was set alight, protesters stormed Marseille's city hall, and curfews are in force in several cities. All of it lands on a 2027 budget that asks for a €54bn adjustment to take the deficit from 5.4% to 5.0% of GDP, in an Assembly with no majority.

The revenue vote planned for Tuesday has been pushed to October 27, with more than 2,000 amendments still on the table. Moody's reviews France on Friday and the ECB meets on the 29th.

What Happens if it Goes Wrong

The headlines will treat each vote as a cliff. The constitution treats them as a sequence, and France ran through the whole sequence last year:

1. The revenue part is rejected. Likely, given the committee threw it out 31 to 3. The bill then moves on in the government's original text. Last year the Assembly rejected the same section 404 to 1.

2. The deadlines bite. Parliament has 70 days in total on the budget. After that, the government can enact it by ordinance, or pass a special law that keeps collecting existing taxes into January. The state keeps paying its bills either way.

3. 49.3 and censure. Last year Lecornu forced the budget through on February 2 and survived the censure motions because the Socialists stayed out. The price of their restraint is concessions, which means a softer deficit path.

4. The government falls. Macron names a sixth prime minister or dissolves the Assembly. A dissolution is the real tail: snap legislative elections with the RN as the largest party, six months before the presidential race.

My take: steps 1 to 3 are noise with a precedent, and the market is pricing step 4.

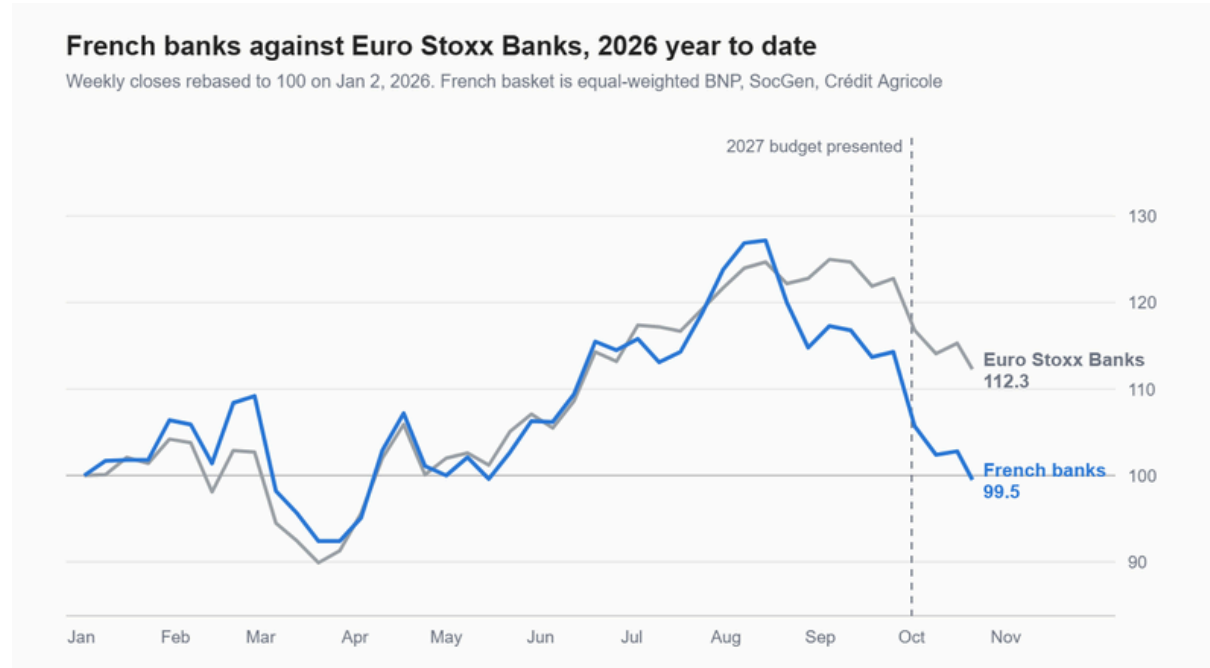
The floor is mechanical. A special law means no shutdown and no missed coupon, so what is left is a ratings and spread story. ING sees the spread settling at 100-125bp over the coming months, and the Banque de France governor has said plainly the answer will not come from Frankfurt, so do not count on the ECB to compress it for you.

That leaves the dissolution scenario, which is where my view from the October 7 edition needs an update. Le Pen's chances certainly haven't diminished after Paris was set on fire, so she now looks like the heavy favorite. Her odds are probably on point, but the fallout of her winning is still vastly overstated.

How the Market Is Taking it

Sovereign stress is showing up hardest in French banks. An equal-weight basket of BNP Paribas, Société Générale and Crédit Agricole is down about 22% from its August high and roughly flat on the year, while the Euro Stoxx Banks ETF is still up about 12%. Relative to European peers, the French names have given up some 15 points since mid-August.

Chart 3: French banks against Euro Stoxx Banks, 2026 year to date



The auctions tell a calmer story. KBRA noted last week that demand for French paper remains very solid, which is what you would expect if the buyer base sees a spread trade and no solvency question.

The trade: a 1-3 month long in BNP Paribas (BNP FP), the most diversified of the three, against the Euro Stoxx Banks ETF (EXV1) as a funding leg, or outright for readers who want the beta. Entry around Moody's on Friday; a downgrade is the classic sell-the-rumor moment. The stop is a dissolution announcement.



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Mikkel is the core geopolitical analyst in Steno Research and host of 'Macro Mondays'. Mikkel hosts geopolitical talks and provides weekly geopolitical analysis in the 'The Drill' article format. Whenever things go down in the realm of warfare, conflict and international affairs, Mikkel has the eye for how developments will impact the market and what the immediate and long-term outlook is.

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