

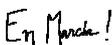
France: Macron n'est pas la réponse

France: Macron is not the answer

-  Emmanuel Macron is set to repeat the failure of the “Third Way”.
-  He says cut deficits and civil servants, yet boost state spending!?
-  Emphasis on “More Europe” offers an attack angle for Le Pen.
-  By September French debt and equities will underperform again.

Given that a formal investigation is now open against François Fillon over the so-called “Penelopegate” scandal, the pathway to the Élysée Palace would appear to be an open road for the left-centrist Emmanuel Macron.

The latest opinion polls [1], suggest that in the first round of voting on April 23 the top two candidates will be:

- Marine Le Pen  25.8%
- Emmanuel Macron  23.7%

The embattled François Fillon of the centre-right, Les Républicains, will have just 20.3% and so miss out on the run-off in the second round of May 7. “Penelopegate” will have cost him the Élysée Palace.

The latest opinion polling for voting intention is a potential second round of Le Pen against Macron shows Macron holding the steady advantage with a lead of 24%, i.e. Macron 62%...Le Pen 38% [2].

Macron, of the left looks to renew the “Third Way”



Macron was a member of the Socialist Party, serving President Hollande as Deputy Secretary-General in 2012 before being appointed Minister of Economy, Industry and Digital Affairs in 2014.

Much has been made of his part in steering thorough business-friendly reforms despite opposition from the hard-left and trade unions.

He resigned from the Socialists in 2016 to form “En Marche!” (Moving up!) seeking the Presidency on a platform of fiscal restraint and deregulation, but wants to boost public spending and extend the size of the welfare state.

Much is being made about his so called "Nordic-Style" economic platform and yet what is being proposed is another attempt to push through policies based on the idea of "The Third Way" that steers a course between socialism and capitalism.

Why is such a policy being cheered?

One can only assume that with Fillon out of the running Macron is seen as better by the majority than the xenophobic and Euro-sceptic alternative offered by Marine Le Pen and the Front National. This is sad for France and Europe as the Third Way as practiced in Sweden proved to be an exercise in economic illiteracy.

It all sounds so appealing as Third Way politics proposes an alternative to unfettered free-markets on the one hand and hard-left socialism/communism on the other. Sadly, in Sweden's case the policies started on the left and stayed there. In the 1960's and early 1970's the overall tax burden increased dramatically to pay for the expanded welfare state and the tax system discriminated heavily against wealth creating individuals who owned businesses.

It is no exaggeration to call it an attack on free market entrepreneurship as the effective marginal tax rate (marginal tax plus the effect of inflation) that was levied on Swedish businesses peaked at 137%. Rather than raise tax revenue the system simply strangled incentive and motivation.

But...didn't it work for Bill Clinton and Tony Blair?

Clinton and Blair took a different approach as they looked to the Third Way in that they wanted to implement a serious break from past policies within left leaning progressive movements that were built around the state and yet steer away from the economic liberalism of Reagan in the US and Thatcher in the UK.

In the US, Clinton offered an echo of the policies followed by Johnson (1963-1969) and Nixon (1969-1974) by embracing fiscal conservatism more than traditional left-wingers would and advocating elements of welfare replacement with workfare. Clinton and Blair also favoured market solutions to traditional problems while rejecting pure laissez-faire economics.

Echoing the US President Tony Blair said "...My kind of socialism is a set of values based around notions of social justice..."

However, Spotlight contends that the weakness of the Third Way that Macron is walking toward can be found in the flaws of both the Clinton and Blair administrations. They both tried to be many things to many people and suffered not just from scandal; Clinton-sexual and Blair-military but also because short-term political and market successes mask the limits of its institutionalised policy achievements. Their version of public-private partnerships led to ultra-low bids winning contracts followed by excessive charges down the road so as to claw back a profit at tax payers expense.

Neither Clinton nor Blair addressed inequality for as Figure 1 illustrates it was unchanged in the US during the Clinton years and in the UK it rose, only falling in 2009/10 after Blair had yielded power to Gordon Brown in 2007.

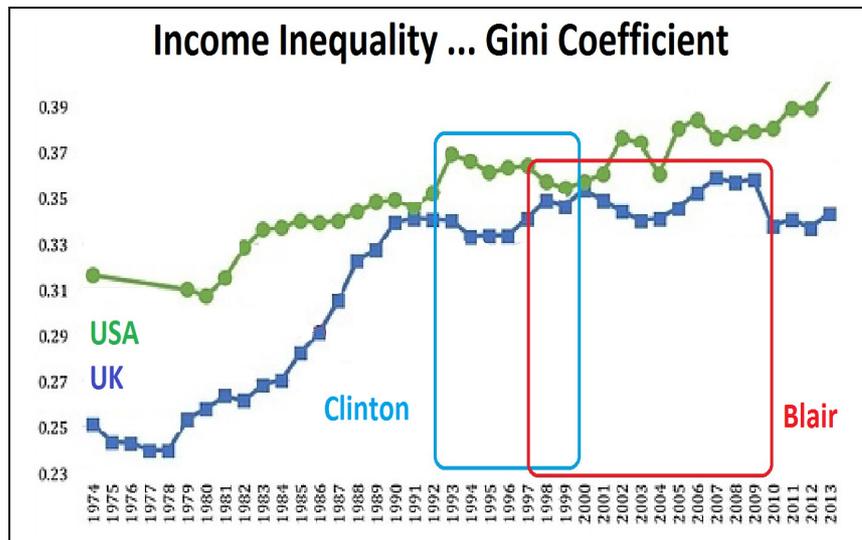


Figure 1: Income Inequality by Gini Coefficient in the US and UK 1974 ~ 2013

Source: Organisation for Economic Cooperation and Development

Despite much talk about job training, both leaders failed to create an “intelligent and active” welfare state that helped the unemployed back into productive employment. This was chiefly because the Third Way feeds a state system that is bloated and lethargic. Unless slimmed down it will always be flabby and unfit for purpose.

What is Macron's message?

As far as one can tell Macron's clarion call is in line with social-democratic policies that are a naked attempt to seek German approval. In short he claims France will meet EU budgetary rules.

Jean Pisani-Ferry, who runs Macron's economic programme said last week

“...We don't think we need to embrace unbridled stimulus, nor to engage in dramatic cuts that would hurt growth, ...That's the kind of moderation we stand for. ...”

However, never forget that France has an appalling record on managing its national budget and the next President must push through tough austerity measures if it is ever to comply with the rules set by the European Union (EU). Now, austerity from the French left...that will be interesting to see.

The European Commission warned the country's budget deficit will hit 3.1% of GDP in 2018. This will be above the Eurozone's 3% limit. France's public expenditure is expected to rise over wage increases for civil servants and rising healthcare costs. Why should anyone believe France will behave in the future?

Spotlight simply asks the reader and investor to be realistic. Deficit targets set by the Commission have not been met by either Nicolas Sarkozy [3] or François Hollande. France, the second largest economy in the Eurozone, has failed to fall below 3.0% since 2007, Figure 2.

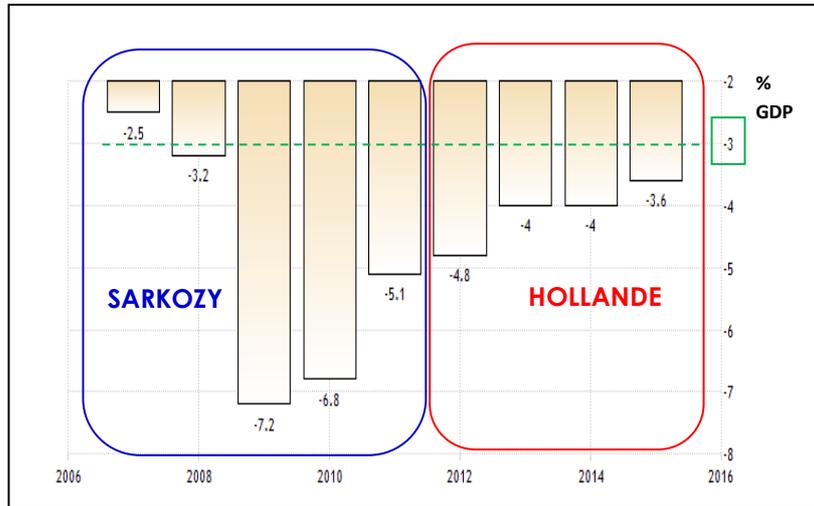


Figure 2: French Government Budget Deficit, % GDP Source: INSEE, France

Macron's plan targets annual cost savings of EUR 60 Billion by 2022, including the loss of 120,000 civil service jobs. This would help bring public spending to 52% of GDP, from 55% currently. Well, that will lead to an interesting standoff between the new President and the civil service union.

This measure will prove hard to introduce as the Hollande administration found it had to appease the unions when it tried to implement business friendly policies in 2014. Then, to ease tensions with unions, the government said it would lift a six-year-old civil servant pay freeze, at a cost of EUR 2.4 Billion. Why should we believe Macron will be able to better succeed in 2017?

Then of course there is the usual political talk about building a new model to engineer growth. Why is it that the left-wing of politics never grasp the fact that the state cannot create growth or wealth...only free enterprise will do that?

In France, despite being home to many world class business enterprises, business is still seen by the political elite as something grubby, inferior to public service that has to use the side entrance.

Macron's plan entails extra spending worth EUR 50 Billion over five-years partly to boost training schemes for the unemployed youth whose jobless rate still runs at 26.2% from 23% when Hollande was elected. We urge the reader at this point to think back to what Spotlight said about Clinton and Blair...where was their meaningful retraining programmes that delivered permanent employment?



March 3 2017

More Europe

Macron is no Eurosceptic; the contrary is in fact the case, as he sees Europe as a positive beacon for France. He does, however, have an astute politician's way of showing it. He has said that the EU degenerated into a theatre of predictable choreography and he called for **"...a revolution of the system..."**.

But for him, this means more, not less EU and his five key points underscore his message that **"...We need more European sovereignty. ..."**

1. A common European security policy...

"...Our real borders are the EU's external ones, not the national ones..."

2. The Euro... Macron says the common currency needs reform, but it remains a prerequisite for an economically successful Europe.
3. An aggressive and coordinated trade policy... only by acting together on trade can the EU compete with global players like China or the US.
4. A common sustainability strategy... although this will flounder as Macron does not support a hard phase-out of nuclear energy in the same vein as Germany.
5. A digital single market...Macron wants common rules and digital infrastructure can Europe hold onto its digital developments.

These five points, especially the first will be the target which Le Pen will seek to attack and expose Macron in May... at Spotlight we fear it is his Achilles heel.

So off to the polling station

Macron's chances in the second round of voting have been boosted by the news that François Bayrou, President of the Democratic Movement, has said he would support Macron and not run himself for the Presidency.

Bayrou has been potentially polling low numbers around 6% and his support for Macron provided a degree of relief to financial markets fearful of the prospect of a victory for the far-right Marine Le Pen.

As such they had switched to the safety of German Bunds and the DAX to escape the risk that Le Pen could, if elected orchestrate the French exit from the Euro.

What Spotlight expects after the May 7 second round is that if Marine Le Pen wins then French spreads over Germany in the 2-Year maturity will soar to 100bps and the CAC 40 will beat a retreat with the DAX/CAC 40 ratio running 2.60 within two-months.

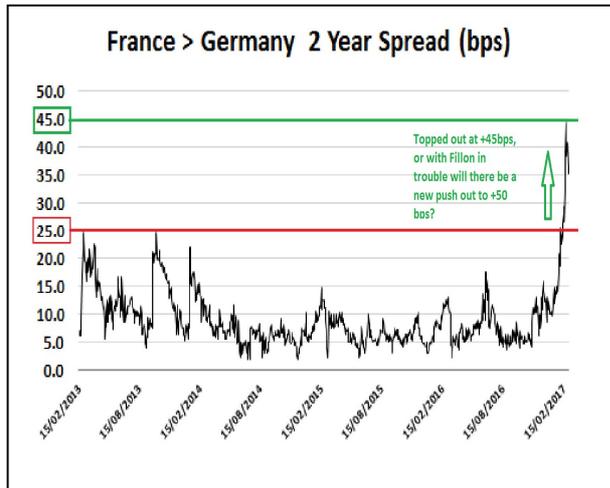


Figure: 3 French German 2-Year Spread (bps)

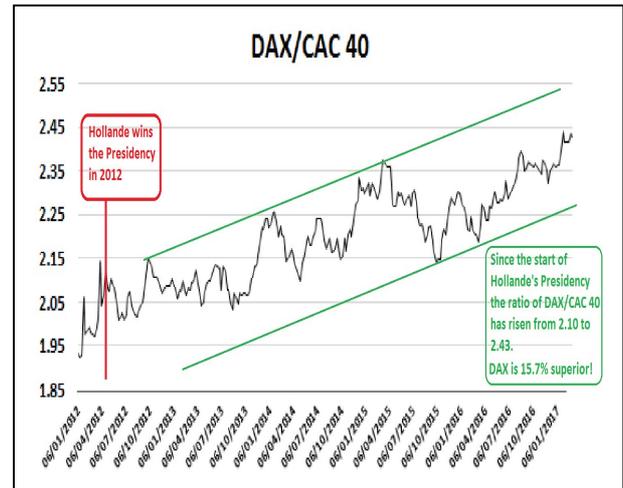


Figure 4: DAX/CAC 40 Spread

Source: www.investing.com Spotlight Ideas

If Macron wins, then at first the spreads will tighten and the CAC 40 will outperform the DAX.

However, by September the markets will have worked Macron out. He will not be able to deliver his promises and France under his rule will just as profligate as it has been under Hollande. It will be clear that once again France is not the second-best economy or market in the Eurozone. Instead it is the least bad. Those two positions are a long way apart.

The tragedy is the France needs a sensible centre-right reformer, Fillon looks to have blown his chances and it is looking far too late for him to be replaced by Juppé with just over seven weeks until the first round of voting.

References:

[1] and [2]

French opinion polls held between February 26 and March 1 2017 by Ifop-Fiducial, OpinionWay and Elable.

[3]

Only in 2007 did France achieve a budget deficit under 3.0%. Some of the credit has to be shared with Sarkozy's predecessor, Jacques Chirac.

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