

CIO Viewpoint

Macron's Acte II

Investment Solutions

16 September 2019

The recent public transport strikes in Paris are a reminder that industrial tensions are alive and well in France. The latest actions, over proposed changes to pensions, point to the challenges ahead and the need to balance more fundamental reforms with lowering public spending.

Nevertheless, street protests mask the underlying story. Half way through President Emmanuel Macron's term in office, there is perhaps a window of opportunity. The French economy, which expanded at 1.4% year-on-year in the second quarter, is performing more strongly than Germany's 0.4%. The French economy is less export dependent than Germany, which earned almost half (47.5%) of its GDP from exports of goods and services in June, compared with France's 31.7%, according to Eurostat (see table) and Germany's manufacturing sector accounts for 26% of gross value added, more than double France's 12%.

The next phase of the president's reform ambitions was set out in the 2018 budget. Mr Macron's approach, which takes a more holistic approach than predecessors from François Mitterrand through François Hollande, appears to be improving confidence among businesses (see chart 1).

While the road is still long for the president, [unemployment](#) is falling (from around 9.5% when Mr Macron took office in May 2017 to 8.5% today), and he faces few political challenges while his [public approval is recovering](#) from the 'gilet jaunes' protests that started in late 2018.

The government has changed labour laws so that employers are less reluctant to hire, without weakening the potentially obstructive unions. There is a simpler flat 30% levy on interest income, a property tax replaces a wealth tax, higher household duties are offset by lower social contributions for private-sector workers, as well as a lower residence tax, while corporate duties have fallen to 28%. The government has also tackled unemployment insurance and is now turning its attentions to pension spending, which accounts for the lion's share of public expenditure.

Of course, the story is not cut and dried. The World Economic Forum ranked France 17th in its 2018 Global [Competitiveness](#) Index, a creeping one-place improvement over 2017. In contrast, Germany ranks a consistent third.



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Key takeaways

- The French economy has often been written-off as un-reformable
- President Macron has an opportunity to reform France's state infrastructure
- Less exposed to trade disruptions than Germany, the French economy is expanding faster than its neighbour
- Unemployment is falling and a series of reforms are being tackled holistically, although the most contentious, on pensions, will be the next major challenge.

Important information: Please read the important information at the end of the document.

Weekly publication of Lombard Odier – Contacts: Investment Solutions, investment-solutions@lombardodier.com

Data as of 16 September 2019 unless otherwise stated.

Lombard Odier · CIO Viewpoint · 16 September 2019

The politics of pensions

French public spending on health, pensions and social services is the highest in the world, relative to the country's economy, accounting for around 32% of GDP in 2018, according to the OECD. That compares with 25% in Germany.

Mr Macron promised to change pensions when he was elected in 2017 and reform is likely to be the focus for 'Acte 2' of Mr Macron's presidency. Pensions are politically sensitive. The last attempt at a complete overhaul of pensions was in 1995. That failed as then-Prime Minister Alain Juppé's plans were halted by strikes. In 2010, President Nicolas Sarkozy, tried again with more cautious changes.

After facing down the gilets jaunes, Mr Macron is wary of stoking more unrest, and so wants to be seen to listen through a programme of national debates.

However, along with this has come a pledge that total pension spending will not decline. That may make it easier to push

through changes, but makes it harder to balance the national pension deficit.

As life expectancy has risen, the fragmented pension system has become unsustainable. France spends more of its GDP on pensions (around 13% in 2018) than most OECD members, and its citizens retire, on average, much earlier than neighbours including Germany's official 65. Under the proposed reforms, the retirement age would increase to 64 by 2025.

A two-speed economy

Since the gilets jaunes protests fizzled out, concerns over the divide between wealthy and poor have not disappeared, and pension reform touches a number of sensitivities. One aspect of the protests was simultaneous demands for lower taxes and higher public spending. The protests may have prompted a change in style from the government, and social security and health have moved up the political agenda. Reforms also now include an estimated 25 billion euros injection into the economy, equivalent to around 1% of GDP.

Top 10 exports France

 Export categories	USD bn	% of total exports
① Machinery including computers	67.7 bn	11.9%
② Vehicles	56.5 bn	9.9%
③ Aircraft, spacecraft	51.8 bn	9.1%
④ Electrical machinery, equipment	44.9 bn	7.9%
⑤ Pharmaceuticals	33.8 bn	6%
⑥ Plastics, plastic articles	22.6 bn	4%
⑦ Perfumes, cosmetics	19.7 bn	3.5%
⑧ Beverages, spirits, vinegar	19.4 bn	3.4%
⑨ Mineral fuels including oil	18.7 bn	3.3%
⑩ Optical, technical, medical apparatus	16.9 bn	3%

Top 10 exports Germany

 Export categories	USD bn	% of total exports
① Machinery including computers	271.7 bn	17.5%
② Vehicles	263.7 bn	16.9%
③ Electrical machinery, equipment	163.8 bn	10.5%
④ Pharmaceuticals	96.8 bn	6.2%
⑤ Optical, technical, medical apparatus	80 bn	5.1%
⑥ Plastics, plastic articles	68.1 bn	4.4%
⑦ Aircraft, spacecraft	41.4 bn	2.7%
⑧ Articles of iron or steel	33.6 bn	2.2%
⑨ Mineral fuels including oil	33.4 bn	2.1%
⑩ Iron, steel	29.2 bn	1.9%

Source: World's Top Exports

While the Macron government continues to roll back cuts to the state bureaucracy, total public spending cost 56.5% of total GDP in 2017, the highest share in the EU. That pushes spending close to the 3% budget deficit ceiling stipulated by eurozone rules, which in 2017 fell below the threshold for the first time [in a decade](#). Mr Macron’s credibility in the EU will in part depend on his ability to meet this cap.

Outside the ‘hexagon’

At the international level, faced with the instabilities of Brexit and Trump, and the slow stepping-down of Chancellor Angela Merkel, Macron has become a relatively more prominent leader.

Most recently the Biarritz G7 summit saw efforts on a range of issues from Amazonian fires to Iran-US relations. After the departure of US security advisor John Bolton, there are now reports that a [French plan](#) is making headway with the Trump administration to open dialogue with Iran.

France’s post-war, state-heavy economy has often, and stereotypically, been written-off as ungovernable or un-reformable. Mr Macron’s [popularity is recovering](#) while he has no obvious political challenger and would almost certainly defeat the far right in a two-way presidential run-off, as traditional parties’ introspection stops them fielding alternatives. The economy is looking balanced and increasingly competitive. President Macron has created an opportunity to reform France’s state infrastructure.

Chart 1 – Relative health: French and German GDP & PMI



Source: Bloomberg

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