European Politics

Macron Majority Gives His Reforms Momentum

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Summary

With a new majority in the French National Assembly, President Macron has increased the chances parliament will pass his ambitious reforms, which are aimed at transforming labour laws and spurring growth. But France also faces some hard fiscal realities that may take some time to fix.

Key takeaways

- The results of the National Assembly elections are an important boost for President Macron as he seeks to advance his ambitious reform package.
- Domestic French stocks are likely to benefit from Mr Macron's economic reforms, including sectors such as construction, infrastructure and banks.
- Despite the optimism, fixed-income investors shouldn't forget the fiscal realities that support a decent spread between France and Germany.

Ahead of France's presidential election in May, it seemed unlikely that the ultimate victor – whatever his or her political colour – would go on to secure a majority in the National Assembly. The numbers seemed too finely balanced for that. But people had not fully factored in the meteoric rise of President Emmanuel Macron.

In the 18 June elections, Mr Macron's La République En Marche (LREM) party – still only a year old – won a much sought-after parliamentary majority. This gives him valuable leverage to push through his ambitious reform agenda.

The result adds to Mr Macron's power and legitimacy at home, while further enhancing his credibility abroad. It's likely that he will seek to pass the most difficult reforms – in particular, those related to labour law – as quickly as possible. French workers are, famously, among the most "expensive" in Europe. Mr Macron wants to give employers more flexibility to negotiate deals with unions and employees on wages and hours, rather than having to stick to rigid rules. He is also looking at pension scheme reform.

The unemployment rate in France, at close to 10 per cent, is higher than many neighbouring countries. During the presidential election campaign, Mr Macron said a target of 7 per cent by 2022 was "reasonable".

His other proposed measures include cutting the corporate tax rate from 33.3 per cent to 25 per cent and replacing France's wealth tax (ISF) with a tax on bricks-and-mortar real estate only – to encourage investment and entrepreneurialism.

Overall, his programme is designed to address the country's structural weaknesses in terms of cost of work and competitiveness, and to attract foreign investors.

Investment implications

Boost for domestically exposed stocks
The most obvious short-term impact of Mr Macron's reform package is on the re-rating of France. By moving quickly on parts of his reform agenda, Mr Macron will send a positive signal that should buoy market perception. An important reason why the "Macron effect" has so far been muted for French equities is that the market does not have a lot of domestic exposure. Similar to the FTSE 100 in the UK, a majority of revenues are earned from international sales.

The more domestically exposed companies are likely to be the biggest beneficiaries of Mr Macron's agenda. Sectors such as infrastructure, construction and banks should benefit from stronger growth and lower taxes – assuming he can push his reforms through.

While not a Macron-specific story, defence sector stocks are also worth watching. In the wake of President Donald Trump's recent comments, European Union Commission President Jean-Claude Juncker reiterated the need for countries to stand on their own two feet when it comes to defence. This may translate into increased defence spending across the EU.

Optimistic fixed-income investors shouldn't forget the fiscal realities
Amid the optimism, fixed-income investors should keep in mind some of the hard fiscal realities. France may struggle to bring its budget deficit below 3 per cent (as a percentage of gross domestic product) for 2017. The lingering lack of fiscal discipline – whatever the commitments for the subsequent years – should support a decent spread between France and Germany, despite the likelihood of a slight tightening between French and German government bonds in the immediate aftermath of these election results.

Political risk in Europe isn't going away anytime soon, but our near-term outlook for the region remains favourable
The UK election result is a reminder that the political landscape continues to throw up surprises. Perhaps the "elephant in the room" is Italy, which is facing continued political stagnation and an inability to pass much-needed reforms. There has been a great deal of speculation about a potential snap election being called for this autumn, instead of early 2018 as scheduled, but this is looking increasingly unlikely. The anti-establishment Five Star Movement seems to have derailed an electoral reform deal. This would have been a critical step in forcing early elections, which could have empowered Eurosceptic parties and posed a threat to the euro zone.

While political risk in Europe has not gone away, we continue to see a favourable near-term cyclical outlook for the euro zone. The election of Mr Macron, the LREM's new parliamentary majority and the likely reaffirmation of Chancellor Angela Merkel in Germany should lead to a constructive partnership between France and Germany. A strong "Merkron" could put Europe back on a path toward achieving the job started in 1950s: a truly United States of Europe.

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