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Holger Schmieding, Chief Economist | [Holger.schmieding@berenberg.com](mailto:Holger.schmieding@berenberg.com) | +44 20 3207 7889

## THE MACRON EFFECT: CAN FRANCE OVERTAKE GERMANY AGAIN?

### Berenberg Macro Flash

#### THE BIG PICTURE: TRADING PLACES

Over the last seven decades, Germany and France have taken their turns at the top. (West) Germany enjoyed its post-war economic miracle in the 1950s before France caught up in the 1960s and 1970s. Following a German rebound after 1985, Germany became the sick man of Europe from 1995 to 2005 while France moved ahead. Thanks to its "Agenda 2010" reforms of 2003/2004, Germany is now enjoying the golden decade we proclaimed in 2011 whereas France languishes in self-inflicted misery. If Macron wins on Sunday, the next turn of the wheel could be ahead.

For Germany, the outlook is clear: it cannot get much better than it is. As success breeds complacency, Germany will lose its edge and fall back to the middle of the European growth league in the next decade, paying the price for its slow-motion reform reversals. Instead, France looks likely to advance from close to the bottom to near the top of the European growth league if Macron wins and [delivers the changes](#) we expect.

#### IS FRANCE UNREFORMABLE? NOT AT ALL

But isn't France different, suffering from specific traits that make it unreformable? We often hear that argument. History suggests otherwise. Change happens. If it can't go on, it won't. In the 1970s, the UK seemed to be the unreformable country, scarred by the shock of having lost an empire and unable to shake off the yoke of particularly Bolshie trade unions. Then came Margaret Thatcher. After 1994, Germany seemed to be blighted by a permanent "Reformstau", unable to change because its federal structure decentralises power to such an extent that a turnaround would be impossible as the two separate houses of parliament with their different majorities always blocked each other. Then came Gerhard Schröder, who struck a deal with then-opposition leader Angela Merkel to get serious reforms through both houses of parliament. We could lengthen that list.

All countries are different. But democracies are capable of serious change. In France, change is in the air:

- Much of the population believes things can't go on like this, even if the French voters disagree very much on what kind of change is needed.
- The standard-bearers of the centre-left (Macron) and the centre-right (Republicans) agree that the country needs pro-growth structural reforms, even if their recipes and tactics are not quite identical.
- France has fallen behind Germany by so much that Berlin had to manage the euro crisis with very little French input. That experience has shocked the French political elite even more than Germany's political elite was shaken out of complacency in 2002 when their country embarrassingly breached the stability pact it had itself imposed on the Eurozone. Paris knows that it will take serious reforms for France to regain its status as a key player in Europe.
- The more moderate of the two big French trade unions, CFTD, already supported some of Macron's ideas when he served as economics minister 2014-2016.

#### SUFFICIENT GLOBAL TAILWINDS FOR SUCCESS?

But isn't the global backdrop much more difficult for France today than it was for Germany which reformed itself from 2003 onwards when the rest of the world and much of Europe was growing strongly? This scepticism is far overdone. Today, the global economy is enjoying a synchronised upturn even if it lacks the characteristics of a genuine boom. More importantly, domestic demand in France's major trading partner, Germany, is expanding at a healthy pace. Yes, Germany benefited from the rise of China with its



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near-insatiable appetite for German machine tools and cars. But as China is progressing from investment-led to service-led growth, France could now be a major beneficiary of China's growing appetite for the best consumer and luxury goods in the world. France (and Italy) have the brands that consumers crave. In addition, the accident of Brexit gives France an opportunity to kindle the interest of global businesses looking for an alternative basis to serve the European Common Market. All in all, the external environment is fairly favourable. If France reforms itself under Macron, as we expect, a rise in inward investment and exports could soon help to raise French growth. The benefits of reforms could become visible within a few years

### **MIND THE DIFFERENCE**

However, we see one major difference between France now and Germany in 2003. Unlike Germany, France now has to reform itself in the wake of the highly disruptive great financial crisis of 2008/09 and the euro crisis of 2011/12. Partly because of costs of these crises, irresponsible Le Pen- and Melenchon-style populists are already riding high in opinion polls in the early stages of the unsettling reform process. Such populists barely existed in Germany at the start of its Agenda 2010 in 2003. As a result, France can't afford to get it wrong. Otherwise, Le Pen or an equally dangerous Varoufakis look-alike on the political left could take over at the next election in 2022.

The stakes are high. It could still go wrong. Macron has not won yet. If he beats Le Pen on Sunday, as expected, he will need to build parliamentary support for reforms, probably enlisting the help of centre-right Republicans after the 11 and 18 June parliamentary elections. If he disappoints, as Sarkozy did and as Hollande did as well despite some reforms in the second half of his presidency, France and the EU could end up in a big mess after the next French election in 2022.

### **COMING UP IN THE 2020s: A GOLDEN DECADE FOR FRANCE?**

Life is always full of risks. However, chances are that France will deliver an imperfect but still sufficient package of reforms soon. If so, France can turn into the continent's economic powerhouse in the next decade, outclassing a Germany that looks set to lose its current advantage as it has virtually stopped reforming itself. France has innate advantages including a first-class infrastructure and a highly competent public service. With its high birth rate, France could even achieve a trend rate of growth beyond Germany's current 1.6% pace over time. After Germany's golden decade now, it could be France's turn again in the 2020s.

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Joh. Berenberg, Gossler & Co. KG  
60 Threadneedle Street  
London EC2R 8HP  
Phone +44 20 3207 7878  
[www.berenberg.com](http://www.berenberg.com)  
[holger.schmieding@berenberg.com](mailto:holger.schmieding@berenberg.com)