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FRENCH UPDATE: WILL MACRON DELIVER?

Berenberg Macro Flash

Crunch time in Paris: Although his popularity has nosedived over the holiday period, French president Emmanuel Macron still wants to deliver the cornerstone of his economic programme, the labour market reform, within less than four weeks. We expect him to succeed and lay the basis for a major French economic and political renaissance. As a result, we look for France to outclass a Germany that remains strong but is becoming a little complacent and a UK that has shot itself in the foot through Brexit in coming years.

Macron's job has become more difficult over the summer. Having hit a peak when he secured a parliamentary majority for his "La Republique en Marche" party on 18 June 2017, his once-stellar popularity has now fallen back down to earth. According to Ifop opinion polls, his approval rating plummeted from 64% in June to 54% in July and just 40% in August, the most pronounced fall in a newly elected president's ratings since the days of Jacques Chirac in 1995. Some reasons for the early end of the honeymoon period are trivial such as the spats over the role of his wife and the expenses for his visagist (€26k within three months, less than his predecessor Francois Hollande reportedly used to spend on it). Other reasons are more serious: that his government announced some poorly-sold near-term austerity of €4.5 billon for the remainder of 2017 including cutbacks in military expenditure and a €5 cut in monthly housing benefits did not go down well with many of his supporters. In addition, a decision to postpone some of the tax cuts he had promised during his election campaign has raised suspicions that, like many of his predecessors, he may not have meant all he said during his campaign.

Macron's waning popularity may raise some concern whether he will be willing and able to implement his reform programme. However, we would emphasise three different aspects: First, Macron seems determined to do what he had said, including to take the measures required to bring France's fiscal deficit to no more than 3% of GDP this year already. Second, his first actions suggest that he really wants to fix France. He knows that it is better to do the unpopular things first. And by showing Germany and his other European partners that he is serious about reforming France, he is strengthening his hand for future negotiations about reforms in the EU27 and the Eurozone that will likely start in earnest after the German election of 24 September 2017. Third, while those voters who flocked to him because they didn't like the alternatives (ultra-right Marine Le Pen, ultra-left Jean-Luc Melenchon and the scandal-tainted centre-right candidate Francois Fillon), his core supporters still seem to approve of his actions. His party will most likely endorse his agenda in parliament.

So far, the crucial labour market reform seems to be on track. As the first step in a three-step process, the two houses of the French parliament adopted the law that authorises the French government to overhaul key aspects of the labour market through a series of decrees on 1 and 2 August. Having returned from the summer recess on Monday, the government will unveil these decrees this Thursday. After discussions with trade unions, parliament is scheduled to either confirm or reject these decrees wholesale without any line-item veto on 21 September, just ahead of the German election on 24 September. France's second-biggest trade union, the communist-leaning CGT, has called for a day of protests on 12 September and a small union may already stage some demonstrations on 30 August. Ultra-left Melenchon plans protests against what he calls Macron's "social welfare coup d'etat" on 23 September. In France, such protests are par for the course. However, the more moderate trade unions have so far preferred to discuss the changes with the government than to call for street protests against them.

The many facets of the labour reform bill include

- a major decentralisation of collective bargaining, giving companies significantly more freedom to negotiate pay and working conditions with their own workers instead of being bound by national agreements,
- a loosening of the rules governing dismissals, including dismissals at French subsidiaries of international companies,
- caps on severance pay by limiting the damages which courts can award in case of "unfair" dismissals,
- streamlining the representation of employees at the firm level by merging various workers' councils.

All in all, the reforms are based largely on Scandinavian "flexicurity" models and the German model of employer-employee co-operation. These models work although they do not fully confirm to libertarian textbooks. Injecting a major dose of flexibility into the labour market by decentralising collective bargaining and making it less difficult and costly to dismiss employees can turn France into a better place to create jobs, just like Germany's "Agenda 2010" reforms did after 2004. While it may take some years for the full effects to show up, the firming economic recovery with rising demand for labour provides an ideal backdrop for such reforms. In turn, a revitalised France at the heart of Europe will help to strengthen the cohesion of the Eurozone and the EU27, mostly by making it more attractive for other countries to stay in or join clubs that are doing better. Pro-growth structural reforms in France will also make it easier to agree on institutional reforms at the Eurozone and EU level over time.

That France is heading for a "golden decade" in the 2020s remains our biggest call for the future of Europe, following up on our 2010 forecast that Germany would enjoy a "golden decade" in the 2010s after the reforms of 2004 and our 2011 call that the European Central Bank will eventually end the euro confidence crisis without the region breaking apart. We may know within less than four weeks whether France and Europe are indeed on track for such progress.

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