

France after the election: What next ?

Pollsters were right: Emmanuel Macron won the second round of French presidential elections clearly with 66% of the vote. The reaction on financial markets were just moderately, which shows that Macron's victory has already been widely anticipated. Now, the focus is back on fundamentals and valuations.

An important victory

Emmanuel Macron won the French presidential election. This is not just a victory for Emmanuel Macron but also for the EU. The pollsters can also shake hands: Their honour is restored. The survey results have been almost confirmed.

The electoral victory of Emmanuel Macron is of great importance. It is particularly important for the EU to unanimously agree on the exit negotiations with Great Britain which are now beginning. France and Germany will get closer again. Only when both big nations pull together, the EU and the Eurozone has a chance to survive. Theresa May is likely to face headwinds during the negotiations.

Nevertheless, there is no reason for exuberant joy. The anti-European slogans of Marine Le Pen agreed with the opinion of broad levels of the French population. Therefore, France remains a divided nation after the elections. Emmanuel Macron has to take action instead of sitting on its hands. The new president is called upon to provide a fresh breeze in the Élysée Palace. The prerequisites for this are favorable. Macron and his movement "En Marche!" have also chance to win the upcoming election of the National Assembly. The door for reform is wide open. If Macron does not take the chance, Le Pen is likely to win the presidency in 2022.

Economic appraisal

The French economy has largely recovered from the international financial crisis and subsequent sovereign-debt dilemma in the eurozone. After the soft patch encountered in 2012, which was mostly due to the latter crisis, France's GDP has been growing roughly in line with its potential since early 2013. In 2016, the economy expanded at an annual rate of 1.2% and a 1.3% reading could be on the cards for the current year, with domestic demand gradually taking over as the primary driver of growth. The ECB's ultra-accommodative monetary policy is giving a boost to the French economy not just by means of the weaker euro; low interest rates are also spurring credit demand there. Loans to companies and private households have risen significantly since 2014.

France has also made progress structurally – at least on paper. The French government under President Hollande has adopted various reforms aimed at making the labour market more flexible. For instance, during economically problematic phases, companies now have an easier time derogating from the covenants of wage agreements, both in terms of compensation and working hours. The conditions governing mass layoffs have

also been eased, as have those for terminations due to operational redundancies. Today, a company can take these measures if its profitability and revenues have declined for several quarters in succession, or when losses have been incurred over a number of months in a row, or if the company has suffered a severe deterioration of its ability to meet payments. And layoffs are still allowed in conjunction with a restructuring that has become necessary on grounds of competitiveness. So in fact, the French labour market has already become more flexible – however, not enough for the self-proclaimed reformer Macron. If he has his way, further revamps of the past norms will be rubber-stamped by Parliament.

Macron: the European

Emmanuel Macron is a declared fan of Europe. Rather than distancing France from Germany, he wants to join Germany in pressing ahead with the full consolidation of Europe. Here are the key items on his economic agenda:

- Walking-back the 35-hour workweek.
- Additional new approaches to collective bargaining: the massive domestic labour disputes should become a thing of the past; going forward, wages should be negotiated at the industry-specific or, even better, the company-specific level.
- Taking a cue from Germany's Hartz IV reforms, labour policy measures should adhere to the principle of "demand and empower": continuing education and personal development programmes should be expanded, whereas the unemployed should no longer be permitted to decline every job offer they receive.
- The corporate tax rate should be cut from 33.3 to 25%.

In a nutshell, Macron's reform agenda is based on distinctly laissez-faire elements, but people with poor chances in the job market should be supported more extensively. It is possible that, with such a policy, Macron can bring the strike-predisposed French to the point where they actually welcome a new economic approach. However, for the implementation of the planned reforms Macron is also dependent on a strong performance in the parliamentary elections held in June. Surveys indicate that "En Marche!" will emerge as the strongest force in the elections, but the absolute majority will probably be missed.

How will the financial markets react?

The financial markets reacted with clear gains after the first round of the presidential election in April. The immediate market reaction in the aftermath of the final round was rather

subdued, which shows that an election victory by Emmanuel Macron was widely priced in.

The Emmanuel Macron scenario

An Emmanuel Macron victory lifts hopes for reforms in France. The following is a brief overview of what we consider to be the potential reactions:

EUR/USD

The euro showed moderate gains after the victory of Macron but later in the day some losses could be observed. We do not expect significant gains of the euro in the upcoming weeks. However, we are not reckoning with a further significant upside move in the common currency. As the year progresses, the financial markets will return their focus to the transatlantic yield differential and politics will be placed on the back burner. Further rate hikes by the Fed and continuing leniency on the part of the ECB suggest that EUR/USD will be curious to take a look at the 1.02 mark. However, before we see lower EUR/USD levels, some patience may still be required. As the euro jumped above the 1.0850, the common currency entered new technical territory. Probably we need some new strong impulses to see lower levels.

EUR/CHF

The SNB will probably scale down its interventions, seeing as how the worst case failed to materialise and thus the flight of capital into the franc starts to wane. A continuation of the trading range between 1.06 and 1.08 appears to be the most likely scenario. This implies a moderate euro weakness against the franc in the coming weeks.

Yields

As political risks are diminishing the ECB could start to consider a tapering (a reduction of monthly asset purchases) in 2018. The yield on 10-year Bunds is expected to rise by 0.5%, whilst that on 10-year Confs remains essentially unchanged, within the next 3-6 months.

Equity markets:

The slightly weaker equity markets after the second round of the presidential election show that the election victory of Emmanuel Macron was widely anticipated. The fear of the Front National is now off the table. The huge share of vote abstentions show that it will be anything but easy to reunite the divided nation. Therefore the chances for the French equity market remain modest. Compared to its European counterparts, the CAC 40 is already considered relatively expensive. The general assessment for France as well as for the entire euro zone is: The air for further price increases has become noticeably thinner in the face of strong stock market developments since the beginning of the year. Within the euro zone, there is still potential in peripheral countries such as Spain and Italy. We still see interesting opportunities in the emerging markets with a focus on Asia. The region is clearly benefiting from a strong positive profit outlook and a relatively low valuation. The US president seems to have arrived in the political reality and

risks for trade restrictions are diminishing. In addition we see some higher growth rate in world trade, which is a positive signal for developing countries. Therefore, we favour emerging markets with a focus on Asia.

Summary

The political risks in the EU are diminishing noticeably. Now, the focus is back on fundamentals. As inflation rates remain low in the euro zone and the US economy is gaining economic momentum, there is much evidence that the transatlantic yield differential will increase. The US dollar should therefore be able to show strength again. Meanwhile, the air for further price increases on stock markets become noticeably thinner - even though the biggest political single risk, a victory of Marine Le Pen, is off the table now. We see best opportunities in peripheral countries like Spain or Italy, as well as selected individual titles. However, due to a relatively favorable valuation, emerging countries with a focus on Asia once again becomes our top pick on the regional equity allocation.

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