



EQUITY

# Why Macron's Reform Agenda Is Boosting Business Optimism

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Market observers have long blamed France's labour code and other policies for the country's slow growth and high unemployment. Yet, Katrina Dudley of Franklin Mutual Series sees a renewed sense of business optimism in France under President Emmanuel Macron. She also thinks Macron's eurozone proposals could make an attractive long-term investment case for select European equities.



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In recent years, France has lagged its larger European Union (EU) peers in terms of economic growth. In 2016, the French economy grew by 1.2%, compared with growth of 1.9% for Germany and 1.8% for the United Kingdom. And France's unemployment rate has been stuck at around 10% for four years. It is now roughly double the rate of those two other European countries.

Yet, we see signs that France's economy is starting to improve under President Emmanuel Macron. France is enjoying its best streak of economic growth in more than six years. And, French companies are hiring at the fastest pace in almost 17 years. Also, the International Monetary Fund (IMF) has said France will likely replace the United Kingdom as the world's fifth-largest economy in 2017.<sup>[1](#)</sup>

## Why French Companies Are Optimistic about Macron's Reforms

In our view, French companies are more optimistic than in the past about hiring employees due to Macron's efforts to loosen the country's labour code. In September of this year, he signed five decrees overhauling the labour code, the first major economic reforms since he took office in May.

Among other things, the labour decrees give French employers more say in negotiating contracts directly with workers. For decades, most French companies have had to follow restrictive union labour agreements based on their sectors.

We believe this change to more flexible labour agreements will better align the needs of French workers and French companies. These custom agreements are likely to help the service sector and other sectors affected by rising labour costs. After Spain introduced its labour market reforms in 2012, many companies were able to negotiate pay with workers and keep wage inflation in check.

A recent survey of European corporates by investment bank UBS showed a sharp uptick in French companies' capital expenditure (CapEx) spending intentions.<sup>[2](#)</sup> We also expect to see a similar increase in the amount French companies plan to invest in their business. These companies are likely optimistic about the benefits of Macron's labour reforms and, as a result, plan to ramp up their CapEx spending. That increase in CapEx spending should boost the economy and likely benefit French equities.

In particular, we think an increase in investment spending, to the extent that it is bank funded, should fuel bank credit growth and benefit the French banking sector. Macron's reforms to cut housing taxes paid by the French middle class could lead to further growth in demand that should drive further strong loan growth in the mortgage area, which is already benefiting from the improving economic backdrop.

Macron is also on the path to delivering on his campaign promise to cut corporate taxes. In September of this year, his government presented its first budget, which included a plan to cut corporate taxes from 33% to 25% by 2022. Lower corporate taxes will likely lead to higher earnings for many French companies.

### **How Multinational Companies Can Benefit from Macron's Eurozone Reforms**

In September of this year, Macron outlined his roadmap for the EU, which includes establishing a common defence budget, increasing investment in clean energy and the harmonisation of tax receipts. Macron has said these reforms are an effort to make the EU more competitive, which he believes has long been too weak, too slow and too inefficient in finding solutions to solve global issues. We agree with Macron—it is time for the EU to take its rightful place on the world stage.

In particular, we think select defence companies could benefit from Macron's plans to boost spending on security. Europe has historically spent much less than the United States on security and we think its leaders are gradually acknowledging the need to start spending more.

We also believe clean energy companies could stand to benefit from Macron's proposals, such as a European carbon tax, aimed at increasing the EU's use of wind and solar power. Macron has also said he wants to phase out France's use of coal power in five years and reduce its reliance on nuclear power to 50% by 2025.

Macron is building inroads with European peers. In September, he gave his blessing for a German conglomerate to merge its rail businesses with a French company. We think this deal is a good example of Macron's pragmatic approach to the role France needs to play in bringing Europe closer together. The two companies are likely to get economies of scale from the deal, and should be better able to compete with a newly merged Chinese train company.

Of course, we think some EU economies may have to adjust their policies and might experience some short-term pain due to some of Macron's proposed reforms. Ireland and the Netherlands could face pressure if Macron is successful in passing reforms that equalise countries from a taxation perspective. For example, these reforms could see that taxes paid by some large US technology and pharmaceutical companies increase as a lower portion of their profits will be taxed in these low-tax jurisdictions.

### **Macron's Call for Broad EU Leadership**

These efforts are part of Macron's push to bring the EU closer together. In recent years, Germany has taken on the role of chief EU decision maker, while other EU economies have stayed behind the scenes. However, after the German elections in September of this year, it's unclear to us if Chancellor Angela Merkel will join Macron in leading this push towards greater EU integration. She is currently trying to assemble a coalition and her ultimate choice of a ruling partner could have significant ramifications in terms of whether Germany is in favour of more or less EU integration.

That said, Macron didn't mention Germany in his EU roadmap, which was released shortly after the German elections. He seems to want all EU member countries to play a role in guiding its future, not just France and Germany. Macron sees the EU as a large region, as big as the United States. He thinks if it works more closely together, it should return to its rightful place as a larger economic and industrial powerhouse.

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[1.](#) Source: IMF World Economic Outlook database, October 2017. There is no assurance that any estimate, forecast or prediction will be realized.

[2.](#) Source: UBS Evidence Lab: Sharp Rise in Investment Plans, September 2017.