Macron 2.0

132 – 25 April 2022

Key points

- E. Macron's second mandate will likely start with the prolongation of the Keynesian/interventionist stance of the last two years, although the financial room for manoeuvre is smaller.
- European Central Bank hawks are strengthened by the resilience in the dataflow so far.

Removing a key source of uncertainty in Europe, E. Macron has been reelected President with 58.5% of the votes. Yet, the weak aggregate result of mainstream candidates in the first round will likely affect his stance. Some expressions in his acceptance speech ("not leaving anyone on the wayside", "turning France into an ecological nation") illustrate how the change from "moderate supply-side reformer" in 2017 to "interventionist" he had to undergo under pressure from the pandemic and the fallout of the Ukraine war will have to be prolonged into his second mandate. To find some financial room for manoeuvre, now that the European Central Bank (ECB)'s normalization reduces the options for expansionary fiscal policy at the national level, we expect Emmanuel Macron to push even more strongly for a second phase of debt mutualization in the EU. We expect this to be an uphill walk. Paradoxically, Olaf Scholz' weaker position (the benefit of the "Zeitenwende" speech is eroding fast) may make him less open to concessions in this direction, while the relief brought about by M. Le Pen's defeat in European capitals may reduce the impetus for reopening this particular Pandora box. Macron's negotiating capacity in Europe will of course depend to his capacity to secure a parliamentary majority in June.

While the ECB always professes to ignore elections, the Governing Council must be relieved by the French result: if "quick wins" on common fiscal action may not be at hand, at least the EU can avoid another "existential moment" and focus can now return to the economic data flow. News are rather good so far on that front: the flash Purchasing Managers Index (PMI for April came out much better than expected, especially in the services sector. It may be that the "economy reopening" tailwind is more powerful and is lasting longer than expected. The income-protection measures immediately put in place by governments to deal with the fallout of the Ukraine war on energy prices may be proving quite efficient. In any case, the resilience in the dataflow – so far – is playing into the hands of the hawks. We maintain our baseline for a lift-off in December, but September is a distinct possibility.

Beyond the impact of the Ukraine war, the extent to which the Chinese economy will rebound from its current Covid-related slowdown is going to be key to Europe's export machine next year. Data for now suggests activity in China is being visibly hit, but nowhere near the levels seen at the beginning of the pandemic. Beijing needs to make hard choices ahead though.

“Not leaving anyone by the wayside”

With 58.5% of the votes, Emmanuel Macron has been re-elected with a wider margin than what the polls were predicting after the first round. It seems he owes much of his victory to the fact that the often feared “convergence of the populists” from the left and the right once again failed to materialize in France (it did, briefly, in Italy). In our reaction to the first round, we had focused on a “lurch to the left” in Macron’s platform ahead of the final vote. It’s impossible to know if it convinced much of this electorate, but the “Republican front” reflex is still strong on the left and, gradually over the last two weeks, three times as many of Melenchon voters in the first round reluctantly gravitated to lend their second round vote to Macron against supporting Le Pen (IFOP data), even if the reflex is eroding (45% abstained), leaving Macron with a tighter margin than five years ago.

Still, although the President’s core support improved in the first-round relative to 2017, “mainstream” political ideas failed to attract more than 35/40% of the votes (depending on how this perimeter is defined). This is going to shape the next five years in the realm of economic policy, and one expression in Emmanuel Macron’s acceptance speech *(“not leaving anyone on the wayside”)* illustrates, as we explored in Macrocast two weeks ago, how **the change from “moderate supply-side reformer” in 2017 to “Keynesian interventionist” he had to undergo under pressure from first the pandemic and then the fallout of the Ukraine war will have to be prolonged into his second mandate.**

Beyond the social agenda, Macron’s second mandate is likely to be characterized by a “green transition” push (we note that one of the first extracts from his acceptance speech which he tweeted was about *“turning France into an ecological nation”*). Given the need to deliver a green transition without exacerbating income inequalities, it is likely that quite a bit of fiscal accommodation will be needed.

The key issue of course is that the financial room for manoeuvre for such policies is limited. True, the “dividends of growth” will likely be higher in France than in the Euro area as a whole this year as the country’s specialization and energy mix make it less sensitive to the rise in energy prices, as well as to the Chinese (and possibly more general) slowdown which is emerging. The country also benefits from the decline in unemployment – it’s somewhat paradoxical that the far-right hits its best score in a national election the year unemployment hits its lowest level since 2008. Still, before the Ukraine war, the European Commission estimated French public debt to reach 113.7% of GDP in 2022, down from a peak at 114.6% in 2021 but still markedly above the Euro area average (97.9%). Since 2014, the advent of quantitative easing in Europe had allowed fiscal policy-makers unusual leeway, but this support is clearly on its way out (see next section). While the market may salute France’s rejection of populist solutions through some re-tightening of the yield spread vis-à-vis Germany, the overall direction of travel of the European Central Bank (ECB) – towards higher rates – is obvious. At some point some fiscal restraint will be needed, possibly colliding with social resistance to any roll-back on public spending.

We would thus expect Emmanuel Macron to maintain his push in the EU for an enhancement of the debt mutualization programmes put in place during the pandemic. His political standing in Europe is likely to rise further: with his re-election he joins the club of “elder statesmen” at a time when Germany’s Chancellor is in difficulty in the management of the Ukraine war – the effect of the “Zeitenwende” speech is fading rapidly – and Draghi will soon need to count with the general elections looming in Italy. Yet, the very fact that the Le Pen’s defeat was clearer than expected might induce some complacency in European policy circles around the need to go “deeper, faster” on fiscal solidarity to fight Euroscepticism. Also, Scholz may be weaker, but somewhat paradoxically this may make him less ready to compromise over European fiscal issues, for fear of losing connection with a coalition electorate which is not necessarily much less fiscally conservative than The Christian Democratic Union(CDU)’s.

To be able to pull all his weight on the European scene, the French President will first need to secure a majority in the parliamentary elections in June. While a “block against block” duel is the logic of the presidential election the voting system in the parliamentary elections allows for a more diverse ecosystem, since candidates gathering more than 12.5% of the votes of the registered voters can compete in the second round, where it’s the candidate winning a plurality – i.e., not necessarily an absolute majority – of the votes who wins. Given the presence of three main “blocks” – Macron’s central forces, Le Pen’s National Rally and Melenchon’s “La France Insoumise” (which is becoming the undisputed leading force on the left) – many three-way races, with hard to predict results, are likely. Macron’s party will benefit to some extent from the usual “presidential premium”: the electorate normally rewards a newly elected (or re-elected) President with a majority in parliament, but it’s not an “iron rule” (the socialist party had to make do with only a relative majority after Francois Mitterrand’s re-election in 1988). What may help Macron’s party is the parlous state of the centre-right, which may convince local members of parliament to shift their allegiance. Yet, we maintain what we’ve been saying since the beginning of our coverage of the French elections: wait for June to get a precise sense of what France’s policy stance may be for the next 5 years.

Surveys holding up well, helping the ECB hawks

While the ECB routinely professes to be unmoved by elections, last night’s result has probably been met with more than a sigh of relief in Frankfurt. True, the central bank may have to wait longer than they would hope for the sort of “second wave” of debt mutualisation which would make its job easier, but at least the European construct can avoid the very uncomfortable moments that a Le Pen administration in Paris, intent on rolling back on so-called “infringements” of the Union’s central bodies on member states’ sovereignty, would have triggered. **Focus can move away from politics – at least until the Italian elections next year – and back to the economic data flow. On that front, the news is better than expected** despite the steep increase in energy prices. Last week’s release of the flash Purchasing managers Index (PMI) for April was a case in point, with a composite index for the Euro area coming out at 55.8, well within expansion territory and unexpectedly up from 54.9 March, while the market was expected a drop to 53.9. The strong headline figure hides a divergence between manufacturing – where activity stagnated, reaching a near-neutral 50.4 for current output, the lowest level in 22 months – and services where demand strengthened significantly, with Markit’s qualitative comments mentioning a strong rebound in recreation and tourism.

This week the release of the IFO survey for April will help gauge any troubling discrepancy between national surveys and the PMIs. While business confidence stood at very similar levels in France and Germany in the manufacturing sector (see Exhibit 1), a significant gap had appeared between INSEE and IFO for the services sector since the middle of last year, coinciding with the different timeline on the pandemic front (see Exhibit 2). Yet, the PMI index in the services sector came out at a strong 57.9 in April for Germany, not that far from France’s 58.8.

Exhibit 1 – Same message from INSEE and IFO in Manufacturing

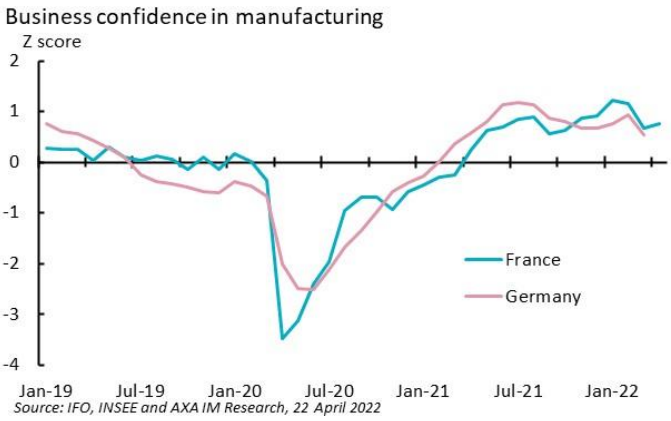
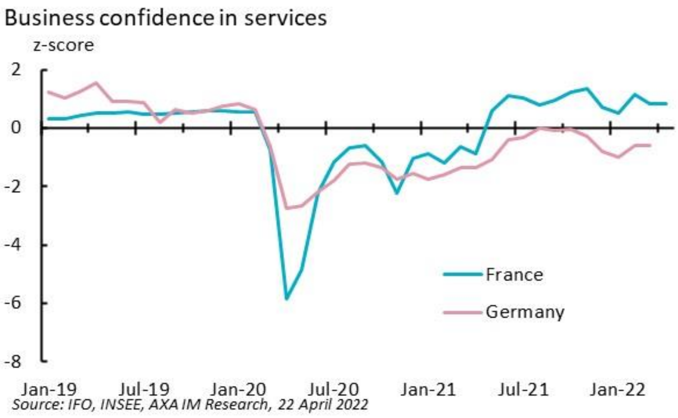


Exhibit 2 – Advantage France in services since mid-2021



We would highlight two non-mutually exclusive explanations to the resilience in business confidence. One is that the “tailwind” of the economy’s reopening may be more powerful than expected. Markit’s insistence on recreation activities and tourism may reflect that the need for “catching up” after the lockdowns is still very much with us and supporting consumption despite the deterioration in real income. The other one is that the emergency fiscal measures swiftly deployed to counter the spike in energy prices may be very effective.

Again, **we should brace ourselves for some additional pressure on costs if economic retaliation against Russia intensifies, but for now, Germany’s reluctance to embark on an embargo of energy imports from Russia seems to be intact**. This was re-affirmed in an interview Olaf Scholz gave to Spiegel on Friday. The German Chancellor argued that a gas embargo would not stop the war because "*Vladimir Putin is not open to economic arguments"*. Actually, as the military conflict has moved away from Russia's thwarted efforts to conquer Kyiv and is morphing into what could end up being a protracted attrition war in the Donbass, political focus may be more on direct military support – and we note that EU countries are getting at the same time bolder and more transparent on the quantum and kind of military hardware they provide to Ukraine – than on economic weapons. Public opinion may accept more easily the continuation of large energy imports from Russia now that the flow of gear to Ukraine is intensifying. At least this might be the calculation of the German government.

Whatever the reasons, the resilience in the real economy dataflow is playing into the hand of the hawks at the ECB. Lagarde had managed to steer a cautious normalization path at the latest Governing Council, and reiterated her view on Sunday that the nature of the inflation shock was different across the Atlantic and that "*an ECB hike would not reduce the price of oil"*, but this prudence is conditional on the materialization of bad news on the real economy side. As they fail – for now – to materialize, the hawks, who for instance in the case of Isabel Schnabel explicitly consider the current fiscal stimulus "fuels the fire" of inflation, have an avenue to call for quicker normalization. Consequently, we had a flurry of comments last week pointing to an early and/or brisk pace of policy tightening from several Governing Council members. Luis de Guindos and Martins Kazaks have both mentioned the possibility of a rate lift-off in July already, while Pierre Wunsch stated that a deposit rate "*at zero or higher by year-end was a no-brainer"*.

The fallout from the Ukraine war – which could still materialize soon if the "reopening tailwind" weakens and fiscal support erodes – is not the only hurdle the Euro area needs to cross though. We have explored at some length in Macrocast how we expect the US economy to decelerate drastically in the second half of the year, which would be detrimental to the European exporting machine. We have also mentioned China as another risk (more on this below). For now, we maintain our call for a December lift-off, with a distinct risk it is brought forward to September, but a summer hike looks like a stretch to us.

The macro cost of "zero Covid" in China

As with all Covid flare-ups since the beginning of the pandemic, gauging the impact of sanitary restrictions on economic activity in China initially relied on "real-time" data such as measures of traffic congestion in cities. Traditional economic data has become available for the last two weeks and **the effect is – for now – looking significant but still nowhere near the complete collapse seen on the onset of the pandemic in early 2020**, judging by the March Caixin Purchasing Managing Index, now visibly in contraction territory but still in a "normal bad times" area, much higher than in February-March 2020 (see Exhibit 3). The services sector is worse hit than manufacturing, which has been a feature of all flare-ups, as consumption is severely curtailed. **Yet, China's production machine still looks resilient, which is key to assessing the impact this resurgence of the pandemic on global supply lines**. Chinese exports are extraordinarily volatile, and the gyrations due to the pandemic (in both supply and demand) haven't helped, but March 2022 shipments still exceeded the level of March 2021 by 15% (see Exhibit 4).

Exhibit 3 – It's bad, but "normal bad"

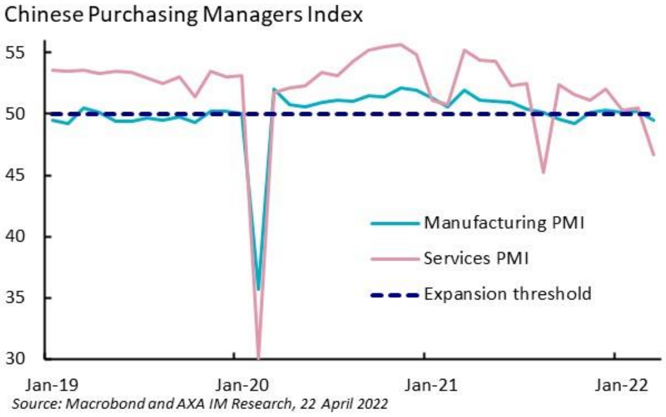
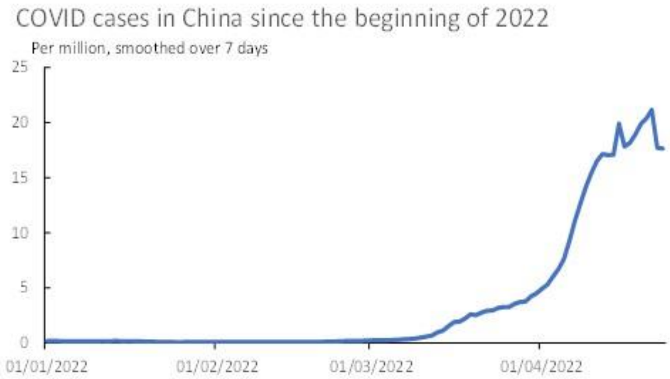


Exhibit 4 – Chinese exports still up year-on-year

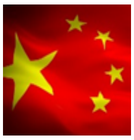
The glaring issue though is that the sanitary measures taken so far by Beijing have only tentatively started to curb the spread of the virus (see Exhibit 5). Political authorities find themselves facing the same kind of trade-off western countries had to deal with over the last two years: opt for generalized lockdowns and accept a significant economic fallout or tolerate significant mortality. Since China has not tapped much into its "policy reserves", eschewing the kind of massive fiscal stimulus accommodated by monetary policy which has been generalized in the West, while a significant fraction of China's older population is not vaccinated, the choice should be obvious, and for now, restrictions remain severe. According to a Bloomberg article from 14 March, only 51% of people over the age of 80 got two shots, and only a fifth have got the booster. We are bracing ourselves for evidence of an additional significant decline in the economy to be reflected in the release of the PMI data for April this week

Yet, as the economic cost piles up. Beijing may be tempted by a "half-way house" approach, a combination of significant but not drastic sanitary measures and "restrained policy support". **Down the road, the choice depends on the social tolerance to risk.** Even within the West, the difference of approach across the Atlantic Ocean has been large. For instance, the US have been tolerating a level of mortality which no European country would have probably accepted without reinstating severe sanitary measures (as of now, cumulated mortality since the start of the pandemic reached 3,044 per million as of last Friday in the US, against 2,213 in France and 1,598 in Germany). So far, aversion to the sanitary risk has been extreme in China. This may change, especially is social acceptability of the lockdowns – and not just the economic cost – falls drastically.

Exhibit 5 - Recent curb in virus circulation is highly tentative



Source: Our World in Data, AXA IM Research, April 2022

Country/Region	What we focused on last week	What we will focus on in next weeks
	• Fed Chair Powell said 50bp hike "on the table" for May, Bullard "would not rule out 75bps" • Fed's Waller and Bostic more cautious outlook • Beige Book recorded "moderate" growth, early signs "strong wage growth starting to slow" • Existing home sales (Mar) down >11% in last two months, lowest since Jun 2020 • Philly Fed index (Apr) fall to 17.6, but still solid • Jobless claims remain around recent lows, no evidence of softening in labour market	• GDP (Q1, p) expect 1.5% (sear) as export volumes drop sharply. • PCE inflation (Mar) headline expected to rise further, but after CPI, core expected to dip. • Personal income & spending (Mar) spending expected down as income falls in real terms • Employment cost index (Q1) • New home sales and mortgage applications for signs of further housing slowdown
	• Emmanuel Macron was reelected President of France with 58.5% of the votes • Eurozone April flash PMIs showed exiting pandemic restrictive measures supporting good momentum in services more than offsetting weakened manufacturing sector.	• Confidence surveys for April: German Ifo (Mon.), EC survey (Thurs.). • Member states' and eurozone April "flash" HICP (Thurs., Fri.) Flash Q1 GDPs in member states (Thurs., Fri.)
	• Retail sales (Mar) fell by 1.4%mom below consensus forecasts of a -0.3% decline • Flash PMIs (April) fell to 57.6 a 3-month low • MPC's Mann: rates may need to rise faster if demand remains robust despite high inflation • Gfk cons conf fell to -38, lowest since 2008	• UK public finances (Mar) PSNBx deficit expected at £20.1bn, down from last year • Nationwide HPI (Apr) expected 0.9%mom (cons) with moderation in RICS surveys • 'Partygate' developments as Parliament enquires if PM intentionally misled it
	• Flash Mfg PMI (Apr) came in at 53.4 (-0.7pt) as output, new orders and employment are down while delivery time lengthens. Svcs Flash PMIs rise by 1.1pt to 50.5 as restrictions ease • CPI (Mar) up by 1.2%, Apr fig should cross 2%	• Pressure is growing on BoJ to lose YCC, but we believe it will keep the status quo, arguing insufficient inflation and incomplete recovery. Comments on yen should be monitored. • IP (Mar) and two-month expectations
	• Q1 GDP surprised on the upside, but sequential growth slowed notably in March due to COVID flare up	• April PMI to decline further reflecting the disruption of Shanghai's lockdown and its contagious effect
	• CB: Indonesia (3.5%) stayed on hold • March CPI (%yoy) accelerated in South Africa (5.9%). April first 2-week inflation in Mexico higher than expected. • Korean 20-days exports in April weakened as expected, still +16.9%yoy	• CB: Hungary (4.4%) and Colombia (5%) expected to hike by 100bps. Russia (17%) • April prelim CPI (%yoy) in Poland Brazil • March IP data in Korea Thailand Taiwan Singapore Russia • Q1 2022 GDP figures to be released in Korea, Taiwan, Mexico

Upcoming events		
	US:	Tue: Durable goods orders (Mar,p), Case-Shiller & FHFA house price indx (Feb), Conf Board consumer confidence (Apr), New home sales (Mar); Wed: Goods trade (Mar), Pending home sales (Mar); GDP (Q1,p), Weekly jobless claims (23 Apr); Fri: PCE inflation (Mar), Personal income & spending (Mar), Employment cost indx (Q1), Chicago PMI (Apr), Michigan consumer sent (Apr)
	Euro Area:	Sun: Fr – 2nd round elections; Mon: Ge IfO indx (Apr); Wed: Fr consumer conf (Apr); Thu: EU19 Business confidence (Apr), Ge & Sp HICP (Apr,p), Ge CPI (Apr,p), It ISTAT business & consumer confidence (Apr), Sp unemp (Q1); Fri: EU19 M3 (Mar), EU19 GDP (Q1,p), CPI (Apr,p), Ge Fr It Sp GDP (Q1,p), Fr consumer spending (Mar), Fr It HICP (Apr)
	UK:	Mon: CBI Industrial Trends (Apr, Q2); Tue: PSNB (Mar); Wed: CBI Distributive Trades (Apr)
	Japan:	Mon: Lead indx (Feb); Tue: Unemployment (Mar); Thu: Ind prod (Mar,p), Housing starts (Mar), BoJ
	China	Wed: Industrial profits (Mar); Fri: Caixin mfg PMI (Apr)

Our Research is available on line: http://www.axa-im.com/en/insights

DISCLAIMER

This document is for informational purposes only and does not constitute investment research or financial analysis relating to transactions in financial instruments as per MIF Directive (2014/65/EU), nor does it constitute on the part of AXA Investment Managers or its affiliated companies an offer to buy or sell any investments, products or services, and should not be considered as solicitation or investment, legal or tax advice, a recommendation for an investment strategy or a personalized recommendation to buy or sell securities.

It has been established on the basis of data, projections, forecasts, anticipations and hypothesis which are subjective. Its analysis and conclusions are the expression of an opinion, based on available data at a specific date.

All information in this document is established on data made public by official providers of economic and market statistics. AXA Investment Managers disclaims any and all liability relating to a decision based on or for reliance on this document. All exhibits included in this document, unless stated otherwise, are as of the publication date of this document.

Furthermore, due to the subjective nature of these opinions and analysis, these data, projections, forecasts, anticipations, hypothesis, etc. are not necessary used or followed by AXA IM's portfolio management teams or its affiliates, who may act based on their own opinions. Any reproduction of this information, in whole or in part is, unless otherwise authorised by AXA IM, prohibited.

Issued in the UK by AXA Investment Managers UK Limited, which is authorised and regulated by the Financial Conduct Authority in the UK. Registered in England and Wales No: 01431068. Registered Office: 22 Bishopsgate London EC2N 4BQ

In other jurisdictions, this document is issued by AXA Investment Managers SA's affiliates in those countries.

AXA Investment Managers SA
Tour Majunga – La Défense 9 – 6 place de la Pyramide 92800 Puteaux – France
Registered with the Nanterre Trade and Companies Register under number 393 051 826