Macron's much-noticed speech: Nothing new in the West?

On Monday, Emmanuel Macron gave a speech at the Sorbonne University that has provoked considerable global media response. The French president again demonstrated his intention to leave his mark on France and Europe. He has already begun to reform France's labor market in recent weeks and in the process he has not made big friends in the unions or among intellectuals. The response to his much-noticed speech regarding the future of Europe has also been divided. While many voices from political circles and the media have been positive, economists have expressed more mixed reactions.

In general, that is presumably because many of the notions presented are not especially new on closer inspection and have seldom proved successful in the past. Many of the proposals are very reminiscent of ideas from French *planification* ("planning"), which has played a great role in France's economic history. Especially in the period after World War Two, the government greatly influenced economic activity down to the enterprise level, intervening intensively in industrial policy, selectively promoting technologies or enterprises, and even actively restricting competition at times.

This was perhaps not evident to many observers at first because media reports about the speech have focused on aspects such as establishing a pan-European military deployment force or setting up a European bureau for asylum seekers. There are indeed good political reasons to consider such institutions. However, perhaps the considerable potential for economic and fiscal policy conflicts posed by some of the other proposals does not get enough attention. That applies, for example, to the idea of creating a common budget for the euro area. There seem to be certain obstacles to this already from a technical standpoint, since operating a second euro area budget parallel to the "normal" EU budget would be difficult. The bureaucratic expense involved would be enormous. Moreover, the speech did not make clear what purpose the euro area budget is supposed to serve.

Evidently, Macron is concerned among other things with cushioning external shocks. But to what extent would a euro area budget be better suited to cushioning external shocks than the sum of the individual member state budgets? After all, there will not be more to distribute just because there are more budgets. Even if new taxes were "discovered" to finance this new budget (and that is probably Macron's plan, but it will fail because most countries involved are not willing), total tax revenue would presumably not increase much, since as of a certain degree of tax burden, economic performance would suffer so much that the net effect on revenue would approach zero. Another question is whether individual national budgets are not able to react much more quickly and purposefully in a crisis than a bureaucratic euro budget. After all, external shocks often act asymmetrically and do not affect all regions or industries of a currency area. It may therefore be difficult for an overarching euro area budget to make political decisions about where resources should be primarily allocated after an exogenous shock. Because this is a delicate issue, tax money would probably be distributed in times of crisis with a watering can and after some delay. What sounds good at first and is well-intended is then usually not done particularly well in concrete situations.

A further interesting question is, why some argue that such a budget is nevertheless needed. Macron refers to individual states' lack of influence on monetary policy and sees a common budget policy as compensating for that deficiency. This is a rather bizarre perspective. For, ultimately, this kind of budget policy aims at counterbalancing monetary policy or at least at being able to do so.

But it is not at all the function of budget policy to compensate for supposed monetary policy errors. It is the sole task of budget policy to finance government expenditures and public goods. And experience shows that centralized budgets are usually less suited to that than decentralized budgets. That does not necessarily argue against budgets at the central level, but it would have to be clarified at what level what public goods and services are being provided and at what level what public goods and services are being financed. Given considerations of democratic political theory, it normally makes sense to establish congruence in this regard. If a good is to be provided at the central level, then it should also be paid for at the central level.

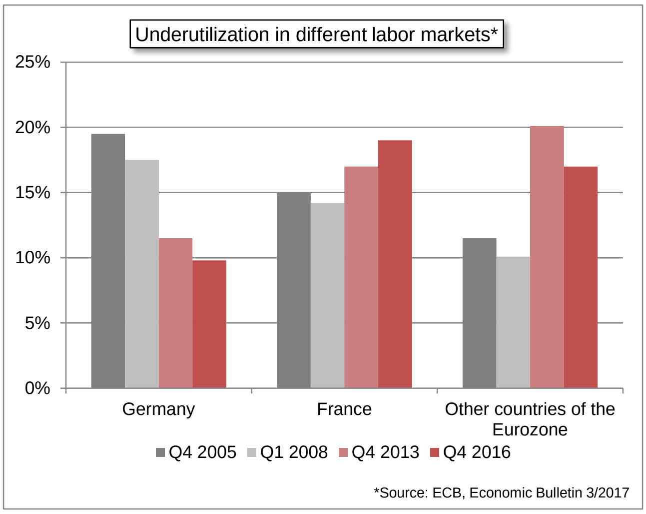
But what goods should be provided centrally? According to the theory of public goods, whenever providing a good or service positively affects other parts of a federal system (economists call these spillover effects), it makes sense to elevate it to a higher level. From this perspective, it could actually be reasonable, for example, to put external and internal security at a central European level and finance those with common budget.

However, it is not clear why this should only concern euro area countries. It would seem to be a classic function of a future EU budget. But these are exactly the thoughts missing in Macron's view. For him, a Euroland budget would simply be a tool for macroeconomic fine-tuning and thus far removed from sensibly taking up the organizational ideas of the theory of public goods.

The basic tendencies of planification may also be found in his ideas on tax harmonization. Macron regards the differences among taxes, tax rates, and tax bases in different countries as a problem and focuses on harmonizing them. What may sound logical at first ultimately turns out to be a matter of prohibiting system competition. After all, there is no such thing as a perfect tax system, but different approaches in different countries may in the course of many years help distinguish between better and worse methods. Making everything the same would disable this process, but that is typical of the anti-competition ideas involved in planification.

The continuation of these ideas consists in creating, protecting, and promoting European industry champions. But how is the state supposed to know which technologies are actually promising for the future? And what gives the state the right to selectively promote certain enterprises more than others? Although this may be part of the planification tradition, it is ultimately pretence of knowledge. And even worse, France has failed several times to implement these ideas and approaches. Practically all attempts to create industry champions have not worked. At most, Airbus may be mentioned as a counterexample, but it is probably the case that Airbus is successful despite political influence rather than because of it. In this connection, it speaks volumes that Macron would like to install a trade prosecutor to oversee fair trade practices, whatever that means. Fundamental skepticism according to which trade creates advantages for all participants in the long run is also discernible here. Instead, globalization is viewed as a problem that needs to be brought under control. This critical attitude towards markets finds expression in many of Macron's other statements, where he talks about the imponderables of the market or takes a positive view of financial transaction taxes. The general tendency towards insulation and regulation in recent decades has not been good for France, and the attempt to apply these failed recipes at the European level now seems dubious.

The result of only moderately successful French industrial policy may be observed quite well in the development of the labor market, among other things. In 2005, underutilization of the labor market in Germany was nearly 20%. Somewhat simplified, this means that in view of the potential workforce in Germany, almost 20% more people could have been employed than actually were. At that time, underutilization of the French labor market was "only" 15%. However, the tables have turned substantially since then. Underutilization has fallen since that time to below 10% in Germany despite massive immigration. But it has risen to almost 20% in France, although it has likewise been declining in the other euro zone countries for some time in contrast to France. That is no proof of effective French economic policy that should now become the blueprint for Europe.



Macron's line of thought outlined above also includes considerations regarding EU social policy. In recent years, many countries have partly aimed social policy at increasing competitiveness and thus indirectly achieving social policy successes. Macron now assumes that this kind of economic policy has abetted populist movements. He therefore relies more on insulation and equalization to increase social welfare. That Macron wants to reform the labor market and dissolve rigidities does not really fit into the picture here. Nevertheless, it is not clear why Macron is classified by many unions and intellectuals and some of the French media as a capitalist monster or a "rubber doll of capital" (philosopher Michel Onfray), since the French president's ideas that really conform to the market are at times rather limited.

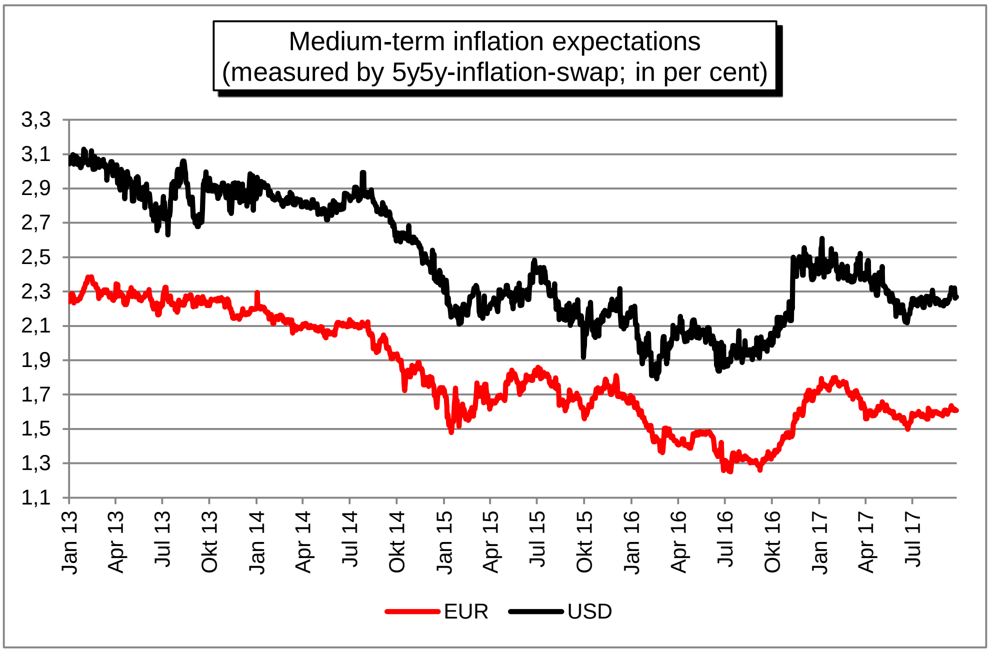
Although Macron enjoys our complete sympathy for his pro-European attitude, we urgently advise against pursuing all ideas coming from Paris now without due reflection. The EU has also had problems in recent years because it has simultaneously pursued many ambitious goals that have not always been well thought out from a regulative standpoint. If similar ambitions are discernible again now, caution is advised – especially since such ideas have seldom led to success at the national level and it is not clear why that should now be different at the European level. Considering the ambitious goals and large number of ideas irrespective of success, we warn against confusing activity with quality. It makes little sense to overburden Europe again with new plans when it has only just recovered from the Brexit referendum. Sometimes small, well-considered steps are better than a big push that will later prove to be a step backwards.

Weekly outlook for October 2-6, 2017

	Apr.	May	June	July	Aug.	Sept.	Release
DE: PMI, manufacturing, final	58.2	59.5	59.6	58.1	59.3	60.6	October 2
DE: PMI, services, final	55.4	55.4	54.0	53.1	53.5	55.6	October 4
DE: New orders, m/m	-2.1%	1.1%	0.9%	-0.7%	0.6%		October 6
DE: New orders, y/y	3.2%	3.9%	5.1%	4.9%	4.5%		October 6
EUR19: PMI, manufacturing, final	56.7	57.0	57.4	56.6	57.4	58.2	October 2
EUR19: Unemployment rate, s.a.	9.4%	9.2%	9.2%	9.1%	9.1%		October 2
EUR19: Producer prices m/m	0.0%	-0.3%	-0.2%	0.0%	0.2%		October 3
EUR19: Producer prices y/y	4.3%	3.4%	2.4%	2.0%	2.4%		October 3
EUR19: PMI, services, final	56.4	56.3	55.4	55.4	54.7	55.6	October 4
EUR19: Retail sales, m/m	0.0%	0.3%	0.6%	-0.3%	0.4%		October 4

MMWB estimates in red

Chart of the Week: Inflation a long time coming



The Fed announced at its last meeting that it intends to reduce its bond holdings. However, the reduction will be very small initially at USD 10 billion per month. The FOMC also still intends to raise interest rates once more this year and three times next year. So, why do capital market participants not fully believe this? Current prices of fed fund futures anticipate another interest rate hike for this year in December, but barely one more for next year. The reason is continuing low core inflation. It stood at just over 1.4% at the end of July, and the majority of economists foresee no appreciable increase in the rest of the year. Medium-term inflation expectations also do not suggest that core inflation will diverge from its currently low level in the near future. And inflation development does not seem puzzling only to capital market participants. Fed Chair Janet Yellen also spoke of a "mystery" at the last press conference. However, Yellen continues to assume that the inflation-dampening effects are temporary in nature. That should make another interest rate increase in December more likely. In the euro zone, ECB President Mario Draghi has eased off the gas of accommodative monetary policy only very slightly in September. No changes in bond purchases have been made, but a timetable for reducing unconventional monetary policy measures is going to be presented in October at the next ECB meeting. The continuing lack of inflation and very cautious approach taken by both the Fed and the ECB, the two most important central banks, have prompted us to lower our yield forecasts for the end of 2017. We now expect yields of 0.5% (previously 0.7%) on 10-year German government bonds (Bunds) and 2.4% (previously 2.8%) on 10-year US Treasuries. We forecast a continuing very low interest rate level in the euro zone for 2018, even if the reduction of bond purchases by the ECB accompanied by a positive economic trend allows yields on government bonds to reach somewhat higher values than at the end of 2017. Because of the relatively steep yield curve, with a spread between 2-year and 10-year Bunds of 115 basis points, we still do not consider it appropriate to shorten duration too sharply. We are therefore maintaining our neutral duration positioning.

Stock marktes	As of 29.09.2017 15:07	Change versus 22.09.2017 -1 week	28.08.2017 -1 month	28.06.2017 -3 months	30.12.2016 YTD
Dow Jones	22381	0,1%	2,6%	4,3%	13,3%
S&P 500	2510	0,3%	2,7%	2,8%	12,1%
Nasdaq	6453	0,4%	2,7%	3,5%	19,9%
DAX	12757	1,3%	5,2%	0,9%	11,1%
MDAX	25864	1,0%	5,0%	4,2%	16,6%
TecDAX	2428	1,1%	7,6%	9,3%	34,0%
EuroStoxx 50	3571	0,8%	4,4%	1,0%	8,5%
Stoxx 50	3157	1,0%	4,2%	-0,9%	4,9%
SMI (Swiss Market Index)	9119	-0,2%	2,9%	0,5%	10,9%
Nikkei 225	20356	0,3%	4,7%	1,1%	6,5%
Brasilien BOVESPA	73567	-2,4%	3,6%	18,6%	22,1%
Russland RTS	1134	1,0%	6,1%	13,1%	-1,6%
Indien BSE 30	31284	-2,0%	-1,5%	1,5%	17,5%
China Shanghai Composite	3349	-0,1%	-0,4%	5,5%	7,9%
MSCI Welt (in €)	1992	1,1%	3,3%	-0,8%	1,4%
MSCI Emerging Markets (in €)	1072	-1,6%	-0,3%	1,9%	10,9%
Bond markets					
Bund-Future	163,14	202	-182	-31	-101
Bobl-Future	131,28	21	-187	-90	-235
Schatz-Future	112,16	6	-10	25	-14
3 Monats Euribor	-0,33	0	0	0	-1
3M Euribor Future, Dec 2017	-0,32	0	0	-2	0
3 Monats $ Libor	1,33	0	2	4	33
Fed Funds Future, Dec 2017	1,25	0	5	0	0
10 year US Treasuries	2,30	4	14	8	-15
10 year Bunds	0,45	0	15	9	35
10 year JGB	0,06	4	5	1	2
10 year Swiss Government	-0,04	-1	10	5	16
US Treas 10Y Performance	583,58	-0,4%	-1,0%	0,1%	2,5%
Bund 10Y Performance	606,57	-0,3%	-1,0%	-0,4%	-1,0%
REX Performance Index	482,44	0,1%	-0,3%	0,2%	-0,6%
US mortgage rate	0,00	0	0	0	0
IBOXX AA, €	0,78	1	11	-5	11
IBOXX BBB, €	1,32	1	7	-4	-18
ML US High Yield	5,96	-3	-13	-8	-50
JPM EMBI+, Index	836	-0,5%	0,2%	1,4%	8,3%
Convertible Bonds, Exane 25	7255	0,0%	1,4%	0,8%	4,9%
Commodities					
CRB Spot Index	427,96	-0,2%	-1,8%	-3,2%	1,2%
MG Base Metal Index	331,36	-0,3%	-1,8%	11,3%	18,4%
Crude oil Brent	57,44	1,1%	9,8%	21,8%	1,3%
Gold	1287,90	-0,6%	-1,5%	3,0%	11,3%
Silver	16,77	-1,2%	-3,5%	-0,2%	4,5%
Aluminium	2107,25	-1,4%	2,0%	11,4%	23,7%
Copper	6473,50	0,9%	-2,6%	10,3%	17,2%
Iron ore	62,43	-12,7%	-16,8%	12,1%	-21,7%
Freight rates Baltic Dry Index	1391	-7,4%	15,1%	49,7%	44,7%
Currencies					
EUR/ USD	1,1823	-1,2%	-0,9%	3,9%	12,2%
EUR/ GBP	0,8824	-0,3%	-4,6%	0,5%	3,4%
EUR/ JPY	132,80	-0,9%	1,9%	4,1%	7,6%
EUR/ CHF	1,1460	-1,1%	0,6%	5,0%	6,7%
USD/ CNY	6,6463	0,8%	0,4%	-2,3%	-4,4%
USD/ JPY	112,35	0,3%	2,8%	0,0%	-3,9%
USD/ GBP	0,75	1,0%	-3,5%	-3,4%	-7,8%

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