SCB Economic Intelligence Center

Flash by EIC

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EU still not in the clear despite Emmanuel Macron's victory

Event

- Results on election night (7 May, French time) indicate a victory for Emmanuel Macron of En March, the pro-EU centrist candidate and now the 25th President of France, with a comfortable margin of 66% to 34% over Marine Le Pen, in line with market predictions and pre-election polls. Macron's victory reflects the majority of French voters' desire to stay in the European Union and forecloses the possibility of France's leaving the EU (Frexit).

Analysis

- **The euro reached its 7-month high following Macron's win.** Since the first-round balloting on 23 April, actual election results aligning with predictions have helped shore up investors' confidence, as seen in the stronger euro and continuously narrowing gap between French and German bond yields, indicating a more positive outlook on the French economy among investors (Figures 1 and 2). Financial markets responded positively, without much volatility, in the wake of the run-off results. Investors expects Macron's policy to bring more stability to the French economy and, subsequently, to that of the EU.

- **However, whether Macron can turn the tide of the French economy through his policy remains to be seen, as he still needs to secure enough seats in the Parliament to enact campaign promises**

EU policy	Pro-reform and sees France's role as one of the EU's main pillars as necessary.
Refugees policy	Welcomes refugees, promised to process all asylum requests within the first six months of his presidency
Security policy	For anti-terror efforts that don't erode civil rights.
Economic policy	self-employedCorporate tax cut, from 33% to 25%, residence tax cut, and inheritance tax reform. 120,000 public sector jobs to be cut, with public spending to be slashed by EUR 60 billion. Unemployment target of below 7%. More flexible labor laws, protection for the self-employed

Although Macron's policy and promised reform bode well for the French economy and the Eurozone, there is a strong possibility of a political gridlock, which would halt his agenda.

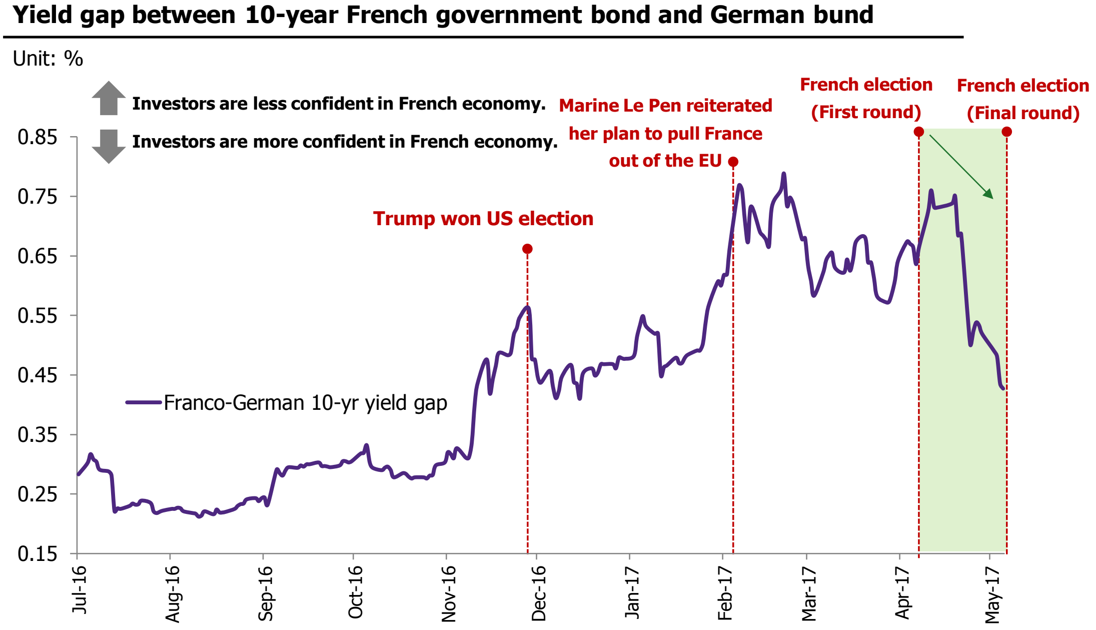
Macron still needs to gain a majority in the French Parliament in the upcoming legislative elections on 11 and 18 June. It is highly likely that he won't be able to, and will need to form a coalition. Such a scenario means not all of his plans for economic and social reforms will come to fruition as promised during the campaign

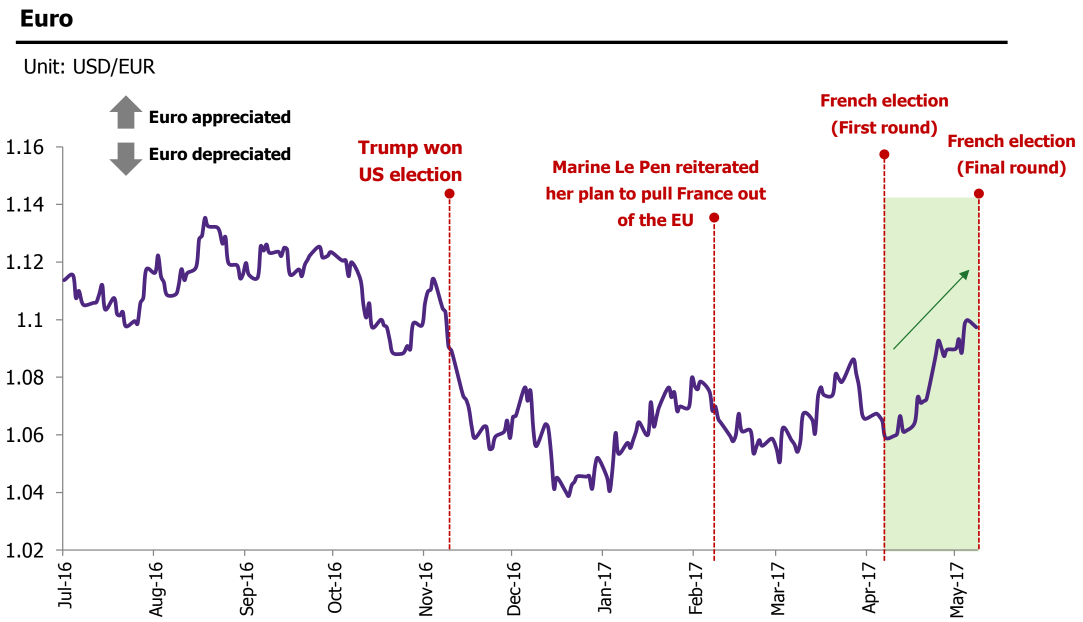
- **Macron's victory puts more pressure on Brexit negotiations.** One of Macron's key agendas is EU reform and strengthening. He believes the UK should not be able to walk away from the EU without difficulty, to prevent another member-state from following suit. Such thinking puts more pressure on negotiations, and it is likely that the process won't be as smooth and fast as Theresa May, the UK's Prime Minister, hopes. On 29 April, EU leaders convened to discuss Brexit strategy and presented a united front: the EU will not let the UK leave without financial costs (no “Free Brexit”) or to pick and choose conditions. According to the Financial Times's analysis, upon Brexit the UK may be billed as much as GBP 100 billion by the EU.

Implication

- **The French election results should ease anxieties over Frexit, with positive repercussions in the global economy both in terms of trade and investments.** Macron's victory brought about a more positive outlook on the world's economy, including the Eurozone. Macron's win represents a rebuke against anti-globalization sentiments. With Frexit out of the picture under his presidency and with expected boost to the French economy through his economic policy and reform, there is now more clarity on the direction of the global economy, with businesses' confidence rising.
- **On the other hand, political risks in Europe remain.** Brexit negotiations may turn acrimonious, French economic reforms may not bring about desired changes, as all eyes now turn to the upcoming German and Italian elections. These factors all pose a risk to the recovery of the EU economy, including the UK. Thai investments and exports may be affected as the EU and UK makes up 12% of Thailand's export market (Figure 3).
- **The European Central Bank (ECB) may not rush into policy tightening, despite a more positive outlook for the Eurozone.** Even without the looming possibility of Frexit, Brexit negotiations will continue to add uncertainty to the Eurozone's recovery. EIC expects the ECB to slow down its quantitative easing, cutting monthly bonds purchases from EUR 60 billion to EUR 40 billion per month from January 2018 onwards. Policy rates may return to normal around the second quarter of 2019.

Figure1 and 2: Investors' confidence in French and Eurozone economy continually on the rise since the first round of French elections



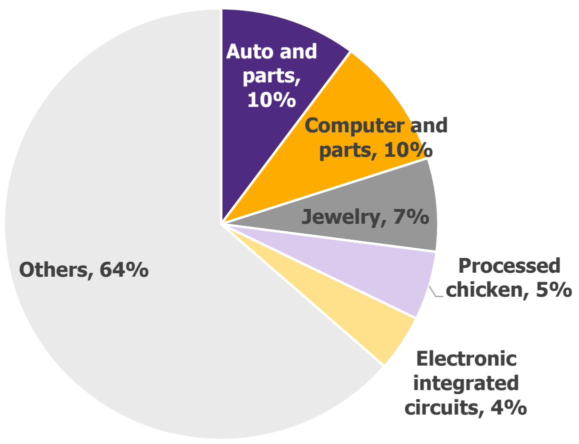


Source: EIC analysis based on data from Bloomberg

Figure 3: Cars and parts, computers and parts are Thailand's key export products to the EU and the UK

Thailand's export to EU and UK – by products

Unit: %



Source: EIC analysis based on data from the Ministry of Commerce

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