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Hollande Day In France

By J. Paul Horne, Independent International Market Economist *

Well, he's in with nearly 52% of the popular vote as Sarkozy was rebuffed with barely 48%, only the second President of the Fifth Republic to be voted out after only one term, a major political reversal for the right. Sarko paid the price of the financial crisis and economic recession. Not only that but France's right and left wing extremes won an unprecedented one-third of the first round vote, showing that many French are really angry.

To this viewer, Hollande proved charming and robust, and spoke well with intelligent control of his facts, in the one TV debate on 2 May. Above all, he kept his temper, even when an exasperated Sarko accused him of being a liar, with 18 million viewers watching . (Sarko was elected in 2007, in part, because Hollande's concubine and mother of his four children, Segolene Royal, lost her temper in their debate.) Of the two, Hollande was much more presidential and considered in his views.

Hollande's first major challenge will be to visit Angela Merkel and work with her, not against, on how to square Europe's austerity circle with economic stimulus and to avoid the double dip recession now starting in Europe. The ECB's Super Mario has made it clear the central bank will back them up by making any amount of liquidity available to the Euro zone's fragile banking system, although the ECB will not buy Euro zone government debt directly. There is no doubt that "Merkozy" will be replaced by "Merkollande" since they have no choice, although there could be friction at the outset.

Especially since Merkel has problems following today's setback in the Schleswig-Holstein lander election; with another one in North Rhineland-Westphalia on 13 May. These and previous lander election losses have weakened her grip on the coalition government. She faces Federal elections by no later than 27 October 2013.

Hollande wants Euro zone bonds to be issued and guaranteed by all 17 governments to finance infrastructure projects. He also supports a financial transaction tax in the E.U. and for E.U. structural funds to be used to stimulate the economy. Merkel may agree to some such ideas but will not back down on the 3% (of GDP) deficit and 60% debt targets which are the basis of the "fiscal compact" agreed by 25 E.U. countries who must ratify the compact by July. Nor will Merkel back down on allowing the ECB to ease its inflation mandate or finance government deficits.

Hollande promised to raise income taxes on major corporations and the marginal tax rate on personal income to 75% for those earning over EUR one million annually. The Socialist Party (PSI) proposes new spending of about EUR 20 billion on social welfare and other programs over the five-year presidential term; and would boost taxes by about EUR 30 billion to balance the budget by 2017. Hollande also would raise the minimum wage, hire 60,000 more teachers and cut the retirement age from 62 to 60 for manual workers.

Since Hollande will take over as President in the next ten days, he must quickly appoint a prime minister who will select a cabinet. He will visit the U.S. for a G8 meeting on 18-19 May, then attend a NATO summit meeting in Chicago on 20-21 May, where he is expected to reiterate his pledge to pull French troops out of Afghanistan by the year end.

He and his new government must also prepare for legislative elections on 10 and 17 June. These will be aimed at replacing Sarkozy's conservative majority in the National Assembly. France, like the U.S., has a strong presidential system when the chief executive controls a majority in the parliament.

Assuming that Hollande's electoral momentum will lead to a center-left parliamentary majority by 17 June, I think markets will be relieved by how moderate Hollande may be, especially in dealing with the renascent Euro crisis. I note that the euro is worth \$1.303 tonight and the 10-year OAT yield is 2.83%, down 20 bps from ten days ago. Assuming that Mercoland can minimize personal friction in public (something Sarko failed to do at the start of his relationship with the Chancellor); we may see the OAT-bund yield spread narrow further.

For the time being, I am relatively sanguine about the consequences of Hollande's election.

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