

Can France Catch Up to Germany?

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I'm extremely excited that because inefficiencies breeds opportunities, and if we fully understand the competitive moats of the companies that we study, we can uncover a lot of opportunities to deliver alpha for our clients.

Can France follow Germany's economic and market success of the last two decades? Taking the German experience of positive economic change can create a favorable country tailwind, which can shift up the trajectory of corporate revenue and earnings growth, increase business and investor confidence, and raise the value of assets. From 2003 to 2016, Germany was one of the best performing markets worldwide. In the last two years, France has begun to take the lead.

Germany is widely recognized as the economic powerhouse of Europe and the envy of its neighbors. Its industrial model is built on a strong skill base and a vibrant universe of small- to middle-sized businesses. In contrast, France suffers from anemic growth, high unemployment and persistent budget deficits. The explanation lies in France's labor participation, number of hours worked and additions to its labor force.

Enter Emmanuel Macron, France's reform-minded president, who shocked the political establishment when his new party, business friendly, surged to victory in May 2017. With experience in the private sector, Macron has been steadfast in his goals of rolling back regulations that inhibit job growth, and enacting measures that encourage new business formation.

In France the challenges are substantial, with active trade unions and a population willing to contest changes benefits and lifestyle. Further, Macron, only 40 years of



age, has shown signs of inexperience. Communication gaffes have cost him poll numbers.

Similar to France today, Germany also once suffered from slow growth and high unemployment. In fact, nine to ten percent unemployment was the norm from the late 1990s through early 2000s. Labor reforms under Chancellor Gerhard Schroder in the early 2000s turned the corner for Germany. Today Germany is near full employment--close to 5%--with the economy and wages growing steadily and the German government running a budget surplus. Macron's reform agenda actually had a head start in 2015, when, as Minister of Economy, he pushed through a series of measures to ease restrictions on businesses, many having to do with employment and hiring. Current reforms continue to relieve employers with regards to employment procedures. Reforms roll back red tape on new businesses and high tax rates on investment income. Additionally, Macron is determined to incentivize entrepreneurship and innovation. Macron's pro-business policies should be beneficial to French businesses and re-align France with its European peers.

The current gap between German and French employment rates indicates the potential that France could unlock with its reforms. Using Germany as a guidepost, these reforms may have meaningful implications for both the French economy and equity markets. It is economic upheaval of this nature that we look for in our investments at Alger.

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