The Telegraph

Despite Emmanuel Macron’s election, the eurozone isn't out of the woods

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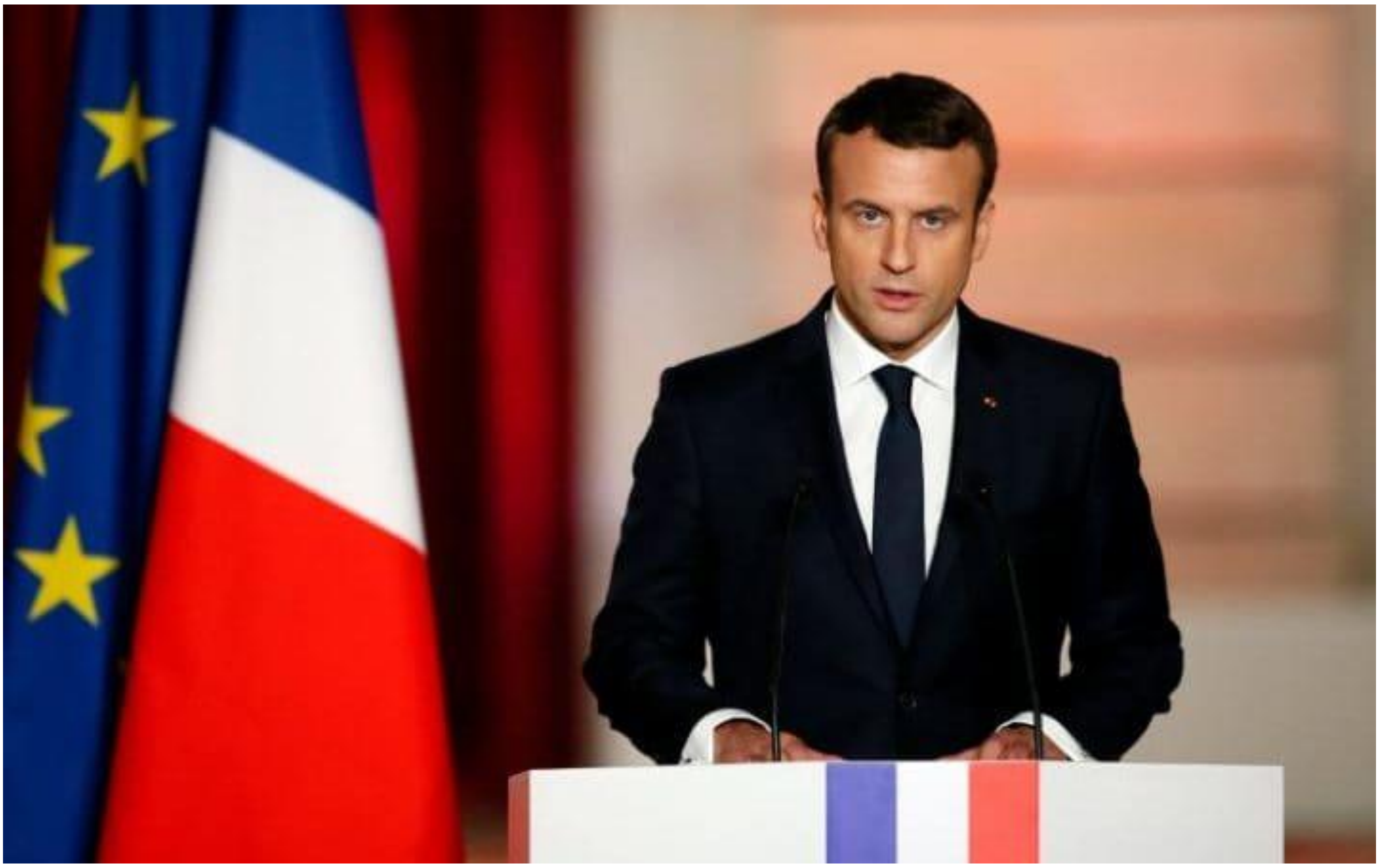
15 MAY 2017 • 6:00AM



Emmanuel Macron wants closer eurozone integration CREDIT: EPA

Many British analysts and commentators, including yours truly, have for some years now been forecasting that a country would leave the euro, or that the whole currency union would break up. But the euro remains intact. Indeed, supporters of the single currency have had a very good couple of months. Is the euro’s future now secure?

The recent run of political good news for the euro started with the failure of the Dutch Freedom Party to break through in the election in the Netherlands in March. It continued with the victory, by a substantial majority, of the europhile reformer Emmanuel Macron in the recent presidential election in France. What is more, you can now begin to imagine that Macron will initiate a programme of radical reform that will reinvigorate the French economy. Certainly, the policies that he espouses, including reform to the 35-hour week, cuts to the public sector, and the relaxation of labour laws, would make a good start.

Moreover, Macron has a real agenda for the eurozone, which he will doubtless be pressing on Angela Merkel at his meeting with her in Berlin today. He wants to push on with closer integration, including the introduction of a eurozone finance minister and the issue of eurozone bonds. He also wants Germany both to soften its fiscal policy and to relax the pressure for other countries to tighten theirs. In other words, he wants to press on with the introduction of the fundamental reforms necessary to make the eurozone viable.

On the economic front, the news has also been good. The eurozone economy has been picking up quite nicely and just about all parts of it, including Italy, are now growing. This should help to ease many of the zone's problems, including obstinately high fiscal deficits and high unemployment.

Mind you, the barriers facing Macron are considerable, beginning with the need to win some sort of majority, even if in alliance with other parties, in the coming elections for the French National Assembly. But this is only the start. Traditionally, attempts at reform in France have foundered, not in the Assembly, but rather on the streets. You can bet your bottom euro that an attempt to reform the labour market and cut back on the public sector will bring hordes of protesters out. In the past, when confronted by such pressure, French governments have buckled. There is every chance this will happen again.

Moreover, recent news from Germany has been disappointing. The electoral position of the SPD, led by Martin Schulz, has been weakening. This is significant because the SPD has taken a softer line in relation to insisting on radical French reforms before considering further eurozone integration, including some sort of pooling of government debt between France and Germany.

As things stand, Merkel's hands are tied unless and until she wins re-election in September. But even after that she is unlikely to give much ground to Macron. The thing about the German establishment, which is so easy to under-estimate, is that they really believe the guff they espouse about the need for fiscal restraint and the virtue of current account surpluses. Macron may be set for a honeymoon period over the summer. But things will not look so good come the autumn if his domestic reform agenda has hit difficulties and Merkel is refusing to make concessions.

Meanwhile, thanks to higher inflation, the European economic environment will become more testing later this year, and perhaps more so next year and beyond, if and when the current global upswing starts to stall. Plenty of observers think that the next US downturn may not be far away.

Admittedly, some European commentators think that the eurozone economy will receive a boost from Brexit as foreign investors shift money from the UK to the continent, and various businesses, including financial ones, leave London for Frankfurt or Paris. But I think this view is misguided. The exodus of businesses, people and capital from London will probably be minor.

Indeed, Brexit may pose a threat to the eurozone if and when it becomes clear that the UK has managed Brexit well and is continuing to outperform its continental neighbours. Of course, this is not an immediate prospect. First the UK has to leave and then it will be some time before it becomes clear how well the country is faring.

All along, though, I have thought that the weakest link in the euro chain was Italy, where elections are due by May next year at the latest. It is striking that all of Italy's opposition parties are now eurosceptic. The Five Star Movement, led by Beppe Grillo, leads in the opinion polls. Grillo's party, although quirky, is not like Marine Le Pen's National Front. It does not have the same protectionist agenda and does not have to fend off accusations that it is tinged with racism and anti-semitism. Moreover, despite the current slight upturn in its economy, Italy remains deeply depressed. Grillo could easily deliver the shock that Marine Le Pen did not.

So do not be fooled by the appearance of calm. There is an almighty task facing the governments of Germany and France to forge the necessary institutions to make the euro system sustainable. What recent political and economic developments have done is to provide a reprieve, but no more than that. Failure by Macron to introduce radical reform, a major row with Germany over the course of its policy and reform to the eurozone, or the election of a eurosceptic government in Rome could all deal the euro a fatal blow.

One way or another, the euro does not make sense. It is only a matter of time.

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