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Macron's youthful France to storm ahead of ageing Germany

AMBROSE EVANS-PRITCHARD

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Powerful demographic forces will give Emmanuel Macron the whip hand over Chancellor Angela Merkel

France is on the cusp of an economic 'golden age'. The country will overtake Germany in the 2020s, emerging as the driving force of a Gallic-led eurozone and the engine of a revived Franco-German axis.

That is the bold prediction of the German bank Berenberg. It is not as far-fetched as it sounds.

The theme running through the work of Nobel Economist Robert Shiller is that cultural narratives are a powerful catalyst for financial cycles. They stir the animal spirits of a nation. Societies talk themselves into malaise, and talk themselves out again.

As narratives go, the Napoleonic ascent of a 39-year-old counter-populist on the ruins of a shattered party system is as close to a 'positive shock' as you are ever likely to see in the realm of political economy.

This child of the digital age - yet steeped in Nietzsche - is surrounded by a cabinet of youth. His prime minister is barely older. Berlin looks stale, almost fossilized.

The eternal Wolfgang Schauble still growls at the finance ministry with his budget and trades surpluses, captive of the pre-Keynesian 'household fallacy' in economics. Chancellor Angela Merkel is more flexible. It is not her fault that she rose from the East German Communist youth league, yet her Weltanschauung seems other-worldly as she marches towards a fourth term.

Germany's Achilles Heel is a 'hive collapse' and the corrosive psychology of ageing. The demographic dividend is turning overnight into deficit as baby boomers retire. The European Commission's Ageing Report (2015) says the working-age cohort will contract by 200,000 a year for the rest of this decade, and by 400,000 annually in the early 2020s.

The old age dependency ratio will jump from 34pc today, to 39pc in 2020, 52pc in 2030, and 65pc in 2060. By then those deemed 'very elderly' (80 plus) will be 41.5pc of the German people. The population will shrink below 71m.

Demography is a soft science. Fertility rates can change over time. The refugee influx into Germany shifts the curve. Yet the overall contrast with France is remarkable.

The French state invested long ago in the critical imperative of the 'famille nombreuse' - keeping the fertility rate at replacement level of 2.0 - and will reap the reward as others go into national decline.

France's population will not surpass Germany's until the mid-century but the economic effects have already begun. The impact will intensify year by year from now on. Emmanuel Macron has the luck of perfect timing.

Holger Schmieding from Berenberg says Germany has a further problem. It is resting on its laurels. After pushing through the Hartz IV labour reforms in 2003-2004, it slipped to 26th place in EU rankings for structural adjustment last year. "As success breeds complacency, Germany will lose its edge and fall back in the next decade. It will no longer be at the top," he said.

It is a drip-drip erosion. Changes allow early retirement at 63 after 40 years work. There is a new minimum wage, restrictions for use of temporary workers, special pensions for mothers. "It is all stuff that Germany can afford, but these little things add up over time," he said.

China's industrial revolution played nicely into German strengths. There was a voracious appetite for the Mittelstand's machine tools. That window is slowly shutting as a richer China moves up the ladder and shifts to consumption. This plays to French strengths: the luxury companies of LVMH, L'Oreal, Hermes, Christian Dior, or Kering.

Hubris was the theme of an extraordinary book by Die Welt's Olaf Gersemann in 2014. Entitled 'The Germany Bubble: the Last Hurrah of a Great Economic Nation', it argued that the second economic miracle from 2005 onwards had “gone to Germany’s head”.

The country had mistaken a confluence of exceptional events for permanent ascendancy and proof of economic rectitude. "Germany considers itself the model for the world, but pride comes before the fall," he said.

Marcel Fratzscher, head of the DIW institute, has a Keynesian variant of this critique in 'Die Deutschland Illusion'. He rebukes Germany's elites for worshipping the false god of balanced budgets, a fundamental error at a time when households and companies are saving too much.

Berlin should instead spend money enhancing the future dynamism of the country and repairing its crumbling infrastructure while it can borrow for five years at minus 0.36pc. Yet net public investment has instead been negative for most of the last 15 years. The result of the savings glut is that Germany ships far too much capital abroad.

"Companies are no longer confident that they can earn a return in Germany and that is not a healthy sign. Vibrant economies find uses for their domestic savings," said Simon Tilford from the Centre for European Reform.

"The truth is that Germany looks good only relative to the dreadful performance of other eurozone economies. Its own problems have been masked," he said. Productivity growth since 2000 has lagged the US, Australia, Korea, or indeed Austria.

Mr Macron complained as French economy minister that Hartz IV measures were chiefly a way to drive down wages, an 'internal devaluation' or a beggar-thy-neighbour policy of gaining export share within the eurozone. Germany was able to pull this off because inflation in the South was eroding their competitiveness. It is much harder for others to claw back lost ground today by the same method.

The jury is still out on Hartz IV but we forget too easily that Germany was deemed the sick man of Europe in the late 1990s, blighted by "Reformstau" or stalled reforms, and thought incapable of change because the Bundestag and a Bundesrat were always at loggerheads. Germany shook itself to life, just as an "unreformable Britain" found Margaret Thatcher.

President Macron campaigned unequivocally for a shake-up and has the mandate so lacking for his pitiful predecessor. It is an error to overstate the reach of his measures. His Nordic flexisecurity will loosen the job market but there will be no a bonfire of the labour code. State spending will be trimmed from 55pc to 52pc of GDP.

He must grapple with a public debt that has vaulted to 96ps of GDP. Borrowing costs held down by the European Central Bank have disguised the underlying costs of interest payments. The budget deficit is worse than it looks.

Yet a young, spirited, educated country with first-class infrastructure and a Cartesian civil service can overcome the relative trivia of accounting.

We love to taunt the French but their country was never really as weak as it looked. The odds are that France will regain its historic role as the dominant political power of continental Europe within ten years.