France's New Prosperity

The European Central Bank's quantitative easing program is already proving beneficial to France's economy, but what happens when it ends?

By Howard Stock

France's economy is turning lemons into citronnade this year, with the help of the European Central Bank's (ECB) quantitative easing (QE) program, which is significantly reducing the value of the euro relative to the U.S. dollar right at the time when oil prices have plunged and could fall further, lowering the cost of doing business.

The result for French companies of QE, especially the largest companies, which export in U.S. dollars, has been quite a windfall. The French CAC 40, an index of the 40 largest companies in France, is already up 16% since January 2015, says David Malamed, a partner at August & Debouzy, who says the success of the larger companies is creating a halo effect in the broader economy.

"The induced fundamental effect of this sudden and unexpected acceleration is to lift the depressive sentiment of many French workers and entrepreneurs: something is finally happening to and in France and there is a silver lining to this economic crisis," Malamed says. "Psychology is everything in economy, and we may be just finally turning a corner."

While the largest companies with sizeable export businesses are benefitting the most, jubilance in the market is also helping spur a spate of new initial public offerings (IPOs), says Jean-Nicolas Soret, a partner at Altana. "The number of IPOs has rarely been so high in Europe," he says. "A dozen IPOs have successfully completed on Euronext Paris since the beginning of the year. For example, Elis raised €750 million in its recent IPO. Another good illustration of active sectors is the biotech industry, with Cerenis Therapeutics who raised €53 million, and OSE Pharma, with an initial capital raise of €21 million."

The ECB's QE program, which launched in March, aims to purchase €60 billion in fixed-income assets per month and the program is due to last until September 2016, with a maximum total amount of €1,140 billion in purchases. "This program will benefit the entire economy. On the merger and acquisition (M&A) side, leveraged transactions should be easier to make and private equity will among those who will benefit the most from the low interest rate environment," Soret says.

STRUCTURAL REFORMS NEEDED

After 2016, though, France will have to press on without such a favorable wind in its sails, says Raphael Mellerio, a partner at Aramis Advocats. It will, however, face exactly the same problems it did before the ECB rode in on its white horse. "The French Government has yet to implement structural reforms targeted at the reduction of public spending and competitiveness of our economy, and may be tempted to delay such reforms," Mellerio warns. "All the more so that the next presidential election is in two years and that the most difficult decisions are generally put on hold a long time before the actual vote."

Another challenge, according to Pascal Bernachon, a partner at KBL Richelieu, is that while all export industries outside the euro zone benefit from the weaken euro, 51% of total exports are inside euro zone, where the currency is worth less than it was.

In Europe and in France in particular, the industries that are likely to benefit the most from the depreciation of the euro resulting from the QE program are those whose products or services are mainly exported outside of the E.U. and billed in U.S. dollars. Some key European industries such as aeronautics, defense or healthcare traditionally see their financial performance greatly impacted by the fluctuations of the Euro against the U.S. dollar. With the euro now approaching parity with the dollar down from 1.60 not so long ago, companies such as Airbus, L'Oréal, Sanofi, Dassault Systemes, AXA should all experience significant growth and the value of their shares should pick up on the stock markets, Mellerio says.

While the big exporters of goods outside of the euro zone will be the first to benefit from a weaker euro, says Malamed, "the feel-good sentiment is too nascent to have an impact on pure economic growth and the job market for the time being, but the trend for an improvement has at least been put in motion," Malamed says. "My butcher around the corner may not feel the tail wind yet, and the real estate sector is still very much depressed, but this will change in the next two years."

France is an interesting case study in that so much of its GDP—56%, according to Bernachon—comes from state spending. He says French industries may have fallen behind global competitors in recent years because struggling French companies haven't spent enough on research and development.

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But because France faces bigger structural problems, QE may ease the pressure enough to help jump-start the economy and spur industrial innovation, Malamed says, which should help make the painful structural reforms necessary to France's long-term growth prospects a little easier to bear.

On the whole, though, France is likely to see its neighbors benefit more from QE—countries such as Italy, Spain and Portugal are likely to enjoy a relative advantage because their borrowing rates are much higher, and since Germany being the main exporter of goods in Europe, the program will probably even be more beneficial to its companies, Soret says. However, if what's good for the euro zone is good for France, "Combined with cheaper oil prices, the QE program sets the best conditions for renewed growth in France, and in Europe generally," he says.

TO BUY OR NOT TO BUY?

Lawyers are split on whether a weaker euro will encourage more M&A activity in France by foreign buyers. Malamed points out that a stronger euro relative to the dollar didn't lead to an explosion in outbound M&A, and Bernachon says that cross-border M&A will likely stick to its traditional targets, pharmaceuticals and food and beverages. Soret is more bullish, and while he says it's too early to know for sure, it seems logical that "the weakening of the euro resulting from the QE program will certainly create M&A opportunities in France for foreign investors using currencies with a relatively stronger value." Some of those buyers may well come from China, "because they need to upgrade its own industry with international brands and technologies," Bernachon says.

China and the U.S. are definitely buyers of France's jewels, Malamed says, "China because it has the largest export surplus in the world and the cash needs to go somewhere, the U.S. because of a strong dollar and economy."

Moreover, "we already noticed that Japanese investors are back in France, with investment and acquisition projects," Soret says. "Although probably not only driven by currency effects, the appetite of Chinese investors is also getting stronger and stronger. A year ago, Peugeot, the French car manufacturer, received a capital injection of €800 million from Chinese Dongfeng."

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The reforms in China, and the decision of the Chinese president to boost outbound investment, will should continue to create business opportunities between France and China. "France's reputation in the areas of luxury and fashion, high tech, as well as leisure and culture and is likely to be the source of new investment and cooperation between China and France," Soret says. "The recent official visit of the French prime minister in China is precisely aimed at encouraging such cooperation." A recent example of Soret's is a Chinese corporation headquartered in Hong Kong, which invested in a French high-tech company with the objective of providing means for development and direct access to the Chinese market.

PASCAL BERNACHON
KBL RICHELIEU

DAVID MALAMED
AUGUST & DEBOUZY

CHEAPER BY THE DOLLAR

If currency conversion advantages aren't likely to be the sole drivers of cross-border M&A, they are certainly likely to sweeten deals. "A weak euro is a good news for foreign direct investment, no question about it," Malamed says. "Assets are 20% cheaper today than they were three months ago in U.S. dollars!"

Soret suggests the declining value of the euro versus the U.S. dollar should perhaps be viewed as a correction. "In recent years, many were those who considered that the value of the euro was too high compared to the dollar," he says. "Now that the QE program has been introduced and the euro has depreciated, we are very confident in the euro zone that there will be even

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more opportunities for foreign investors."

While France's economy is likely to benefit from QE, the jury is still out on whether France's law firms will enjoy a similar lift. "International law firms are more and more subjected to price pressure from their clients due to the economic crisis," Malamed says. "Bids on transactions against other firms have become routine and large corporate have hired internal lawyers to reduce the external lawyers' fees cost. It is too early to tell at this point whether the ECB's program will eventually change this new model."

Soret says economic difficulties over the past five years have made it harder for some international law firms to increase or maintain their presence in France. "The competition among these firms is extremely harsh and keeping high hourly rates is a constant challenge for them," he says. "Several U.S. firms even closed their Paris office in the past few years."

OPPORTUNITIES FOR LAWYERS

However, with the global financial crisis came a spider's web of new regulations. "More regulations after the 2008 crisis is an opportunity for lawyers of course," Bernachon notes, by creating the need to help navigate them.

Another opportunity is the entrepreneurial spirit among young French technology, biotech and telecom companies, which are forging a strong presence internationally, especially in the U.S. "Law firms should stay ahead of these economic changes by understanding not only the sectors that are moving forward, but also their clients," Malamed says. "Large corporate firms are equipped for large transactions, not so much young entrepreneurs and it is our duty as professionals to stay ahead of the game."

A case in point, Soret's firm Altana now has a practice specifically dedicated to cyber security, comprising of lawyers specializing in criminal law, information technology and labor law, in order to keep up with the needs of younger companies that would equally be as at home in Silicon Valley as they are in Paris.

France only has a little over a year left of QE if the ECB decides to end the program when it is scheduled to expire. That's not a long time to turn around the underlying problems facing its economy when, as is said of Federal Reserve monetary easing programs in the U.S., the punchbowl is removed. Bernachon projects that France's GDP will fall in the 0.7%-1% range in 2015, and will likely lag neighbors Germany, the Netherlands and Spain, the latter of which has at least started to implement meaningful and necessary structural reforms. Bernachon says that too often in France, state spending tends to stand in for actual structural reform, which usually is unpopular with voters and involves engaging France's powerful labor unions, hardly something politicians relish.

Malamed agrees that France's labor market still needs more flexibility. "If this can be achieved, we will see solid and sustained economic growth in France for the foreseeable future," he says.

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STRONGER GROWTH FORECAST

However, the announced resumption of growth in France and throughout the euro zone could be stronger than expected, Soret says. "The Organization for Economic Cooperation and Development (OECD) has just raised its forecast for growth in the region, which benefits from the program of the ECB, accompanied by a decline in the exchange rate of the euro, as well as the fall in oil prices," he says.

For France, the OECD anticipates a growth rate of 1.1% in 2015 and 1.7% in 2016, respectively 0.3 and 0.2 higher than it previously announced. "OECD is now aligned with the French government on these forecasts," Soret says, although Bernachon remains skeptical.

However, as the European Commission has reaffirmed, France needs reforms to achieve these objectives. "France desperately needs a tax reform aimed at boosting investment and risk-taking, as well more flexibility and lower costs on the labor market," Soret says. "These reforms are critical for restoring France's competitiveness in the coming years." ■