45.7 million French people registered on electoral lists

Once upon a franc

Several candidates for the French presidency want currency sovereignty restored. Asset management veterans share their memories of the time of the French franc with Adrien Paredes-Vanheule

The euro is dead, long live the franc! At least four candidates running for the French presidency (as of 14 March) are campaigning for a return to the former currency.

The two rounds of the election will be held on 23 April and 7 May 2017 respectively, and France's seat within the eurozone has been one of the core topics – mostly because far-right and far-left candidates alike have threatened to leave it.

France's withdrawal from the euro would cost at least €30bn more per year in French government debt interest, said Banque de France's governor François Villeroy de Galhau.

Paris-based think tank Institut Montaigne has developed three scenarios taking the idea into account. Its median forecast suggests that France's GDP would fall by 2.3% in a year and by 9% over 15 years, meaning a €180bn long-term loss for the country and some 500,000 job losses.

"THE MOVE TO THE EURO WAS NOT SUPPOSED TO BE REVERSED ONE DAY"
Nicolas Duban, Convictions AM

Also, the new franc would depreciate by some 15%-20% of its value.

TRANSITION

Convictions AM's chairman Nicolas Duban was head of Fixed Income and deputy managing director at BFT Gestion when France switched from the French franc to the euro.

He explains the situation at that time was different to today.

"A treaty had been signed, a clear strategy and calendar were set. Some doubts had been raised around countries like Italy as to whether they would adopt the euro. However, because of the strong Franco-German relationship, we knew France would obviously drop the franc.

"The French franc/euro peg had been an unknown for some time but we focused much on spreads between European govies to assess the consequences of a move from a local to a single currency. The move raised a number of material issues but in the end, all was planned and predictable," Duban remembers.

He adds that today "we find ourselves with no reverse plans deliberately, because the move to the euro was not supposed to be reversed one day."

Duban suspects central banks have outlined plans since the 2011 Grexit episode and kept them private, not for political reasons but for an inexorable reason which could be the end of the eurozone.

"If Greece exits the eurozone, the situation remains manageable albeit difficult but if France abandons the euro, what will be left of the eurozone? Not much," he argues.

A relief Duban highlights from the franc-euro switch has been the removal of the depreciation threat over French short interest rates as they used to rise sharply on each depreciation threat.

For Didier Le Menestrel, chairman and CEO of La Financière de l'Echiquier (LFDE), which he co-founded in 1991, a turning point in the move from the franc to the euro was an announcement made in 1996 by former French president Jacques Chirac.

"His speech was understood by markets as a signal that France was entering the path to the euro. Following Chirac's win in the French presidential election of 1995, the 'Franc Fort' policy was being tested by the markets.

"Locally there was hope Chirac would eventually take away the pressure from French interest rates after the Banque de France raised them quite sharply in previous years. Hence there was hope France could keep the franc," he says.

Le Menestrel underlines that in the mid-1990s interest rates had been raised to follow the German Bundesbank's rate hike after reunification, and a peg was being established around the Deutsche mark.

Also, the euro was still somewhat virtual and the European monetary system still under monitoring with the implementation of the ECU.

"I thought being sovereign on our currency was an edge but when markets cleared all doubts over Chirac's motivation to bring France into the euro, they were raised immediately and French rates started to slowly converge with German rates in 1996 and stayed low until 2008-2009," he points out.

Le Menestrel also recalls that in the 1980s, European countries had discussions regarding the evolution of local currencies, which had an important role in investment cases because fluctuations in results were huge.

"Volatility was extreme. If you were a financial director at that time, you had to be smart and hold foreign assets," he says.

Jean-Christophe Cotta, founder and CEO of Allocation & Sélection, did not notice any major change or impact during the switch from the franc to the euro.

Nevertheless, he observes the risks associated with a return to the French franc highlighted by various studies, especially those of massive consumer price inflation for any product that may be imported into France trimming therefore the purchasing power of most fragile social classes.

"The whole French financial ecosystem would suffer from an eventual return to the French franc. I stress that people having cash surpluses on their bank accounts have started to transfer them on foreign accounts domiciled in other European countries and are likely to put it back once the French elections are over," Cotta says.

TWO EUROS?

Allocation & Sélection's CEO does not believe France would exit the eurozone. He says a first solution could be the setup of a strong euro driven by Germany and the establishment of a Mediterranean euro.

Another option would see the euro as a unique currency being transformed into a common currency with the implementation of pegs between the strong euro and the Mediterranean euro.

Like Cotta, Convictions AM's Duban and LFDE's Le Menestrel highlight the divergences between European countries that put pressure on the unique currency.

"Is the euro viable on the mid-long term? The main issue is the lack of coordination between countries. In the US, when a state gets almost bankrupted, the federal authorities intervene in order to give financial compensation. In Europe, that does not exist. Production curves of European countries since the 2008 financial crisis have shown Germany is the only country to have enjoyed a continuous

growth surplus while most other countries have stagnated or seen a fall.

"Germany is not likely to re-invest its surplus in neighbouring economies. Could all eurozone members handle that on a mid-long term? If no initiative is taken over the five coming years, we cannot say that the probability of a eurozone ending does not exist," Duban says.

Le Menestrel recalls France but also southern European industries were more impacted by the franc-euro switch because it was used to devalue their currencies in order to gain competitiveness.

"It is rather funny that Germany finds the euro is a weak currency today while southern European countries find it almost appropriate. Germany enjoys a record trade surplus because it is more efficient in productivity and more flexible in labour laws whereas southern European countries have struggled to reform themselves," he adds.

RETURN TO THE FRANC

Duban wonders how French sovereign bonds will be processed and traded if France leaves the eurozone.

"Will they be issued in French francs or in euros? Marine Le Pen argues French regulation will apply. But if you tell foreign investors holding French debt that their French govies have lost 15% to 20% in value because of a currency devaluation implemented for political reasons, it will take a long time before they come back and reinvest in French debt. Argentina has been a pretty good example," he argues.

For him, only an ultra-rigorous economic policy would help France to finance its deficit in that case. He adds France should not drop the euro alone but coordinate with governments of other eurozone members.

Le Menestrel says he has no doubt the far right winning the French presidential election would be catastrophic for financial markets but that France cannot exit the eurozone overnight.

"Consequences would be dramatic if this happens. Some investors would turn their backs on French francs and debt to rather invest in dollars and other currencies. I believe the eurozone would not resist France's withdrawal.

"The Armageddon scenario has not happened yet, but a Frexit from the eurozone would be a thousand times Brexit," LFDE's chairman assesses. ■

FOREIGN VIEWS ON FRANC TALKS

John Taylor, manager of the AB Diversified Yield Plus Portfolio, says that even in the unlikely event that Le Pen wins the presidential election, "Frexit is by no means a foregone conclusion."

"The Front National is unlikely to win sufficient National Assembly seats to enact her policies. Even if it did, the decision would be subject to a referendum, allowing the French electorate to pull back from the brink," he argues.

Mark Burgess, CIO EMEA and global head of Equities of Columbia Threadneedle, has said: "France leaving the euro will have a significant knock-on effect on the wider economic currency union."

He believes France 's structural issues in the labour market that need to be addressed won't be helped by devaluation of the currency.

"As a Le Pen presidency is perceived to increase the likelihood of France's withdrawal from the euro, in the event she wins the election we would expect the spread of French bond yields over German bunds to widen significantly."