Euler Hermes Economic Research

Country Report

France

Reaching escape velocity…in 2016?

General Information

GDP	USD2806.43bn (World ranking 5, World Bank 2013)
Population	66 mn (World ranking 21, World Bank 2013)
Form of state	Republic
Head of government	François HOLLANDE (President)
Next elections	2017, presidential and legislative

Strengths

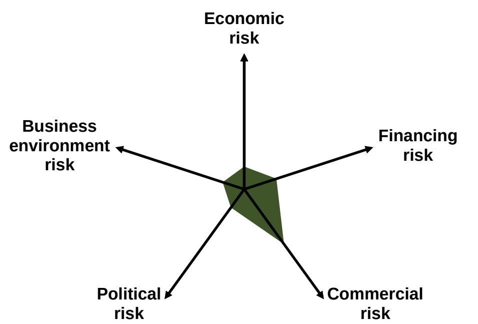
- Dynamic demographics and elevated hourly productivity
- Infrastructures (e.g., transport) and public services are of high quality
- Many international corporate giants and a growing presence of technological start-ups ('French tech')
- Diversified economy
- Tourism revenues
- Quality education system

Weaknesses

- Dual labour market: Insiders vs. outsiders, leading to structurally high unemployment rate
- Low employment rate among youth and seniors
- Growing inequalities in spite of costly redistribution
- Rapid deindustrialisation and low competitiveness of manufacturing firms
- Lack of large SMEs that can bear the sunk costs associated with innovation and exports
- Rent-based economy (e.g., retail distribution, taxis)
- Elevated level of public spending and questionable efficiency

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total; 2013)

Exports		Rank		Imports
Germany	15%	1	19%	Germany
Belgium	8%	2	10%	Belgium
Italy	8%	3	8%	Italy
Spain	7%	4	7%	China
United States	7%	5	6%	Spain

By product (% of total; 2013)

Exports		Rank		Imports
Aeronautics	10%	1	7%	Crude Oil
Pharmaceuticals	6%	2	5%	Refined Petroleum Products
Cars And Cycles	4%	3	5%	Cars And Cycles
Engines	4%	4	5%	Aeronautics
Toiletries	4%	5	4%	Pharmaceuticals

Sources: Chelem

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Economic Overview

Stars will finally align in 2015 ...

In 2014, France has experienced a third year of +0.4% Real GDP growth, for the 1st time since WW2. In 2015, growth should accelerate to +1%, against a backdrop of a more benign macroeconomic outlook. More specifically, the combination of a lower Euro, lower oil prices and more accommodative monetary policy will provide a much-needed boost to the French economy. As such, the main drivers of the rebound should be threefold: (i) a more dynamic private consumption, (ii) a positive contribution from net trade and (iii) corporate investment should stop falling, at last.

Still, Real GDP growth has been on a downward trend since the end of the 1990s, resulting from a fall in labor productivity (-1pp every decade for the past 30 years). Preventing a further fall should be a priority for the government if it wants to increase potential growth.

... leading to a positive contribution from net exports…

In Q4 2014, France continued to tread at a slow gait, with GDP only rising +0.1% over the quarter, as expected. The breakdown was relatively uneventful, but interestingly, exports accelerated markedly (+2.3%), while imports kept on increasing (+1.7%). All in all, in 2014, the trade deficit in goods narrowed to -53,5bn EUR, from -60,8bn in 2013. This narrowing stems from a 10,9bn reduction in energy imports (-12,7%). Ex-energy, the deficit thus increased by c. EUR 3bn. 2015 should see a continuation of the positive trend we observed at the end of the year.

... and rising consumption growth despite unemployment concerns!

Recent business surveys point to greener pastures, with household confidence rising rapidly and reaching levels not seen since mid-2012. Consumption credit growth finally turned positive on a yoy basis for the first time since end-2011. Housing loans growth continues to be positive (+2.2% yoy in 2014), even though it has slowed from 2011 levels, where it was growing at a +9% clip. These simmering signs underpin our positive outlook for consumption growth in 2015. However, it will be far buoyant for the simple reason that unemployment remains a key concern for households.

In that respect, our forecast is anything but supportive, given that we do not see an end to the rise in the unemployment rate. Job creations should finally outpace job destructions but not enough to compensate the rise in the labor force. Moreover, according to the latest industrial survey, firms consider that they still have unused capacities, meaning that they would not need to hire in response to an increase in demand.

Time to have faith: corporate investment will finally rebound…

In real terms, investment is -9.7% below pre-crisis levels. This deficit is broad-based, echoing throughout all components of investment. First, residential investment by households has declined for 11 consecutive quarters and is now -24% below the previous peak in December 2007. Following a 150% rise in housing prices between 1999 and 2011, a correction has barely begun, as evidenced by the modest -3.7% fall since 2011. Prices-to-income ratios remain close to all-time highs and about 27% above long-term average, pricing most French households out of the market.

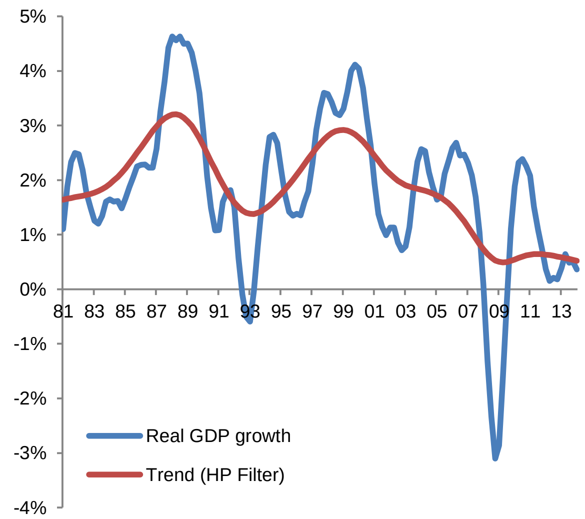
Key economic forecasts

France		poids	2013	2014	2015	2016
GDP		100%	0,4	0,4	1,0	1,4
Consumer Spending		55%	0,3	0,6	1,4	1,5
Public Spending		24%	2,0	1,9	1,5	1,1
Investment		22%	-0,8	-1,6	-0,4	1,3
Stocks	*	0%	-0,2	0,3	-0,1	0,0
Exports		28%	2,4	2,7	4,1	3,6
Imports		29%	1,9	3,8	3,6	3,2
Net exports	*	0%	0,1	-0,3	0,1	0,1
Current account	**		-31	-22,8	-8,2	-5,7
Current account (% of GDP)			-1,4	-1,1	-0,4	-0,3
Unemployment rate			10,3	10,3	10,5	10,3
Inflation			0,9	0,5	0,2	1,0
General government balance	**		-87	-94,3	-91,8	-91,8
General government balance (% of GDP)			-4,1	-4,4	-4,2	-4,1
Public debt (% of GDP)			92,2	95,4	97,7	99,5
Nominal GDP	**		2 115	2 143	2 186	2 239

Change over the period, unless otherwise indicated: * contribution to GDP growth
** euro billions

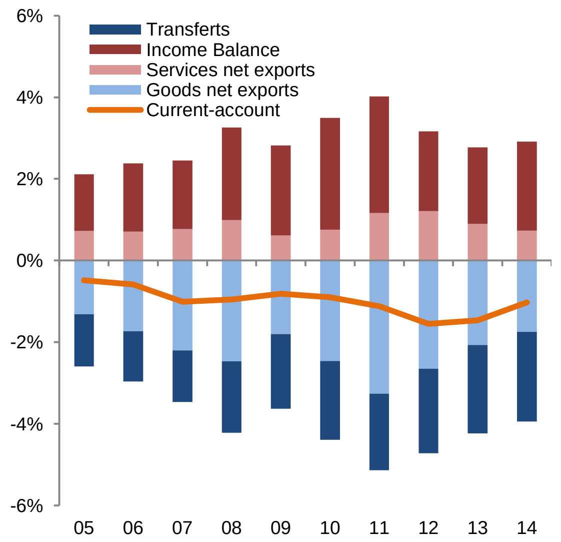
Sources: National statistics, IHS, Euler Hermes

Real GDP growth



Sources: INSEE, Euler Hermes

Current-account balance



Sources: INSEE, Euler Hermes

Second, public investment is falling markedly. As such, orders books in private works are about 1.5 standard deviations below their long-run average, the lowest they have been since 1996.

More worrying though is the lack of corporate investment. Even though we expect it to pick-up slightly, the corporate 'investment-gap' (compared to a pre-crisis trend) will continue to widen in 2015, up to a cumulative EUR 78 billion (or 3.5% of GDP).

…even though nominal growth will remain lacklustre…

The main explanation behind this investment deficit is the lack of aggregate demand stemming from a lackluster nominal growth rate (c. 1.3% in 2014, compared to +4% on average between 2000 and 2008). In turn, low nominal growth translates into barely growing turnovers: since end-2011, the turnover of the manufacturing sector has fallen -0.3%. Still, it should be noted that the revenues of business services firms have grown +2% in 2014. A good omen for 2015?
Turnovers are slowed down by the lack of price pressures in the French economy. The value-added deflator has risen only +3.1% since end 2010: firms cannot price in their products. A good illustration being the *Wholesale and Retail Trade* sector where the deflator has fallen -1% in Q4 2014 vs Q4 13. Surveys point to even lower prices in the coming months.
Further evidence of these developments can be found in the consumer price index, which has fallen -0.4% yoy for the first time since 2009, driven down by the -1.7% yoy fall in the price of manufactured products. All in all, we forecast a **moderate pick-up in Nominal growth** to +1.9%

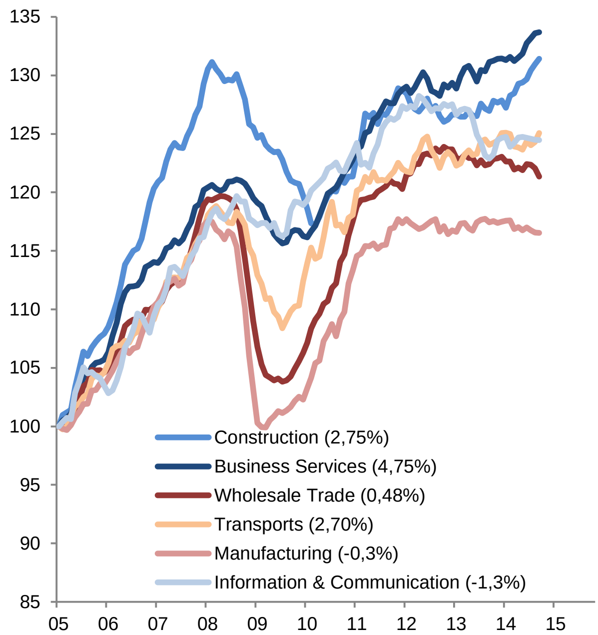
… but external factors will support firms

We expect corporate margins to recover from their current low level, on the back of a moderation in input costs. The CICE will lower labor costs by 2-3% whereas lower oil prices will be a boon to many sectors. We estimate that a sustainable fall of 25% in oil prices could lead to c. 9bn increase in total value-added and an increase of c. 0.35pp in margins, on average. In addition, the responsibility pact will kick in and reduce corporate taxes for small SME (e.g., gradual phasing out of C3S).

Insolvencies are expected to decrease in 2015

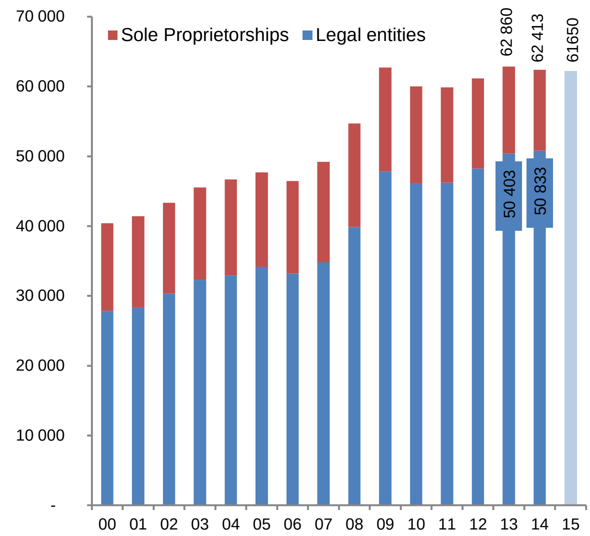
Following a very positive December, the number of insolvencies surprisingly fell in 2014, after a 3 year uninterrupted rise. For 2015, the number of corporate insolvencies is forecast to decrease by c. -1% to around 61 650 cases. However, a worrying trend emerged in the second half of the year: the rise in 'large' insolvencies, which rose +6.8% in H2. This should be monitored closely in 2015.

Turnovers by sectors of activity (% of GDP)



Sources: INSEE, Euler Hermes

Corporate insolvencies



Sources: Euler Hermes

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Country Risk Analyst:
Frederic Andres
frederic.andres@eulerhermes.com