Euler Hermes Economic Research

Country Report

France

A tepid and gradual recovery

General Information

GDP	USD2829.192bn (World ranking 6, World Bank 2014)
Population	66.2mn (World ranking 21, World Bank 2014)
Form of state	Republic
Head of government	François Hollande (President of the Republic)
Next elections	2017, presidential and legislative (National Assembly)

Strengths

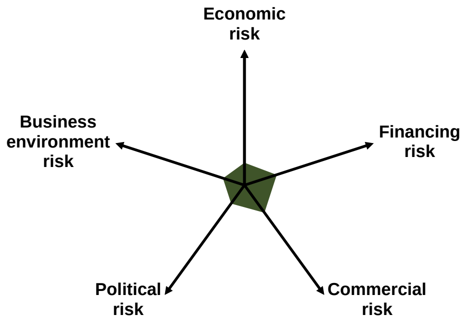
- Dynamic demographics
- Infrastructures (e.g., transport) and public services are of high quality
- Many international corporate giants and a growing presence of technological start-ups (‘French tech’)
- Diversified economy
- Tourism revenues
- Quality education system

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)

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

By product (% of total)

Exports		Rank		Imports
Aeronautics	12%	1	6%	Crude Oil
Pharmaceuticals	6%	2	5%	Cars And Cycles
Toiletries	4%	3	5%	Refined Petroleum Products
Engines	4%	4	5%	Aeronautics
Plastic Articles	4%	5	5%	Pharmaceuticals

Source: Chelem (2014)

Economic Overview

Better late than never !

In 2015, France finally broke out from its frozen spell, growing +1.1%, from +0.4% on average in the previous 3 years. As expected, consumption was the primary driver of growth (+0.8pp). In 2016, the recovery should continue, but at a moderate pace. As such, the French economy is expected to grow by +1.3%. Interestingly, growth will be more balanced because investment will contribute positively for the first time since 2012.

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). The government is trying to address this issue with various laws aiming at deregulating the economy, such as the Macron Act in 2015 and, more recently, the El Khomri Labor Act. However, not unlike what happened with the former, we expect the latter to be watered down in its final form, so that its economic impact will probably prove limited. Moreover, it aims strongly at reducing labor costs but it lacks proposals as regards enhancing the productivity of low-skilled workers through vocational training for instance.

These boosts are made for walking: A positive demand shock backed by a supply-side boost

Aggregate demand took a boost last year, as the oil price slump lifted consumer spending and the recovery in the Euro Area helped the export sector. Moreover, the *policy-mix* became more growth supportive. Fiscal policy was less contractionary, as public investment is no longer falling. Monetary policy was made more accommodative by the ECB, favouring a new decrease in debt costs.

As a result of this friendlier environment, corporate investment has finally picked up, rising +2.8% y/y in Q4. The corporate sector saw also an improvement of its profit margins, increasing by 2 points from its 2014 lows to 31%. The lower oil price helped quite a bit, as well as the lower fiscal burden (CICE impact on labor costs and Responsibility Pact impact on corporate taxes for small SMEs). Investment in construction remained a drag on growth but is expected to land during 2016. Low borrowing costs fuelled housing sales and regulations (Pinel Act) were implemented in order to help rental housing.

Potential growth not so far from stagnation

Private debt is not very high in France. So, with positive net savings (about 3% of GDP each year) and low borrowing costs, the private sector has the possibility to spend more. The reason why the private sector maintains a high saving ratio can be related to the structural fiscal deficit (Ricardian equivalence: "your debt will become my taxes"), but the high unemployment level is also a part of the story for households.

The relative weakness of the export sector during the last ten years can be explained by sectoral reallocations, implying that resources (labour and capital) were mainly allocated to sectors with low productivity growth (e.g. real estate, financial sector) and not to innovative sectors (producing or using new technologies). France was clearly moving down the value chain. The goods produced and exported became less complex, implying a rising number of competitors.

Figure 1 – Key economic forecasts

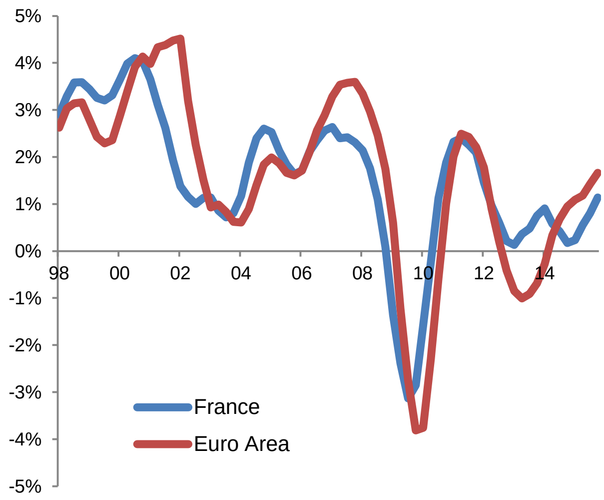
France		Poids	2014	2015	2016	2017
GDP		100%	0,2	1,2	1,3	1,5
Consumer spending		55%	0,7	1,4	1,5	1,6
Public spending		24%	1,5	1,5	1,7	1,6
Investment		22%	-1,2	0,0	2,4	2,4
Stocks	*	1%	0,2	0,3	-0,1	-0,2
Exports		29%	2,4	6,1	4,5	3,4
Imports		31%	3,9	6,7	5,4	3,4
Net exports	*	-2%	-0,5	-0,3	-0,4	-0,1
Current account	**		-19,6	-2,7	-10,5	-16,0
Current account (% of GDP)			-0,9	-0,1	-0,5	-0,7
Unemployment rate			10,3	10,3	10,2	10,0
Inflation			0,5	0,0	0,1	1,7
General govenrment balance	**		-84,8	-77,4	-74,3	-71,7
General govenrment balance (% of GDP)			-4,0	-3,5	-3,3	-3,1
Public debt (% of GDP)			95,2	95,7	96,2	96,4
Nominal GDP	**		2140	2191	2235	2293

*Change other the period, unless otherwise indicated * contribution to GDP growth*

*** euro billions*

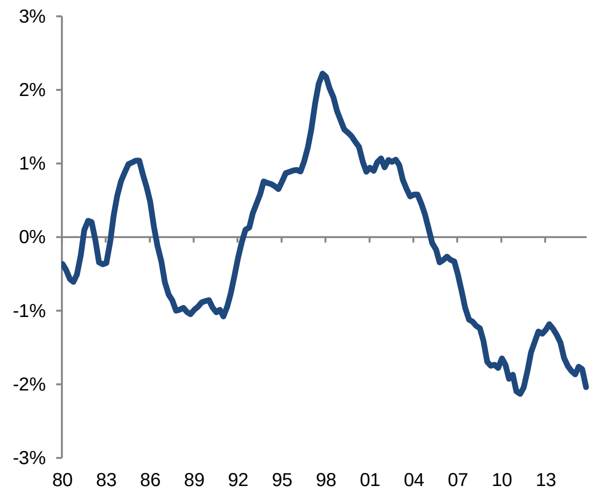
Sources: National sources, IHS, Euler Hermes

Figure 2 – Real GDP Growth



Sources: National sources, IHS, Euler Hermes

Figure 3 – Net exports in volume (% of GDP)



Sources: National sources, Euler Hermes

Low innovation and low productivity gains explained why competitiveness and labour costs became such an issue. As a result, the unemployment rate should not decrease dramatically during the next quarters. A small improvement was seen, but it was mainly through temporary employment, as growth still remains too bumpy and the uncertainties are still too strong.

At the end of the day, potential growth is lacklustre (about 1% per year) and is lower than before the crisis (about 1.5% per year). The cyclical outlook is helped by a negative output gap, but we expect that this output gap will only close in 2020: it means a sluggish growth, a dual job market (with structural unemployment) and no inflation pressures (core inflation is below 1%).

The corporate sector will cope with rebalancing and capital ageing

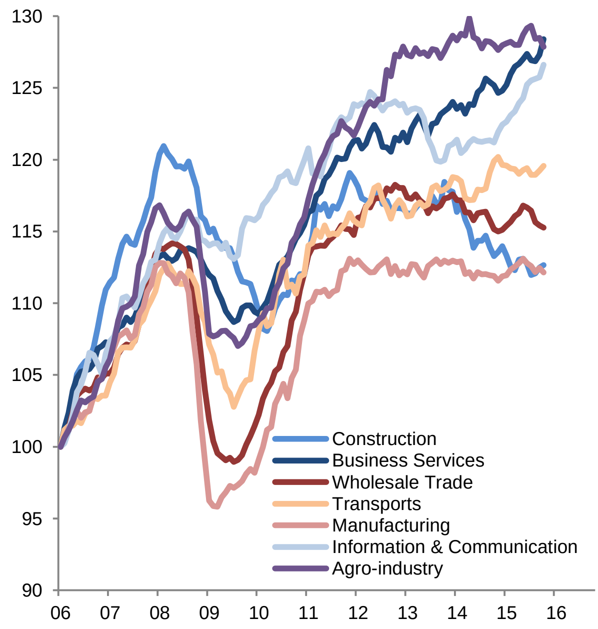
In our view, the recovery of corporate investment is a matter of investment lags accumulated during years of balance sheet recession and opportunities created by the current environment (consumption growth and low interest rates). It doesn't mean that the corporate sector will not try to return to its pre-crisis profit margins' level (32.5% on average), but it will be necessary to cope with capital ageing. In real terms, investment is 8.3% below pre-crisis levels. This deficit is broad-based, echoing throughout all sectors.

Nominal aggregate turnovers remained stagnant in 2015, but we expect more growth in 2016 (about +1%) since the negative inflation shock led by plummeting oil prices is behind us. The sectors related to services should remain the best performers, but other sectors are expected to register a better performance than in 2015. Turnovers growth should prove positive but anaemic in the manufacturing sector, and landing is expected in the construction sector (see Figure 4).

Insolvencies are expected to decrease in 2016

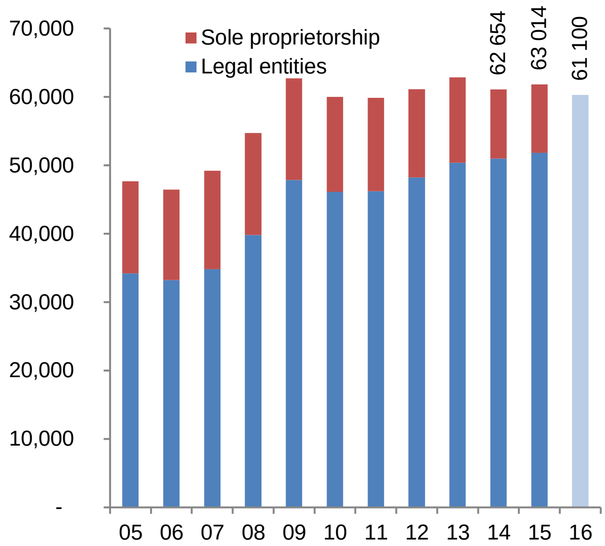
The negative inflation surprise weighed on the number of insolvencies in 2015. As a result, nominal growth was lower than previously estimated and insolvencies increased by +0.6% in 2015. However, we think that a new growth cycle has begun and we expect room for a new decrease in insolvencies in 2016 (-3% from the 2015 level). But, as nominal growth should remain somewhat low during the next years, we don't expect a dramatic decrease thereafter and forecast the number of corporate insolvencies to decrease by 4% to around 58600 cases in 2017 (still 9400 more than in 2007). A strong issue will be the outlook for the construction sector, as it represents about 25% of insolvencies. In the agricultural sector, the number of insolvencies is lower (about 1400 per year) but is the highest on record, as this sector is trapped by persistently low prices.

Figure 4 – Turnover by sector of activity



Sources: National sources, Euler Hermes

Figure 5 – Corporate insolvencies



Sources: IHS, Euler Hermes

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