

## **Euler Hermes: Without the support of inflation, a hesitant recovery is not enough to boost the turnover of French businesses**

**PARIS – 2 JULY 2014** – In its latest economic report, [Euler Hermes](#) the global leader in trade credit insurance provides its macroeconomic forecasts for France and French businesses.

### **1. France will gradually return to growth but this is not strong enough to ensure a real decline in insolvencies**

Euler Hermes growth forecast for 2014 remains unchanged at 0.7%. However, foreign trade statistics for the first-half are disappointing: demand for French goods and services dropped from €19 billion to €14 billion, due mainly to slower growth outside the euro zone in some countries (China, Russia and the United States). The smaller contribution of exports to French GDP was offset by reduced public spending adjustments.

This soft growth will be accompanied by a very limited decline in insolvencies. Euler Hermes forecasts a drop of 1% in 2014, the first in four years. Although insolvencies among businesses with turnover of more than €15 million begin to decline (down by 11.1% year-on-year at the end of May), overall insolvencies remain at a record level.

For 2015, Euler Hermes expects growth to reach 1.2% in France, boosted by a mechanical rebound in consumption and investment, corresponding to a point of equilibrium that could reverse the upward trends in insolvencies and unemployment. In contrast, the fiscal adjustments required under the Stability Pact will wipe out the positive effects of the Responsibility Pact out to 2015. Reducing the public deficit to 3% of GDP currently seems out of reach as it would require additional adjustments of approximately €15 billion, which are certainly not wanted, to achieve this target in 2014. Euler Hermes therefore continues to forecast a public deficit of more than 3.3% this year.

“French businesses are finding it difficult to capture the economic recovery. We can see a slight upturn in activity but growth appears to be blocked by reduced creation of value resulting from disinflation in France and the euro zone,” explains Nicolas Delzant, Chairman of the Board of Management of Euler Hermes France.

### **2. To generate a genuine rebound for French business, inflation would need to double**

Many euro zone countries are currently experiencing disinflation, which is damaging to the real economy and hampers deleveraging, lending to business and competitiveness. Since mid-2012, the euro has appreciated by on average 10% whereas the US dollar has remained stable and the Japanese yen has depreciated by 26%.

Despite recent positive announcements from Germany, the price effect still seems to be missing. Euler Hermes calculates that it would take an additional €2,000 billion in circulation, i.e. the equivalent of France’s GDP, to reverse the present disinflationary tendency.

Despite a slight macroeconomic upturn, the shortfall in money circulation has a major impact for France by hampering growth in business turnover. Price competition has become very stiff and it is becoming increasingly difficult to create value. With forecast growth of 0.7% in real terms (i.e. 1.6% on a nominal basis at the year-end) business turnover will continue to stagnate out to the end of 2014 at approximately +0.4%.

“Only a two-fold increase in inflation (from the forecast level of 0.7% to 1.4% in 2014) would ensure a clear rebound in business growth to 2% in France,” says Ludovic Subran, Euler Hermes’ Chief Economist.



Accordingly, given the weak trend in prices, and forecasts for inflation and growth of respectively 1% and 1.2% in 2015, Euler Hermes predicts turnover growth of just 1.3% for French business. It seems clear that inflation would need to return to between 1.5% and 2% - the average level before the crisis – to ensure a business recovery.

Italy's presidency of the EU could rekindle the debate on a more accommodative monetary policy particularly as Germany is also beginning to feel the effects of disinflation within the euro zone and an overly strong euro outside the zone.

### 3. Three ideas for targeting value creation, even without inflation

The threshold effects linked to a business's size have become a focal point of public policies. Tax disadvantages and limited access to financing are seen as strong brakes on small businesses' capacity to grow bigger (from 9 to 10 employees or from 49 to 50, for example). To accelerate value creation, it seems more effective to target and support young businesses (under five years). There are two reasons for this: their contribution in terms of creating jobs (15% of employment and 22% of net job creations<sup>i</sup>), and their insertion in global and innovative value chains (service companies, French Tech, etc.).

Business competitiveness is of key importance for exports. However, support is still too concentrated on sectors that are sheltered from international competition. In 2014, more than half, i.e. €3.3 billion, of the second portion of the CICE tax credit designed to boost competitiveness will go to sectors with little competition or which are sheltered from competition. Companies that generate a large part of their turnover from export will receive only a small portion (€540 million) of the total CICE amount. France also needs to step up investment to get of the mid-range trap and make its businesses more resilient against countries with cheaper labor costs. Exports are forecast to grow by 2.5% in 2014, in both volume and value, which will not offset the increase in labor costs.

Contrary to other euro zone countries, there doesn't appear to be any constraint on investment loans and cash loans in France. Moreover, the government's creation of a public investment bank and its reflection on how to unlock long-term savings show its determination to deal with the investment shortfall in France. Euler Hermes calculate that corporate investment is still 7% below its pre-crisis high.

"We urgently need to introduce new tools for financing the economy," says Ludovic Subran. "Initiatives such as regional exchanges, incentives for business angels, innovative investment structures, just to mention a few, would trigger a new virtuous investment circle whereas the self-financing rate is set to drop below 60% this year, i.e. 40 points below that of Germany."

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<sup>i</sup> Source « The Dynamics of Employment Growth: New Evidence from 18 Countries », Criscuolo et al (2014)