EULER HERMES
Our knowledge serving your success

Press release

Euler Hermes report: Reflation, rebalance, retrenchment - French election issues after a lost decade

PARIS – 15 MARCH 2017 – According to Euler Hermes, the world leader in credit insurance, the French economy continues to bear the scars of a decade that saw two successive crises. The company identifies the cumulative economic delays that underpin the concerns of French voters.

Overall, growth should accelerate to +1.4% in 2017, after 1.1% in 2016. The increase will be due to its traditional driver, private consumption -- expected to grow +2% and to contribute 1.1 pp to GDP. Household consumption should gain further momentum (+3.6%) in 2017.

"Despite this encouraging dynamic, the French economy continues to experience delays," explains Stéphane Colliac, France economist at Euler Hermes. "The level of public debt, which represents 96.7% of GDP vs 67.4% in 2007, only partially explains what has changed in 10 years."

2006-2016 The stigmata of a loss decade

The French economy is only beginning to recover: in 2015, growth exceeded 1% (1.2%) for the first time in 4 years, benefiting from a recovery private consumption supported by price decreases. In 2016, despite lower growth (+1.1%), the number of growth drivers increased: corporate investment accelerated to 4.2% vs 2015, and household investment returned to growth (+1.5%).

"The gradual return to normality remains too recent to mask the gaps that continue in terms of income, jobs, profits and investment. The decade 20016 – 2016 could be described as a lost decade," declared Ludovic Subran, Euler Hermes chief economist. "This explains in part the global focus on the risk of a disruptive election result in France. In addition, our estimates indicate the markets already fear the election of a president without a parliamentary majority, which would slow the pace of reform. The cost of political uncertainty has added 30 basis points on the cost of financing for France since the beginning of the year."

In 2017 GDP per capita is almost equal to that of 2007, and private sector growth is sluggish - a weak +0.07% per year. The trend is expected to continue through 2017, but the popular national perception is that household income is unchanged over 10 years while prices have increased +12%. This backdrop could fuel reform fatigue.

Despite recent improvements, unemployment in 2016 remained at 10%. Noticeable progress is not expected in 2017 (9.7%) and improvement in industrial strength remains too modest to expect a rapid return to full employment. Companies remain susceptible to shocks and conservative investment strategies; despite an expected -7% improvement in 2017, the level of corporate insolvencies (+49%) remains above 2007 pre-crisis levels.

The financial crises depressed French corporate margins by 3pp between 2007 and the end of 2013 -- to 29.6%. While subsequent favorable events – the oil price slump, government measures – generated a modest recovery. But at 31.3% they remain below the pre-crisis average of 32.5%. It is likely companies will continue to see further improvements, to the detriment of investment.

Corporate balance sheets remain too weak to drive a decisive rebound in investment – despite a +4.2% increase in 2016. – The corporate sector is losing production capacity and struggles with tax levels equivalent to 60% of gross profits (vs the 40% OECD average). To correct the issue, without creating debt, public expenditures need to decline: they represent 57% of GDP in France, vs an average of 49% across the Eurozone.

Reflation, Rebalancing and Retrenchment
According to Stéphane Colliac, the potential frameworks of post-election French economic policies can be summarized as 'the 3Rs':

- Reflation (increasing prices and salaries)
- Rebalancing (turning savings into investment, generating yields) and
- Retrenchment (from Europe).

1. Reflating the economy for higher income growth and increased purchasing power

In 2016, corporate results improved by only 0.3%. In that period, wage increases remained relatively constrained. In the public sphere, the desire to reduce debt has also had a moderating effect on wages. Household purchasing power is impacted, particularly for modest income households.

"With the decline in oil prices, we saw an improved purchasing power generating demand. Increased disposable household income, whether through lower taxes or higher wage increase, could support growth. Labor market reform and a clear unleashing of growth in protected sectors could kick-start the economy," explained Ludovic Subran.

2. Rebalance the French economy to raise competitiveness, reduce fiscal and trade deficits, and improve taxation.

French structural reforms are long overdue. Public spending declined by 3.25 of GDP in 2016 (vs 5.1% in 2011) and measures were taken to limit rising labor costs. Nonetheless, full-time employment continued to decline. Leveling the playing field with other Eurozone countries will be difficult without public spending cuts and labor market reforms. Increased competitiveness would help produce more growth, budgetary maneuvering room and employment through revitalized production.

3. Retrenching from Europe – a necessary evil?

After years of weak growth, the global economy is challenged by the temptations of isolationism. The first wave of globalization brought cheaper goods and services to all, and a positive impact on household purchasing power. The second wave produced job outsourcing and inequalities, while preserving a positive aggregate GDP impact. Many options exist to resolve the issues, but the temptation to retrench continues to increase globally. The EU has been blamed for many of problems of the industrial sector in France. Without going to the extremes of a "Brexit", the concept of redesigning Europe exists on several electoral campaign platforms.

Read the full report

# # #

Media Contacts

Publicis Consultants
Romain Sulpice +33 (0)1 44 82 46 21
romain.sulpice@mslfrance.com

EULER HERMES
Our knowledge serving your success