

## Here comes the rooster

### General Information



<b>GDP</b>	USD2418.836bn (World ranking 6, World Bank 2015)
<b>Population</b>	66.8mn (World ranking 21, World Bank 2015)
<b>Form of state</b>	Republic
<b>Head of government</b>	François Hollande (President of the Republic)
<b>Next elections</b>	2017, presidential and legislative (National Assembly)



### Strengths

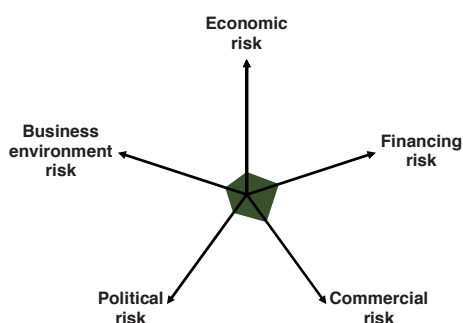
- Dynamic demographics
- High quality infrastructures (e.g., transport) and public service
- Large number of corporate giants with a global presence and a growing presence of technological start-ups ('French tech')
- Diversified economy
- Tourism revenues

### 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 de-industrialisation 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	14%	15%
United States	8%	9%
Spain	6%	8%
United Kingdom	6%	6%
Italy	6%	6%

By product (% of total)

Exports	Rank	Imports
Other transport equipment	16%	10%
Road vehicles	8%	9%
Miscellaneous manufactured articles, n.e.s.	7%	8%
Medicinal and pharmaceutical products	5%	7%
Electrical machinery, apparatus and appliances, n.e.s.	5%	5%

Source: UNCTAD (2015)

## History repeating

France entered a new growth cycle in 2015 after growth reached +0.4% on average in the previous three years. Yet performance in every year from 2015 to 2018 has been – or is expected to be – similar. No dramatic acceleration is in sight.

Volatility is explained by sectoral specificities. For example, in 2016, agricultural production tumbled by -6% due to bad weather and subtracted -0.2pp of the country's GDP growth.

Thus, growth is roughly stable. The drivers may change, but not the performance.

Hence, despite a good cyclical juncture, growth remains far below what is needed to stabilize the public debt ratio and to rapidly close the gaps caused by the crises:

- France's economy lost volumes: (i) Unemployment peaked in 2015 at 10.4% and only marginally decreased afterward; (ii) Corporate insolvencies (see next page) were up +49% from pre-crisis lows as of end 2016.
- What you put (invest) is what you get (income): (i) Corporate investment was only marginally higher (+3%) from pre-crisis levels in real terms (end of 2016). (ii) GDP per capita (see chart) in 2016 roughly equalled its 2007 level. This entails stalled income in real terms. Lower aggregate income level growth also means that both household wage growth and corporate profit margins are lower in terms of value.

People perceive such gaps. The result is discontent, which cannot be offset by recent cyclical improvements.

## Whenever, wherever

Since what we see is a growth cycle, investment is progressively recovering. Spare capacities and inventories decreased, particularly in the housing market. Unemployment angst is much lower since the jobs market improved.

As a result, households are keen to increase spending. This renewed appetite applies to durable goods, as shown by the oil price dividend, while residential investment is set to recover (+3.6%, 2017 forecast).

As current policies will continue to yield long-term results, France is on track to close the gaps described above – first and foremost the negative output gap.

## Supermassive black hole

Tackling the key weakness of the French economy is long overdue, despite some efforts at improving competitiveness ("Pacte de responsabilité", CICE).

The 2016 trade balance deficit – roughly -3% of GDP in volumes – is the worst on record (see chart). Exceptional factors, such as agricultural exports being hit by output loss and airbus exports losses, made things worse. But the trend is clear.

In the 1990's, growth recovered after a decisive rebalancing of the economy. That was not the case this time. Labour costs deteriorated for a long period, implying deindustrialization.

Then there is *hysteresis*: Fresh efforts to contain labor costs such as the "Pacte de responsabilité", and CICE were a case of too-little-too-late. Too many plants simply already left the country.

Figure 1 – Key economic forecasts

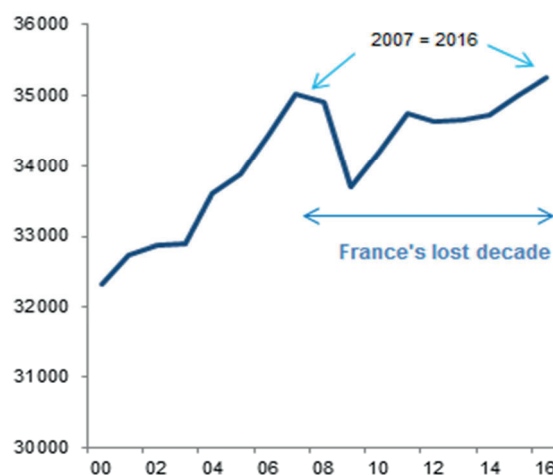
Key indicators	2015	2016	2017	2018
GDP	1.2	1.1	1.4	1.3
Consumer spending	1.5	1.8	2.0	1.8
Public spending	1.4	1.5	1.8	1.5
Investment	0.9	2.8	2.2	2.2
Stocks	*	0.1	0.0	0.0
Exports	6.0	0.9	3.7	5.0
Imports	6.4	3.6	5.3	6.8
Net exports	*	-0.3	-0.9	-0.8
Current account	**	-4.4	-26.6	-31.0
Current account (% of GDP)		-0.2	-1.2	-1.4
Unemployment rate	10.4	10.0	9.7	9.3
Inflation	0.0	0.2	1.1	1.5
General government balance	**	-76.5	-71.3	-70.2
General government balance (% of GDP)		-3.5	-3.2	-3.1
Public debt (% of GDP)		96.2	96.7	97.0
Nominal GDP	**	2 81	2222	2273
			2328	

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

\*\* euro billions

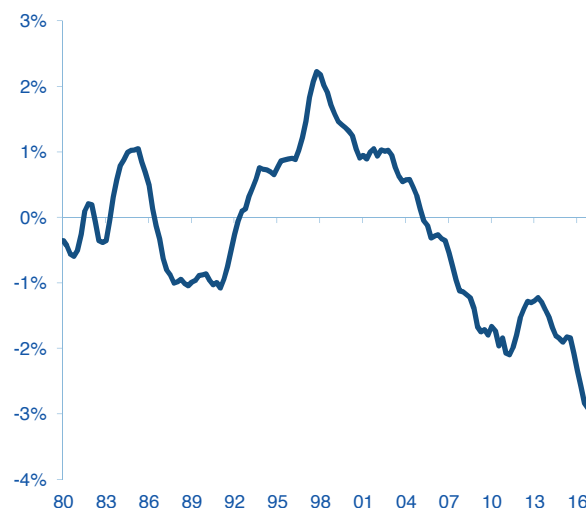
Sources: National sources, IHS, Euler Hermes

Figure 2 – GDP per capita, constant prices



Sources: National sources, IHS, Euler Hermes

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



Sources: National sources, Euler Hermes

Subdued innovation and low productivity gains also explain why potential growth suffered. The financial sector, particularly real estate, has served as the main driver over the last decade.

In other words, a wealth effect has benefitted households. The latest Allianz Wealth Report shows that France's middle class has seen the biggest rise in wealth during the last fifteen years.

Things are no different this time around. As a new housing cycle begins, growth may speed up. But its quality will not be improved by this process. In fact, the external deficit will probably deteriorate further along any growth acceleration.

### Sweet dreams: the corporate sector saw its financial situation improving

In our view, the recovery of corporate investment stems from investment lags accumulated over years of balance sheet recession. It is also the result of opportunities created by the current environment (consumption growth and low-interest rates).

This doesn't mean that the corporate sector will not strive to return to pre-crisis profit margins (32.5% on average, 31.3% currently). Yet it will be necessary to cope with capital aging. In real terms, corporate investment is still stuck at pre-crisis levels. This broad-based deficit's impact is felt across all sectors.

Nominal aggregate turnovers remained stagnant in 2016 (+0.3%). Yet we expect more growth in 2017 (about +1.4%) since the negative inflation shock caused by plummeting oil prices is over. Services-related sectors should remain the best performers.

But other sectors are expected to perform better than in 2015. Turnovers growth should prove positive but anemic in the manufacturing sector. The construction sector would not fare much better (see chart).

### Under pressure: corporates are still exhibiting high levels of insolvencies

Insolvencies are forecast to decrease in 2017 by -7%. 2016, with similar figures, was the first year of improvement. However, by the end of 2016, business insolvencies were still +24% above pre-crisis levels. Moreover, considering only corporates, the gap stood at a staggering +49%.

Not only the insolvencies levels in France are very high, the average two-year period required to resolve bankruptcy cases is far longer than in other European economies (one year in the UK, 1.2 in Germany).

The outlook for the construction sector is of critical importance, as it accounts for about a quarter of insolvencies. In the agricultural sector, the number of companies going bust is lower but is the highest on record (1480 in 2016). The sector suffers from persistently low prices.

Figure 4 – Turnover by sector

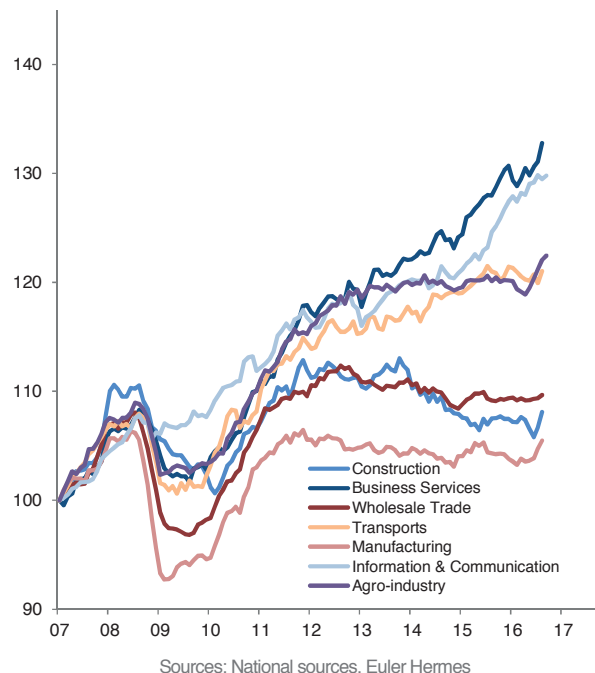
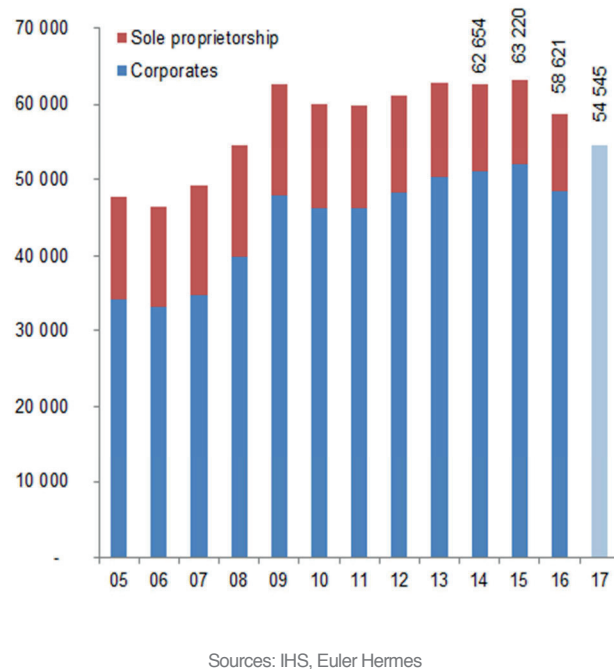


Figure 5 – Business insolvencies



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