BNP PARIBAS

The bank for a changing world

Eco FLASH

ECONOMIC RESEARCH DEPARTMENT

Overview of the French economy

- The French economy now seems to be in better shape than it was five years ago, but the improvement has been limited.
- Growth has picked up, but still lacks vigour. Although progress has been made to boost competitiveness, the country still has a long way to go. The fiscal deficit continues to be reduced, and the unemployment rate has finally begun to decline. Yet given the slow pace of adjustments, both indicators are still high.
- According to the European Commission, these imbalances are gradually being corrected, to the point that in 2018, France's status could be revised from "excessive imbalances" to "imbalances", and the country will probably exit the excessive deficit procedure.

Since early 2013, the French economy has been slowly recovering. This turnaround goes beyond a cyclical improvement and a simple return to growth, which is still not very high. Fundamental improvements are also taking place, in terms of competitiveness, public finances and the labour market, although these positive signs still need to be confirmed and accentuated. This article will present an overview of the current state of the French economy at the start of a new administration. We only intend to provide a broad outline of the situation, and will provide a more in-depth analysis in our next issue of *Conjoncture*.

Growth recovers, but lacks vigour

Over the past nine years (2008-2016), the main characteristic of French growth has been its sluggishness, although it also stands out for its resistance to shocks, from the 2008 financial crisis to the European sovereign debt crisis of 2011-2012. Between 2008 and 2016, real GDP in France rose at an average annual rate of 0.6%, the slowest pace for such a long period in the entire post-war period. Yet this figure is skewed downwards by the two years of recession in 2008 and 2009. Looking only at the period 2010 to 2016, annual growth averaged 1.1%. Yet if we zoom further on 2012-2016, the specific review period of this article, growth averaged 0.8%. This reflects the weak performances in 2012 and 2013, with average annual growth of 0.2% and 0.6%, respectively, followed by a rebound over the next three years (1% in 2014 and 2015, 1.1% in 2016).

■ GDP

GDP in volume, Q1 2008 peak = 100

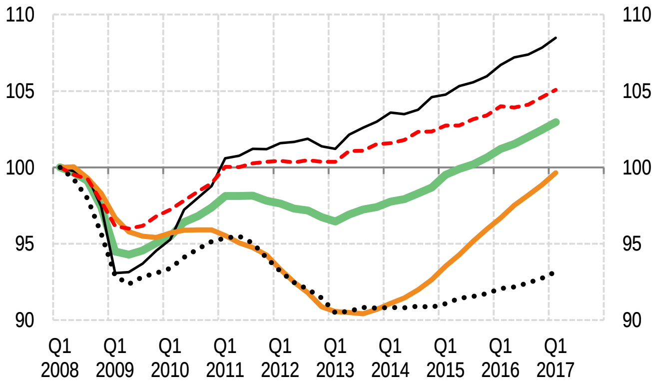

Chart 1 Sources: INSEE, Eurostat

We will begin by looking at the positive aspects of France's economic performance (see chart 1). The first observation is that the 2008-2009 recession was less severe in France than in the Eurozone: in 2009, GDP contracted at an average annual rate of 2.9% and 4.5%, respectively. It was followed by a robust recovery in France (1.9% in 2010, 2.1% in 2011), but this momentum was cut short in Q2 2011 by the European sovereign debt crisis. The average annual growth rate for 2011 is therefore misleadingly high: it was lifted solely by very strong growth in Q1 2011 (+1.1% q/q, +2.9% y/y), before slowing down sharply thereafter due to the impact of the sovereign debt crisis.

Our second positive observation is that the French economy managed at that time to avoid relapsing into recession. French GDP managed to only stagnate between Q2 2011 and Q1 2013[1], while Eurozone GDP declined 0.2% per quarter on average over the period. Our third favourable observation derives from the first two: French GDP returned to pre-crisis levels in early 2011, while the Eurozone one failed to do so until Q3 2015.

[1] Official trough date by the Centre for Economic Policy Research.

Although French GDP is now significantly higher than its pre-crisis level (by about 5%), other indicators illustrate the sluggishness of French growth. Per capita GDP did not rise above its pre-crisis level until 2016, and by only 1%. Industrial production, a much narrower but also symbolic indicator, is still 12% below its pre-crisis level. In the Eurozone, this shortfall is much smaller at 7%. The Eurozone's less negative performance is nonetheless due to Germany, where production has returned to the pre-crisis level (albeit without exceeding it). In Italy and Spain, production is still well below pre-crisis levels by 20% and 24%, respectively (based on data available through March 2017).

Although less blatant, the current sluggishness of growth also can be seen by comparing growth rates with previous recoveries. If we take 2013 as our starting point, when France exited a period of stagnation and the Eurozone pulled out of its double-dip, the recovery is already four-years old. Over this 16-quarter period (Q2 2013 to Q1 2017), French quarterly growth averaged 0.3% (which masks a rather bumpy growth profile, with no signs of acceleration over the quarters). This pace is a pale comparison to the figures reported in the 1970s (quarterly growth averaged 0.9% over the same period), although the differential narrows to only 0.1 point in more recent cycles (1980s, 1990s and 2000s), when quarterly growth averaged 0.4%, reflecting the trend towards slower growth.

Another indicator of sluggish French growth is the output gap. It is still significantly negative [2], and does not seem to be closing. For the past three years (2014-2016), effective growth has barely matched potential growth (estimated at 1-1.1% by the European Commission), unlike the Eurozone, where effective growth (average annual rate of 1.6% in 2014-2016) was significantly higher than potential growth (1%). As a result, the output gap in the Eurozone is closing rapidly (see chart 3).

France's negative growth differential with the Eurozone is the last illustration of its sluggishness. First appearing in 2014, the differential is big (1 point in 2015, 0.6 points in 2016). Granted, there is nothing unusual about this situation. Between 2006 and 2008, France already underperformed the Eurozone by a similar margin (see chart 4).

The big question is whether the current situation will prevail. At what point is the previous norm discredited, when the growth differential was slightly in France's favour (by an annual average of 0.2 points from 1996 to 2013)? The answer is not clear-cut. In recovery phases, France is usually handicapped by its less cyclical nature. Yet at the same time, the Eurozone's stronger performance is mainly fuelled by Spain's catching up movement. When this movement will have run its course, Spanish growth will lose momentum. France's growth, unlike the Eurozone, still seems to have the potential to accelerate. In our latest set of economic forecasts, we estimate that the growth differential will narrow to 0.3 points in 2017 (annual growth is expected to average 1.6% in France and

Breakdown of French GDP growth

Contribution to growth of the components of GDP, percentage points, annual average

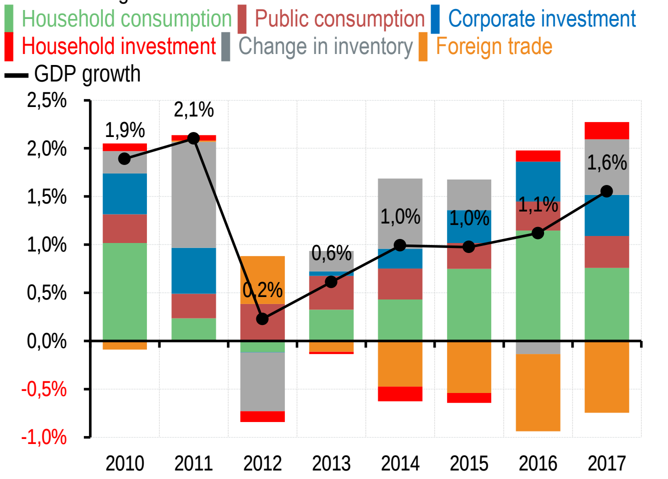

Chart 2 Sources: INSEE, BNP Paribas estimates

Output gap

%

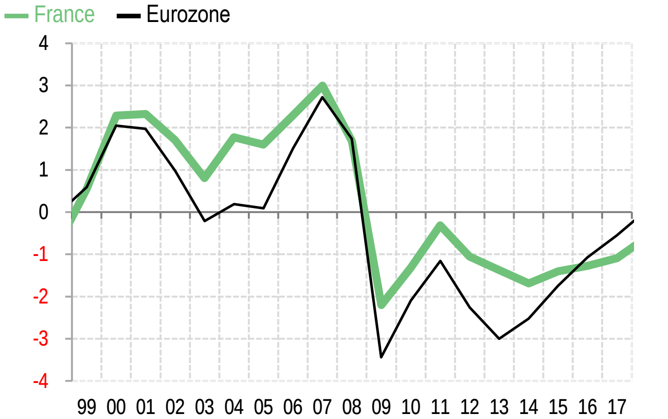

Chart 3 Source: European Commission

Growth

Year-on-year, %

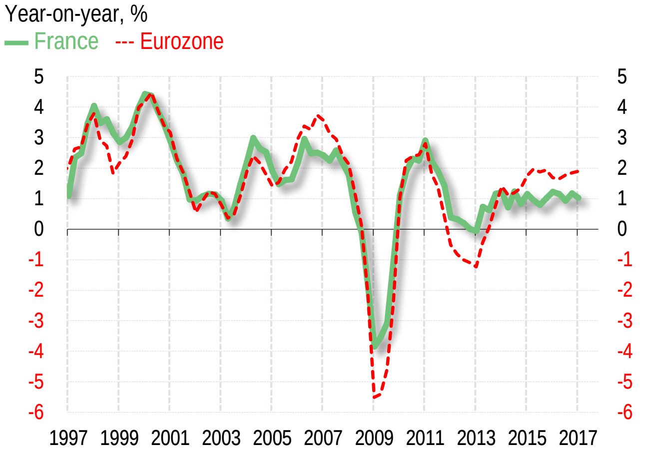

Chart 4 Sources: INSEE, Eurostat

[2] The negative output gap is estimated at 2% by the IMF and 2.3% by the OECD, compared to 1.3% for the European Commission.

Economic scoreboard for France

	Indicator	Threshold	2007	2012	2015	2016
External imbalances and competitiveness	Current account balance, 3-year average, % of GDP	-4/+6%	-0.1	-1.0	-0.7	-0.7
	Net external position, % of GDP	-35%	-8.9	-12.8	-16.4	-15.8
	Real effective exchange rate, 3 years % change	+/-5%	-1.6	-7.8	-2.7	n.a.
	Export market share, 5 years % change	-6%	-17.0	-18.0	-5.4	-2.1
	Nominal unit labour costs, 3 years % change	+9-12%	+5.7	+4.4	+2.5	+2.1
Internal imbalances	Deflated house prices, % year-on-year change	+6%	+3.6	-1.9	-1.3	+1.0
	Private sector credit flow, % of GDP	+14%	11.2	4.4	4.4	n.a.
	Private sector debt, % of GDP	+133%	115.6	138.5	144.3	n.a.
	Public debt, % of GDP	+60%	64.3	89.5	96.2	96.0
	Total financial sector liabilities, % year-on-year change	+16,5%	+12.6	+1.2	+1.8	n.a
	Unemployment rate, 3-year average	10%	8.6	9.4	10.3	10.3
	Participation rate (15-64 age group), 3 years change, in percentage points	-0,2%	-0.1	+0.4	+0.8	+0.6
	Long-term unemployment rate, % of labour force, 15-74 age group, 3 years change in percentage points	+0,5%	-0.3	+0.7	+0.6	+0.3
	Youth unemployment rate, % of labour force in 15-24 age group, 3 years change in percentage points	+2%	-0.9	+0.8	+0.3	-0.3

Table 1

Sources : INSEE, Commission européenne

1.9% in the Eurozone) before closing the gap in 2018 (average growth of 1.6% in both France and the Eurozone).

France's sluggish performance in 2012 to 2016 can be attributed to a combination of cyclical factors, temporary shocks and structural hindrances. To summarise, three factors had a particularly big impact: fiscal consolidation, the loss of impetus in emerging countries, and the construction sector crisis. These negative factors offset external support factors (ECB monetary stimulus and the decline in oil prices and the euro) as well as domestic factors (notably measures to reduce labour costs), against a backdrop hampered by the structural weaknesses of the French economy.

Imbalances straining the economy: an overall assessment

In its latest in-depth review of the French economy, published in February 2017, the European Commission reviewed these weaknesses and reported on the country's progress. France is subject to an in-depth review because it has been identified as a country with excessive macroeconomic imbalances. To summarize using the Commission's own words, these imbalances *"related to a weak competitiveness and a high and increasing public debt, in a context of low productivity growth. Other vulnerabilities were identified, including as regards the segmentation of the labour market, the innovation capacity, the limited efficiency of public spending and the complex tax system, which weighs significantly on production factors"*. An aggravating factor, given the size of the French economy and its strong commercial and financial integration with the rest of the Eurozone: *"these vulnerabilities have cross-border relevance"*. In other words, France is *"a potentially important source of (negative) spillovers for several other Member States"*.

Assessing the progress that has been made to correct these excessive imbalances, the European Commission notes that *"a certain number of economic developments and reforms implemented suggest that they are in the process of a gradual correction."* If this progress is confirmed, the Commission even raises the possibility that France's status could be revised from "excessive imbalances" to "imbalances" in the next review in 2018. The country is also likely to exit the excessive deficit procedure, assuming the government manages to uphold the commitment to lower the fiscal deficit below 3% of GDP in a lasting manner in 2017.

Although the Commission recognises that progress has been made towards its 2016 country-specific recommendations, it immediately qualifies them as follows:

- *Limited progress* in terms of spending savings, corporate tax reductions, streamlining the tax structure and improving the efficiency of public innovation policy.
- *Some progress* in terms of ensuring that minimum wage developments are consistent with job creation and competitiveness, vocational training, removing certain barriers to activity in the services sector, and simplifying and modernising the fiscal system (introduction of a withholding tax on personal income).
- *Substantial progress* in terms of ensuring that labour cost reductions are sustained, and providing incentives for employers to hire on open-ended contracts (thanks to the El Khomri labour law).
- *No progress* on two recommended reforms: unemployment benefits system[3] and size-related criteria in corporate regulations.

Table 1 lists the indicators monitored by the Commission to quantify these imbalances, and flags the figures falling outside

[3] After the setback in June 2016, negotiations on a new agreement re-opened in early March 2017 and were completed in the same month, after the Commission published its assessment.

of the MIP thresholds in orange[4]. In 2015, the reference year for the Commission's in-depth review, four out of fourteen indicators exceeded the MIP thresholds: significantly so for private debt and public debt, moderately so for the unemployment rate, and just barely for the long-term unemployment rate, which dropped back below the alert threshold in 2016. The public debt ratio has been above 60% since 2003, and private debt has been in warning territory since 2011. The unemployment rate moved into the danger zone more recently, in 2014. These unfavourable trends are countered by one remarkable development: the export market share indicator no longer exceeds the threshold for the first time since 2001 (earliest available statistic).

Although well above the MIP threshold, the high private sector debt ratio is not considered to be an excessive imbalance. Despite the size of liabilities, in particular for non-financial companies (NFC), equally large assets serve as a guarantee. In the Commission's eyes, the high debt burden of French NFCs is therefore not particularly risky. Yet its steady growth since 2006 is noteworthy, especially since 2009, the year when the trend began to reverse at the Eurozone level, i.e. pointing to a deleveraging of NFC (see chart 5), driven largely by Spain, and to a lesser extent by Italy and Germany. For the first time, the debt ratio of French NFCs is now higher than the Eurozone average. This trend, assuming it lasts, combined with the persistently low profitability of French NFCs, is a potential source of concern for the Commission.

Competitiveness, public finances, and the labour market: what progress has been made?

In this section we will examine in greater detail the progress that has been made on three major areas of reform for the French economy: competitiveness, public finances and the labour market.

We will begin with the one that has advanced the most, competitiveness. There has been definite progress, but it is still incomplete. We highlight here three points of improvement. The most visible is the upturn in NFC profit margins, which have regained a little more than 2 points from a Q3 2013 low of 29.7%. At nearly 32% now, they are still 1 point below their pre-crisis average. The second point of improvement, and a component of the first, is the slower pace of unit labour costs, which slowed from an average annual rate of 1.9% between 2000 and 2010 to 1.1% between 2011 and 2016.

In terms of cost competitiveness, although France has posted gains relative to Germany, where unit labour costs accelerated between the two periods (to an annual average of 1.8%, from 0.8%), it continued to lose ground relative to Spain, where unit labour costs dropped even more sharply (from +2.8% to -0.8%). Compared to the Eurozone as a whole, France's cost-competitiveness continued to deteriorate slightly (see chart 6).

[4] Unlike the public deficit threshold of 3%, which automatically triggers the opening of excessive deficit procedures, the thresholds for a procedure for macroeconomic imbalances are not critical: they simply indicate a threshold that it is best not to exceed.

Private debt

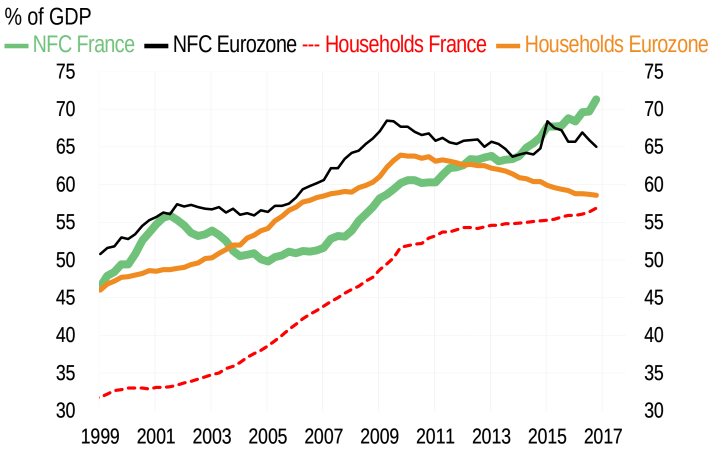

Chart 5 Source: Banque de France

Unit labour costs

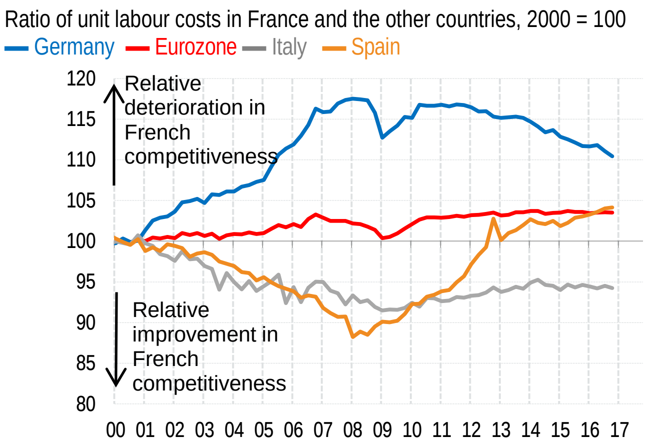

Chart 6 Source: OECD

The third area of improvement is the significant slowdown in the loss of export market share. Even so, there is still a long road ahead before France regains market share, assuming that is even possible, and reduces its structural trade deficit. That will also depend on improving non-cost competitiveness, a field where signs of improvement are hardly visible today.

France has also made some progress in reducing its fiscal imbalances, but the results are more mixed. The deficit has been cut sharply (from -7.2% of GDP in 2009, to -3.4% in 2016), but it is still very high in absolute terms, and relative to the Eurozone average, which has narrowed to 1.5% of GDP (see chart 7). France has made a major commitment to return below the 3% threshold in 2017 and to maintain the deficit below this level, but it will be a hard pledge to keep. Since 2014, fiscal consolidation has barely advanced because of the combination of austerity measures (freeze on some government's areas of spending, cutbacks in transfers to local governments, etc.) and stimulus measures (jobs plan, tax cuts, etc.). As a result, the deficit is still high. The distinguishing feature of the half-point reduction in the deficit in both 2015 and 2016 is that it was obtained through cutbacks in public spending as a share of GDP (-0.6 points), although revenues also declined (0.1 points).

Yet each of these factors still has a high weighting (56.4% for public spending, 53% for revenues, and a high compulsory tax rate of 44.4%). The sustainability of the deficit reduction also raises question because it is based more on temporary factors (easing of debt servicing charges due to sharply lower interest rates; decline in investment spending by local administrations) rather than structural ones. Lastly, and most importantly, the public debt ratio continues to rise, albeit at a slower pace, whereas in the Eurozone, this trend as already reversed course since 2015.

The least progress has been made in terms of the job market. Granted, some improvements have been taking shape since 2015, in terms of job creations (+351,000 between Q2 2015 and Q1 2017 for the non-farm payroll sector) and decline in the unemployment rate (-0.9 points over the same period). There was also a remarkable improvement in the job content of growth. In 2016, employment increased at the same pace as GDP (+1.1%), the strongest increase since 2007, a year of much more buoyant GDP growth (+2.3%). Yet these trends are also accompanied by squeezing labour productivity gains. And despite this favourable momentum, employment is still slightly lower than its pre-crisis peak (by 1.3%). Another positive factor worth noting is the turnaround in the Dares job market tension indicator[5]. It means that job seekers are unlikely to remain as long in unemployment. Last, in Q1 2017, the unemployment rate finally fell well below the symbolic level of 10% (to 9.6% of the labour force). Though still high, this is the lowest level since early 2012.

We would also like to highlight the belated, slow pace of the improvement on the unemployment front. In the Eurozone indeed, the unemployment rate began to decline in mid-2013, and has fallen faster (-1.6 points since the French unemployment rate began to decline in Q2 2015, and down 2.6 points since the Q2 2013 peak of 12.1%). As to the long-term unemployment rate, the decline in France is even more recent (mid-2016) and milder (-0.2 points to 4.1% in Q1 2017). Although underemployment seems to have levelled off (at 6.2% of employed persons), the unemployment halo continues to spread[6].

The number of Category A jobseekers registered with Pôle Emploi (i.e. that have not had any work over the past month) began to reverse itself in late 2015 and early 2016, and the decline has been even milder still: from 3.6 million in October 2015, it was still holding at 3.5 million in April 2017[7]. There is still a long road ahead before the number of jobseekers drops below the 3 million threshold and returns to the 2012 level. The threshold of 2 million unemployed -- the low point reached in 2008 – seems even further off. We are also still waiting for the early signs of improvement to take root and to grow sufficiently to cut into the structural component of unemployment (see chart 8).

Public finances

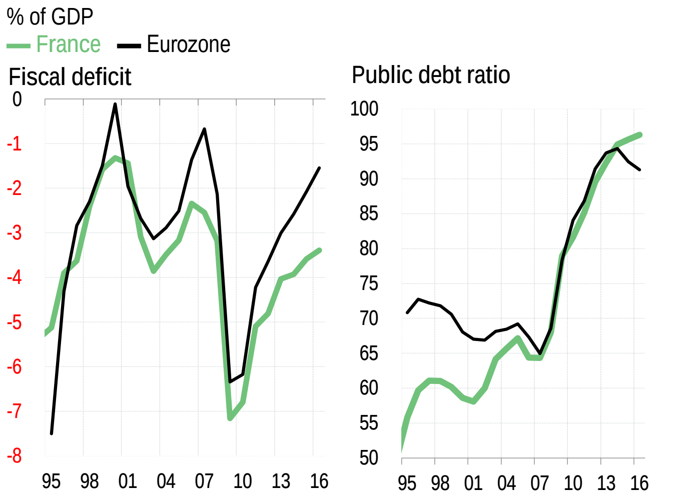

Chart 7 Sources: INSEE, European Commission

France: Unemployment rate

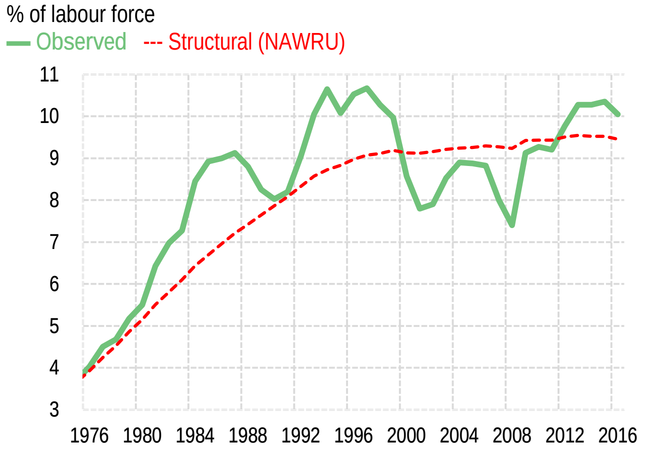

Chart 8 Sources: INSEE, European Commission

Hélène Baudchon
helene.baudchon@bnpparibas.com

[5] Ratio between job offers received and jobs wanted registered by Pôle Emploi.

[6] Underemployment concerns part-time workers who would like to work longer hours, and those who are involuntarily working fewer hours than usual (notably partial unemployment). The unemployment halo comprises people who are not considered unemployed because they do not meet all of the ILO criteria (to be without work, available to work within two weeks, and actively seeking work).

[7] All categories combined (A, B, C, D, and E), the number of job seekers reaches 6.6 million and is only just beginning to level off.

BNP PARIBAS

The bank for a changing world

Group Economic Research

- **William DE VIJLDER** +33(0)1 55 77 47 31 william.devijlder@bnpparibas.com
  Chief Economist

ADVANCED ECONOMIES AND STATISTICS

- **Jean-Luc PROUTAT** +33.(0)1.58.16.73.32 jean-luc.proutat@bnpparibas.com
  Head
- **Alexandra ESTIOT** +33.(0)1.58.16.81.69 alexandra.estiot@bnpparibas.com
  Works coordination - United States - United Kingdom - Globalisation
- **Hélène BAUDCHON** +33.(0)1.58.16.03.63 helene.baudchon@bnpparibas.com
  France (short-term outlook and forecasts) - Labour markets
- **Frédérique CERISIER** +33.(0)1.43.16.95.52 frederique.cerisier@bnpparibas.com
  Euro Area (European governance and public finances), Spain, Portugal
- **Thibault MERCIER** +33.(0)1.57.43.02.91 thibault.mercier@bnpparibas.com
  Euro Area (short-term outlook and monetary policy), France (structural reforms)
- **Catherine STEPHAN** +33.(0)1.55.77.71.89 catherine.stephan@bnpparibas.com
  Nordic countries - World trade - Education, health, social conditions
- **Raymond VAN DER PUTTEN** +33.(0)1.42.98.53.99 raymond.vanderputten@bnpparibas.com
  Germany, Netherlands, Austria, Switzerland - Energy, climate - Long-term projections
- **Tarik RHARRAB** +33.(0)1.43.16.95.56 tarik.rharrab@bnpparibas.com
  Statistics and Modelling

BANKING ECONOMICS

- **Laurent QUIGNON** +33.(0)1.42.98.56.54 laurent.quignon@bnpparibas.com
  Head
- **Céline CHOULET** +33.(0)1.43.16.95.54 celine.choulet@bnpparibas.com
- **Thomas HUMBLOT** +33.(0)1.40.14.30.77 thomas.humblot@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

- **François FAURE** +33.(0)1 42 98 79 82 francois.faure@bnpparibas.com
  Head - South Africa,Argentina - Methodology
- **Christine PELTIER** +33.(0)1.42.98.56.27 christine.peltier@bnpparibas.com
  Deputy Head - Greater China, Vietnam, other North Asia countries - Methodology
- **Stéphane ALBY** +33.(0)1.42.98.02.04 stephane.alby@bnpparibas.com
  Africa (French-speaking countries)
- **Sylvain BELLEFONTAINE** +33.(0)1.42.98.26.77 sylvain.bellefontaine@bnpparibas.com
  Turkey, Brazil, Mexico, Central & South America - Methodology
- **Pascal DEVAUX** +33.(0)1.43.16.95.51 pascal.devaux@bnpparibas.com
  Middle East, Balkan countries, Nigeria, Angola - Scoring
- **Anna DORBEC** +33.(0)1.42.98.48.45 anna.dorbec@bnpparibas.com
  CIS, Central European countries
- **Johanna MELKA** +33.(0)1.58.16.05.84 johanna.melka@bnpparibas.com
  Asia, Russia
- **Alexandra WENTZINGER** +33.(0)1.42.98.74.26 alexandra.wentzinger@bnpparibas.com
  Chile, Uruguay, Paraguay

- **Michel BERNARDINI** +33.(0)1.42.98.05.71 michel.bernardini@bnpparibas.com
  Public Relation Officer

The bank
for a changing
world

OUR PUBLICATIONS

CONJONCTURE

Structural or in news flow, two issues analysed in depth

EMERGING

Analyses and forecasts for a selection of emerging economies

PERSPECTIVES

Analyses and forecasts for the main countries, emerging or developed

ECOFLASH

Data releases, major economic events. Our detailed views...

ECOWEEK

Weekly economic news and much more...

ECOTV

In this monthly web TV, our economists make sense of economic news

ECOTV WEEK

What is the main event this week? The answer is in your two minutes of economy

You can read and watch our analyses
on Eco news, our iPad and Android application

http://economic-research.bnpparibas.com

Prepared by Economic Research – BNP PARIBAS
Registered Office: 16 boulevard des Italiens – 75009 PARIS
Tel : +33 (0) 1.42.98.12.34
Internet : www.group.bnpparibas.com - www.economic-research.bnpparibas.com

Publisher: Jean Lemierre
Editor : William De Vijlder