Economic Update France

3 June 2013

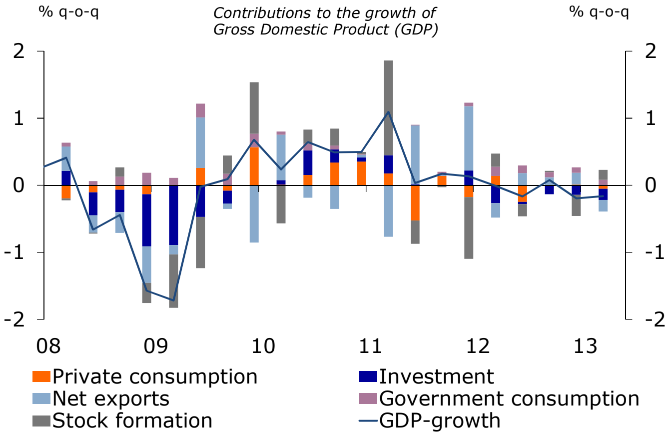
Budget relaxation will not alter weak outlook

year-on-year change (%)	'12	'13	'14
Gross Domestic Product	0	-¼	¾
Private consumption	-0.4	0	¾
Government consumption	1.4	-¼	-¼
Private investment	-1.3	-1½	1½
Exports	2.5	¾	3¾
Imports	-0.9	0	3¼
Inflation	2.2	1¼	1¾
Unemployment (%)	10.3	11	11¼
Government balance (% GDP)	-4.8	-4	-3¾
Government debt (% GDP)	90.2	94	95½

Source: Reuters EcoWin, Rabobank

The mild GDP contraction that France experienced for a year now is expected to continue in 13Q2. It is disappointing that private domestic spending has contracted in recent quarters and that sentiment indicators only show a marginal improvement. Given this bleak growth outlook we do not foresee a labour market recovery anytime soon. This is supported by surveys among entrepreneurs regarding employment expectation. The extra two years France was granted to reach the budget target of 3%-GDP prevent an undesirable tough fiscal adjustment which would further hamper the recovery. However, even with the relaxation, the fiscal impulse will be strongly negative in 2014 and 2015.

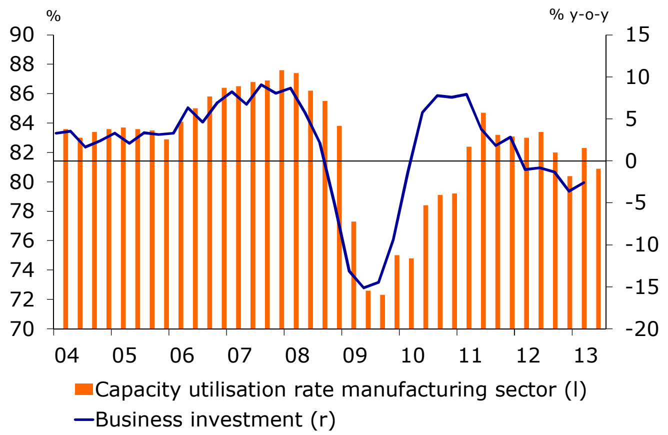
Mild GDP contraction seems persistent



Source: Reuters EcoWin

France experienced another mild GDP contraction in the first quarter of 2013 (-0.2% q-o-q). Just like the final quarter of 2012, both investment and exports contracted and private consumption remained more or less stagnant. Again, government consumption was one of the few components that grew. Imports remained stable in 13Q1, after contracting in 12Q4, as a result of which net exports contributed negatively (-0.2%-point) to the headline figure. The overall picture is disappointing since private domestic spending shrunk again and there is no sign of economic rebalancing. Looking forward, a number of reliable leading indicators point to another mild GDP contraction in 13Q2.

Investment climate remains depressed



Source: Reuters EcoWin

Business investment contracted in 13Q1 for the fifth quarter in a row. There are several factors that depress the investment climate. First of all, the capacity utilisation rate in the manufacturing sector is expected to deteriorate in 13Q2, according to the European Commission (EC) survey. This does not bode well for investments with the aim of expanding production capacity. Secondly, large companies experienced large tax hikes in both 2012 and 2013, which have compressed profit margins. Thirdly, due to the ongoing European debt crisis, the economic outlook remains uncertain and the supply of bank credit remains limited.

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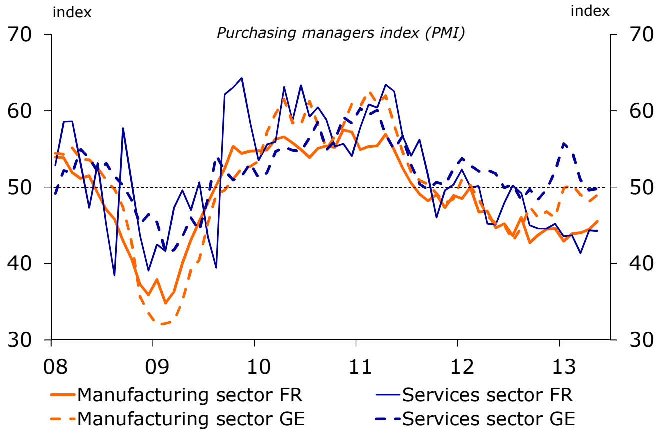
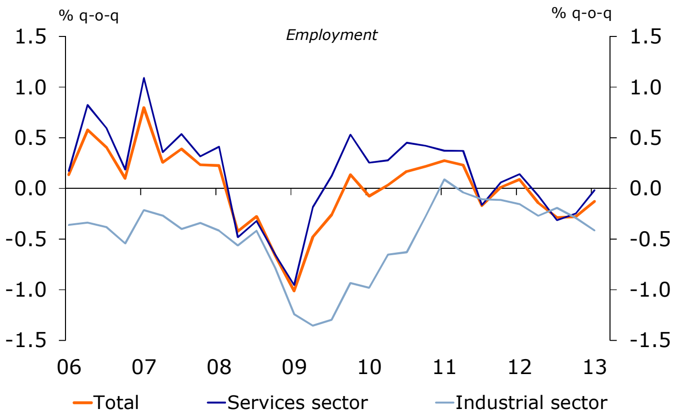
Confidence improving, but remains at a low level



Source: Reuters EcoWin

The sentiment among purchasing managers (PMI) slightly increased in recent months. The index for the manufacturing sector even rose – albeit gradually- for the fifth month in a row. Indices of consumer and producer confidence, from INSEE and the EC, show a mixed picture. On balance, there seems to be a very small improvement of sentiment, but the current levels remain very low. Based on that, a recovery of domestic spending seems unrealistic in the near-term. Besides that, it is worrying that also the sentiment of France's most important trade partner –Germany, which represents 17% of France's export value- is at a much lower level than end-2012.

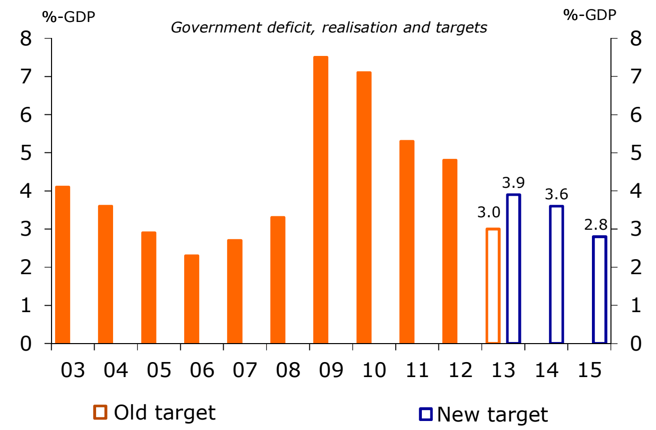
Job destruction in industrial sector continues



Source: Reuters EcoWin

Employment contracted in 13Q2 (-0.1% q-o-q) for the fourth quarter in a row. This is mainly due to a drop in the number of jobs in the industrial sector. Employment in the services sector remained constant. As a result, the level of employment is almost back at its low level reached in the autumn of 2009, which is around 3% below the pre-crisis peak. As the labour force gradually increased in recent years (and is still rising), the unemployment rate rose quickly to 11% in April. A survey among entrepreneurs shows that employment expectations have deteriorated in recent months. All in all, we do not foresee a labour market recovery anytime soon.

Two years of budget relaxation ≠ end of austerity



Source: Reuters EcoWin, European Commission

The EC granted France two more years to reach its budget target of 3%-GDP. In return, the EC demands, among others, a pension reform, lower labour costs and a stronger focus on lower government spending instead of tax hikes. However, it is questionable to what extent the EC can enforce such structural reforms. From an economic perspective, the budget relaxation is justifiable. The required structural fiscal adjustment in 2014 and 2015 amounts to 0.8%-GDP in each year. Although France's fiscal impulse will be less negative compared to 2013 (1.3%-GDP), the amount of public sector retrenchment is still substantial and will, therefore, act as a strong economic headwind in the coming years.

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