

# Economic Update France

## 2 October 2012

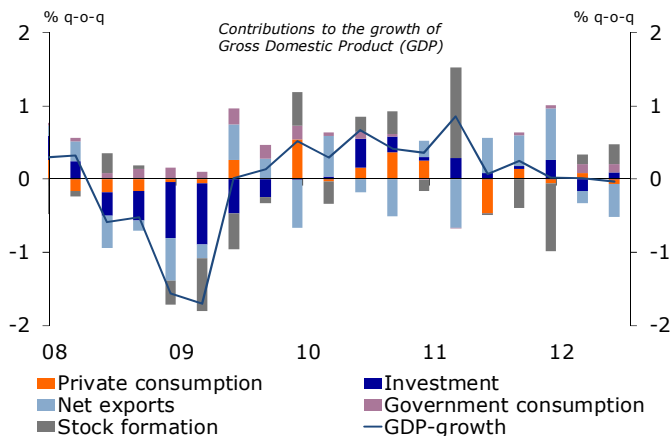
### The patient is flatlining

year-on-year change (%)	'11	'12	'13
Gross Domestic Product	1.7	0	½
Private consumption	0.2	0	¼
Government consumption	0.2	1	0
Private investment	4.6	¼	1
Exports	5.5	2½	3
Imports	5.2	¾	2
Inflation	2.3	2½	1¾
Unemployment (%)	9.6	10¼	10½
Government balance (% GDP)	-5.2	-4½	-3½
Government debt (% GDP)	86.0	91	92

French GDP stagnated in 12Q2 for the third quarter in a row. Although this quarterly figure was better than expected, the breakdown paints a gloomy picture. If we add the weak sentiment levels (PMI, EC) into the equation, a mild GDP contraction in 12Q3 seems to be a realistic scenario. The poor economic momentum is reflected in weak labour market dynamics. The resulting rise in unemployment rate will weigh on wage growth. The recently presented 2013 budget shows that the budget deficit will be brought down predominantly by tax hikes. Altogether, these developments do not bode well for domestic demand next year.

Source: Reuters EcoWin, Rabobank

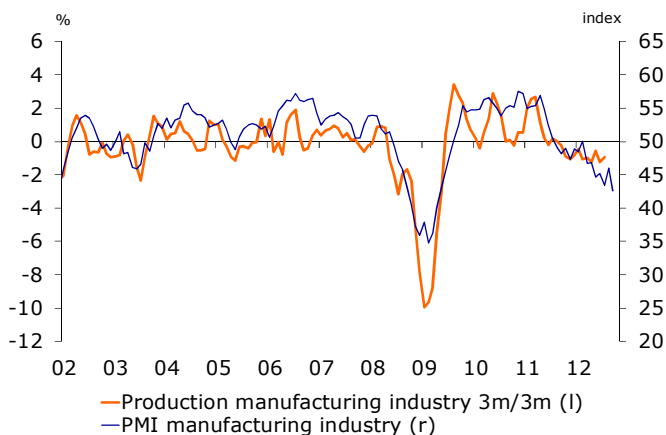
### Third stagnation in a row in 12Q2 ...



Source: Reuters EcoWin

Although leading indicators pointed to a small contraction, GDP stagnated in 12Q2. This was partly due to the remarkable positive contribution of stock formation (+0.3%-point). Also government expenditures grew strongly (+0.5% q-o-q). That said, we doubt that the positive contributions of these two components will prove sustainable. Besides that, the French economy seems to be increasingly hindered by weak foreign demand, as net exports were able to knock 0.4%-point off growth. Domestically, private consumption managed to contract slightly (-0.1% q-o-q). The increase of business investment (+0.6% q-o-q) should be considered as a bright spot after the contraction in 12Q1.

### ... but GDP contraction in 12Q3 is probable



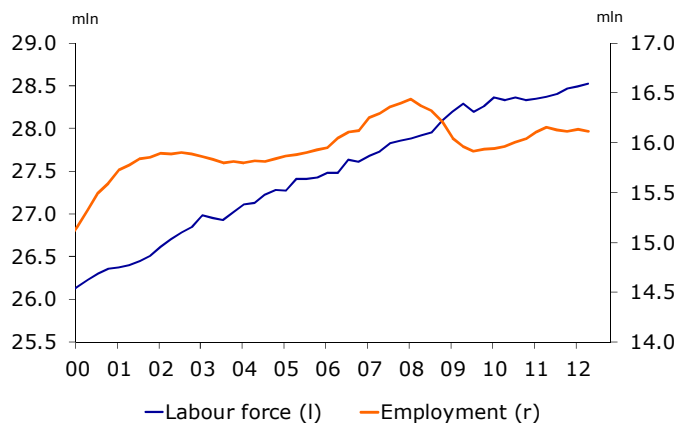
Source: Reuters EcoWin

Although manufacturing production grew in July (+0.9% m-o-m) for the first month since March, the 3m average remains on a downward trend. Moreover, sentiment indicators point to weak activity going forward. The manufacturing PMI dropped significantly in September to 42.7. This is both the strongest decline and the lowest level in more than three years. This negative outlook is confirmed by the pessimistic level of producer confidence according to the EC-index. Based on the low level of PMI services in September (46.1), it is unlikely that the services sector will be able to compensate for the weakness in the manufacturing sector. Overall, a mild GDP-contraction seems realistic.

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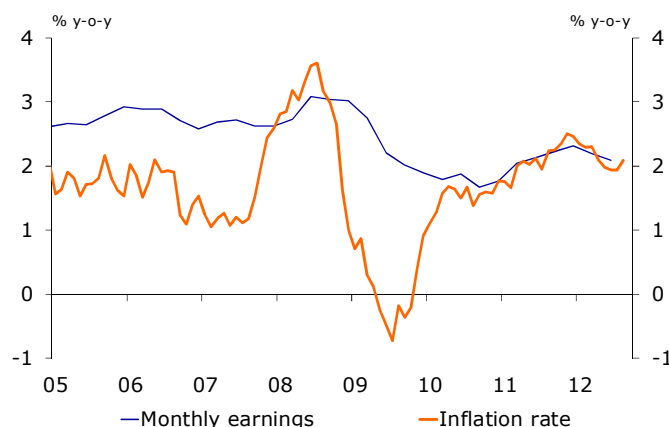
### As long as the labour market weakness persists ...



Source: Reuters EcoWin

Employment contracted slightly in 12Q2 by 0.1% q-o-q. As the labour force increased gradually during this period, this resulted in higher unemployment. More specifically, the unemployment rate increased in 12Q2 (10.2%) to its highest level since 1999. Against this backdrop, we are positive about the recent plan of the government of president Hollande to reform the labour market in the future –including larger flexibility for employers to adapt work to the current stance of the economy. This is because the lack of flexibility discourages employers to hire new people. Until the end of the year employers and employees are expected to negotiate about the reforms suggested by the ministry.

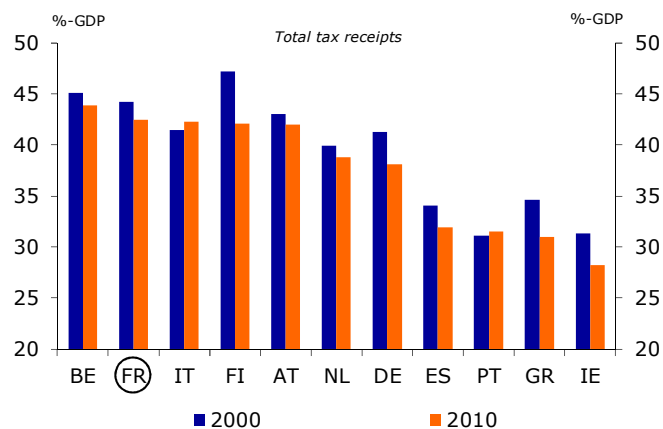
### ... wage growth will not keep track with inflation



Source: Reuters EcoWin

In the short term the weakness in the labour market will probably result in downward pressure on wage growth. This is due to the fact that the high unemployment rate undermines the bargaining position of employees. As inflation rose in August to 2.1% -mainly due to an increase of the energy contribution (to +0.6%-point)- this will probably result in a lack of real wage growth. Together with the low level of consumer confidence and the recently announced tax hikes this does not bode well for private consumption going forward. Of course, we expect consumers' purchasing power to improve slightly next year as inflationary pressures subside.

### Taxes in the spotlight



Source: EC, 2012

The recently announced budget 2013 of president Hollande shows EUR 30bn of austerity measures to bring down the deficit to 3%-GDP next year. Of this amount, EUR 20bn should come from tax hikes: EUR 10bn from households and EUR 10bn from companies. Despite the fact that a relatively large share of the burden will be on wealthy households, the impact on domestic demand next year cannot be neglected. More generally, we do not see further tax hikes as the right solution to restore France's public finances. Next to the fact that higher taxes weigh on growth more than spending cuts, the relatively high tax burden of French companies will also undermine their price competitiveness.

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