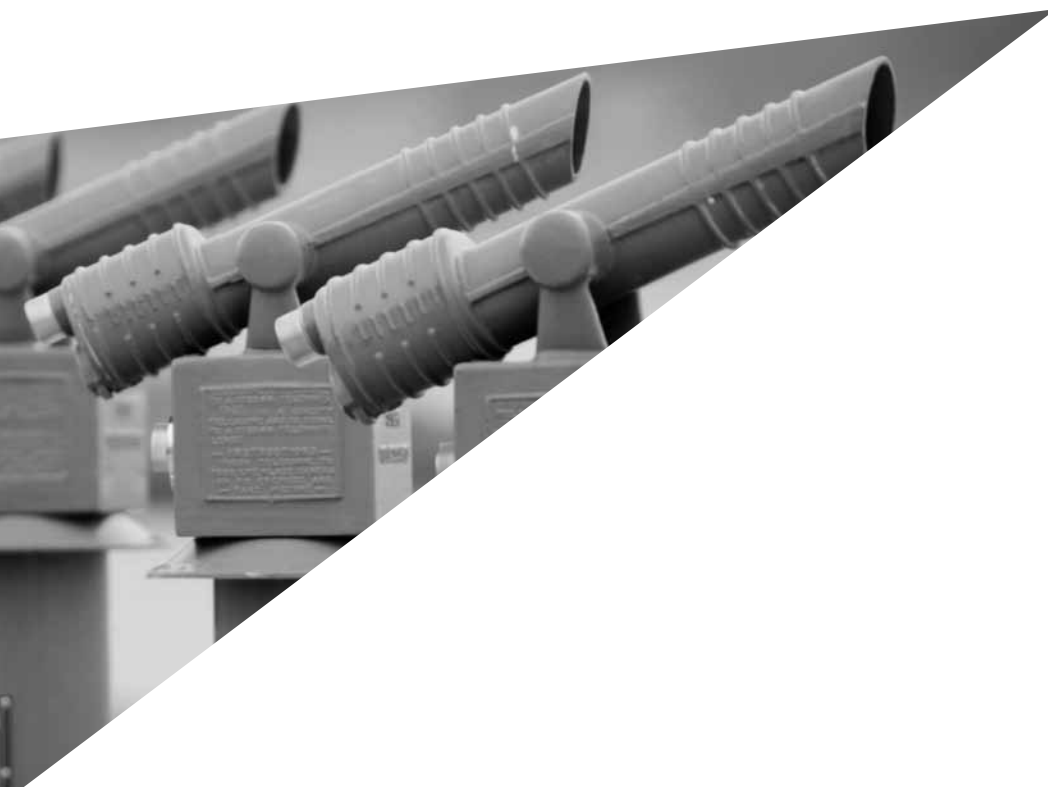


# Ernst & Young Eurozone Forecast

France  
Spring 2010



# Outlook for France

Ernst & Young Eurozone Forecast

Spring 2010



Please visit our dedicated Eurozone website for access to additional information on the Eurozone report, the 16 individual country reports and additional perspectives and interview content. The site contains the latest version of our reports, provides access to print ready files as well as an archive of previous releases.

To find out more please visit [www.ey.com/eef](http://www.ey.com/eef)

---

# Highlights

---



## Recovery is on track but corporate debt is a risk

- ▶ Having fared much better than many of its Eurozone neighbours during the global financial crisis, we expect France to continue to outperform much of the Eurozone over the next few years. We forecast GDP growth at 1.2% this year and an average of 2% year-on-year in 2011-14. However, this does not mean that France will enjoy a smooth recovery, as rising unemployment and corporate deleveraging could knock the recovery off course.
- ▶ As in the other Eurozone economies, we expect growth to have faltered at the beginning of this year, weighed down by the cold weather and the fading impact of some stimulus measures. In addition, a recovery in the labor market is still some quarters away. We expect further rises in unemployment throughout this year, from 9.6% in 2009Q4 to peak at 10.5% at the turn of 2010/11.
- ▶ The recovery in France will be aided by the sound financial position of French households. Consumers have relatively low levels of debt and do not need to go through the same degree of painful adjustment as in US, UK, Spain or Ireland. Although the savings ratio increased during the recession, as a response to increased uncertainty around job and income security, this was not the same level as many other European countries. As the recovery builds momentum during 2010 and unemployment stabilizes, French households will be able to free up some of these savings and increase spending.
- ▶ The financial position of French businesses appears less healthy as non-financial companies have seen debt rise to around 150% of GDP. As with personal debt, this is also lower than in other Eurozone countries on average, but quite a bit higher than levels in Germany, for instance. Moreover, leverage has merely levelled off during the crisis. High levels of debt could see French businesses go through an extended period of deleveraging as well as limiting their ability to borrow. As a result, we expect investment by French business to be broadly unchanged this year and to expand by around 3% in 2011.
- ▶ The French fiscal position appears stretched with the deficit at around 8% of GDP in 2009. However, a large part of the increase in the budget deficit is accounted for by automatic stabilizers. The budget deficit should therefore narrow significantly as growth resumes and spending falls. As a result, the discretionary measures required to rein in the deficit are smaller than in many other countries. We expect the deficit to fall to around 6.75% in 2011 and to 3% of GDP by 2014. The government's priorities seem to have shifted to the medium term, with the 'Grand Emprunt' aimed at boosting innovation and growth and the start of a long overdue debate on the pension system. However, the government's poor results in the March regional elections may dent its appetite for reform.

# Recovery is on track but corporate debt is a risk



## France fared relatively better in the crisis ...

France has weathered the crisis relatively well, with a smaller fall in GDP than in most other developed economies. Peak-to-trough GDP fell by 3.5% in France compared with 5.7% in the rest of the Eurozone. The country has benefited from not being too exposed to financial and housing markets or to world trade. For instance, while exports account for around 30% of French GDP, for the rest of the Eurozone, exports (including within the Eurozone) account for 50% of GDP. Moreover, large automatic stabilizers have also helped buffer the impact of the crisis on household incomes: government transfers that account for around 20% of consumers' disposable income increased by 5% last year, providing a useful offset to a marked slowdown in wage income.

## ... and should grow faster than average in coming years

We expect the French economy to grow slightly faster than the Eurozone average over the next few years; GDP growth is forecast at 1.2% this year and 1.8% in 2011. In the medium term, we expect growth to average 2% per year during 2012-14, which is around 0.2% points higher than in the rest of the Eurozone.

However, this does not mean that France will enjoy a smooth ride along the recovery path. French growth was surprisingly high side in

2009Q4, at 0.6%, while the Eurozone as a whole only increased by 0.1%. Nevertheless, as in the other Eurozone economies, we expect growth to have faltered at the beginning of this year, weighed down by the cold weather and the reduced effects of some stimulus measures. Business confidence, which improved rapidly in the summer last year, has slowed down or even reversed according to the services PMI. In addition, industrial production and exports have been volatile in recent months. We estimate that GDP growth was only 0.1% in 2010Q1.

When measured by the labor market, the recovery still seems to be some quarters away. We forecast further rises in unemployment throughout this year, from 9.6% in 2009Q4 to peak at 10.5% at the turn of 2011. Indeed, like their peers in other Eurozone countries, French companies have held on to more workers than warranted, given the slump in production. In order to restore profitability, businesses are beginning to delay new hiring until activity levels rise. After a sharp plunge at the beginning of the crisis, temporary employment started to rise again in the second half of 2009. Instead, the number of permanent jobs continues to decline. This is likely to continue for a while, until growth is more established in France and amongst its main trade partners.

Table 1

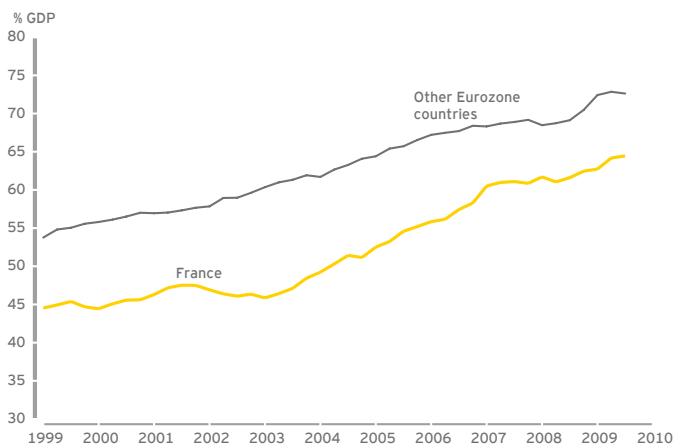
France (annual percentage changes unless specified)

Source: Oxford Economics

	2009	2010	2011	2012	2013	2014
GDP	-2.2	1.2	1.8	2.2	2.0	2.0
Private consumption	0.8	0.5	1.2	1.9	2.0	2.0
Fixed investment	-7.0	-0.6	2.8	3.2	2.9	2.5
Stockbuilding (% of GDP)	-0.8	-0.7	-0.6	-0.5	-0.5	-0.4
Government consumption	1.6	1.5	0.9	1.1	1.2	1.2
Exports of goods and services	-10.9	3.0	4.8	6.7	6.1	5.8
Imports of goods and services	-9.6	0.9	3.9	5.8	5.8	5.5
Consumer prices	0.1	1.4	1.7	1.8	1.9	1.9
Unemployment rate (level)	9.4	10.6	10.9	10.3	9.5	8.8
Current balance (% of GDP)	-2.0	-2.4	-2.4	-2.3	-2.2	-2.3
Government budget (% of GDP)	-7.5	-8.7	-6.9	-5.2	-3.9	-3.1
Government debt (% of GDP)	84.6	91.3	96.1	98.6	99.6	99.7
ECB main refinancing rate (%)	1.1	1.0	1.6	3.3	4.3	4.3
Euro effective exchange rate (1995=100)	129.7	124.8	122.0	119.7	117.7	116.3
Euro-US dollar exchange rate (\$ per €)	1.39	1.34	1.32	1.30	1.29	1.27



Figure 1  
Households' debt



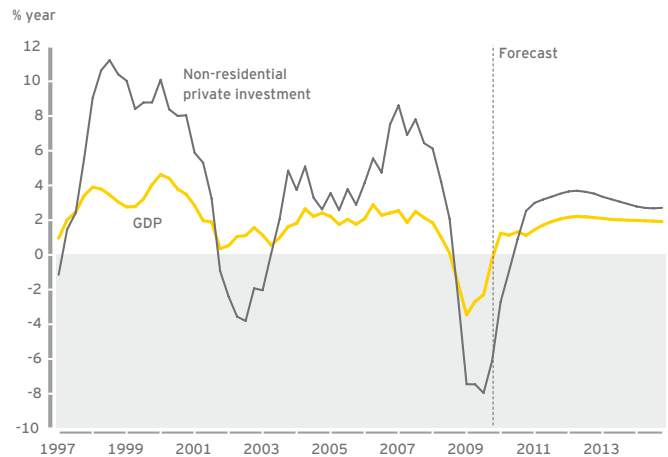
Source: Oxford Economics/Haver Analytics

### Sound households balance sheets should help consumption ...

French consumption has been the mainstay of growth for many years and we expect households to emerge from the doldrums as the impact of the financial crisis fades. Robust income growth will help sustain consumption. Average earnings growth was quite firm last year, despite the downturn. We estimate that it averaged 1.7%, which given the fall in inflation, generated comfortable increases in purchasing power for those who kept their jobs. Downward rigidity in wages is still quite strong in France, more so than say in Germany, so even though unemployment is forecast to rise, earnings growth should remain robust. However, this will contribute to inflation being slightly higher than the Eurozone average.

The recovery in France will also be aided by the sound financial position of French households. Although as in many other countries household debt has increased in France in recent years, debt levels remain relatively low at around 65% of GDP, compared with 73% in the rest of the Eurozone. Moreover, while French household assets were battered by the fall in share and house prices, their value has rebounded sharply since mid-2009 to stand at 190% of GDP, suggesting a strong overall financial position for consumers.

Figure 2  
Business investment



Source: Oxford Economics

Although the savings ratio increased during the recession from below 13% of disposable income in mid-2008 to close to 15% one year later, as a response to increased uncertainty around job and income security, this was not to the same level as other European countries. As the recovery takes hold during 2010 and unemployment stabilizes, French households will be able to free up some of these savings and increase spending.

The outlook for savings and incomes combines to point to robust growth in consumption. Although we forecast consumption to rise by just 0.5% in 2010, this mainly reflects the impact of the car scrappage scheme – as a result of this scheme, some car purchases were brought forward to last year. Although the French government has tried to smooth out the end of the scheme by reducing the amount of money given to scrap cars gradually, monthly data on new car registrations show that the country will not manage to avoid the wide fluctuations in car sales seen in other countries. But once the effect of the scrappage scheme fades and the labour market picks up, consumption is expected to strengthen and rise by more than 1% next year and around 2% per year between 2012-14.



**Recovery is on track but corporate debt is a risk**

**... but high leverage of corporate sector could hamper investment**

The position of the non-financial sector is more of a concern. French non-financial companies have also increased their debt in the run-up to the crisis to around 150% of GDP. This is below the debt levels in other Eurozone countries, but it is higher than levels in Germany, for instance. Moreover, leverage has merely levelled off during the crisis. High debt could hamper French businesses' ability to raise funding either from banks or financial markets, which would weigh on investment.

Investment will also be hampered by low capacity utilization. Utilization rates picked up slightly from their low in 2009Q2, to 73.9% at the beginning of this year, but that is still around 10 points below historical average levels. As of the end of 2009, French businesses were still cutting investment quite rapidly (-0.9% in Q4). According to INSEE's survey, manufacturing businesses are planning to keep investment at about the same level this year as last year. This is also what we forecast for total private-sector business investment. Only from 2011 do we expect private sector investment to rise substantially, by around 3% per annum.

**Deficit reduction to come mainly from stronger growth**

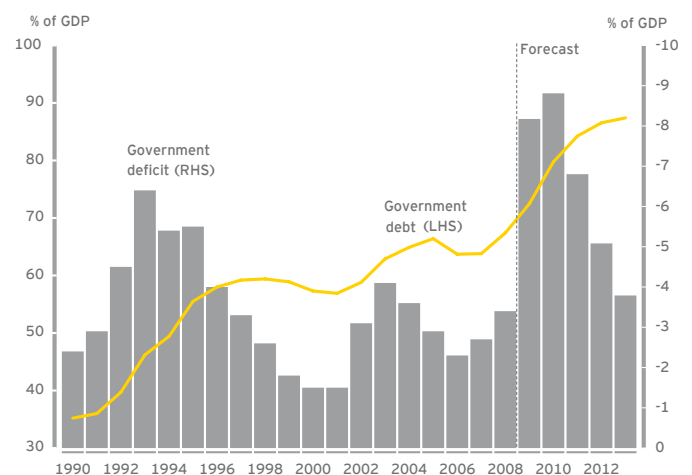
The French fiscal position also appears stretched with the deficit at around 8% of GDP in 2009. Although the French government did implement a large stimulus package (which has now been largely spent), part of the increase in the budget deficit is accounted for by automatic stabilizers. As a result, the discretionary measures required to rein in the deficit are smaller than in many countries. So after deteriorating further with the continued rise in unemployment to around 9% of GDP in 2010, we forecast the deficit to decline to 3% in 2014.

We expect the deficit to narrow more slowly than the government expects – it forecasts a deficit-to-GDP ratio down to 3% by 2013, in line with the EU rules. This is mainly because the government's consolidation plan relies on overly optimistic assumptions about medium-term growth. The plan also implies tight control of government consumption. However, successive governments have been unable to effectively rein in government consumption in the past. To achieve the cuts that that the government

has pledged would require a previously unseen level of fiscal discipline and commitment.

Despite the current focus on quick deficit reduction in the Eurozone, the French government's priorities seem to have shifted to the medium term, with the "Grand Emprunt" aiming at boosting innovation and growth and the start of a long overdue debate on the pension system. Both could boost medium-term growth in France, but the focus should be on the politically much more difficult pension reform. France looks increasingly behind its European neighbours in this respect, with a system that is still much more generous, but also much less viable. A more flexible and less costly pension system – achieved by delaying the retirement age and encouraging personal contributions – would make France more attractive to business. Bringing public sector pensions in line with those of the private sector would free up a very large part of the public budget. However, the government's reform appetite is likely to dampen following the poor results in the March regional elections. Further delays in the reform of the pension system would have a negative impact on the country's growth in the medium term.

Figure 3  
Government deficit and debt



Source: Oxford Economics



### About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 144,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [www.ey.com](http://www.ey.com).

© 2010 EYGM Limited.  
All Rights Reserved.

EYG No. AU0500



In line with Ernst & Young's commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

The views of third parties set out in this publication are not necessarily the views of the global Ernst & Young organization or its member firms. Moreover, they should be seen in the context of the time they were made.

### About Oxford Economics

Oxford Economics was founded in 1981 to provide independent forecasting and analysis tailored to the needs of economists and planners in government and business. It is now one of the world's leading providers of economic analysis, advice and models, with over 300 clients including international organisations, government departments and central banks around the world, and a large number of multinational blue-chip companies across the whole industrial spectrum.

Oxford Economics commands a high degree of professional and technical expertise, both in its own staff of over 70 professionals based in Oxford, London, Belfast, Paris, the UAE, Singapore, New York and Philadelphia, and through its close links with Oxford University and a range of partner institutions in Europe and the US. Oxford Economics' services include forecasting for 190 countries, 85 sectors, and over 2,500 cities sub-regions in Europe and Asia; economic impact assessments; policy analysis; and work on the economics of energy and sustainability.

The forecasts presented in this report are based on information obtained from public sources that we consider to be reliable but we assume no liability for their completeness or accuracy. The analysis presented in this report is for information purposes only and Oxford Economics does not warrant that its forecasts, projections, advice and/or recommendations will be accurate or achievable. Oxford Economics will not be liable for the contents of any of the foregoing or for the reliance by readers on any of the foregoing.