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**GLOBAL MACRO & THEMATIC
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LEVERAGING FRANCE'S KEY STRENGTHS

In Pursuit of an Alternative Path

SPRING 2013

Leveraging France's Key Strengths

Fact: France's economy is not going well and is facing a very real risk of lapsing into critical condition

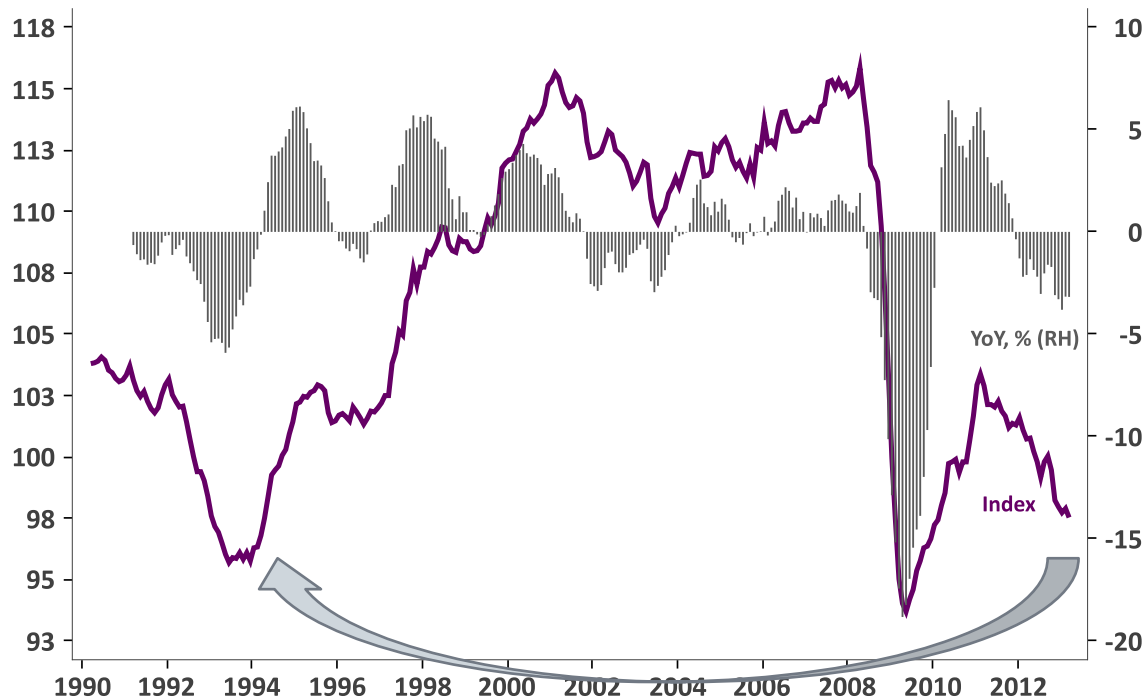
I – A negative demand shock aiming to boost competitiveness would be the most dangerous path that could be taken

II – France has other strengths, let's give them some consideration

Industrial production: returning fifteen years back in time

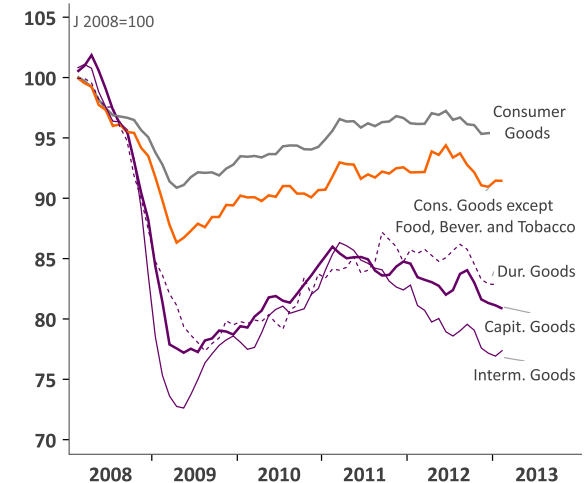
Declining for over a year, industrial production is not higher today than it was in 1994.

Industrial Production Excluding Construction, France



Sources: RichesFlores Research, Macrobond

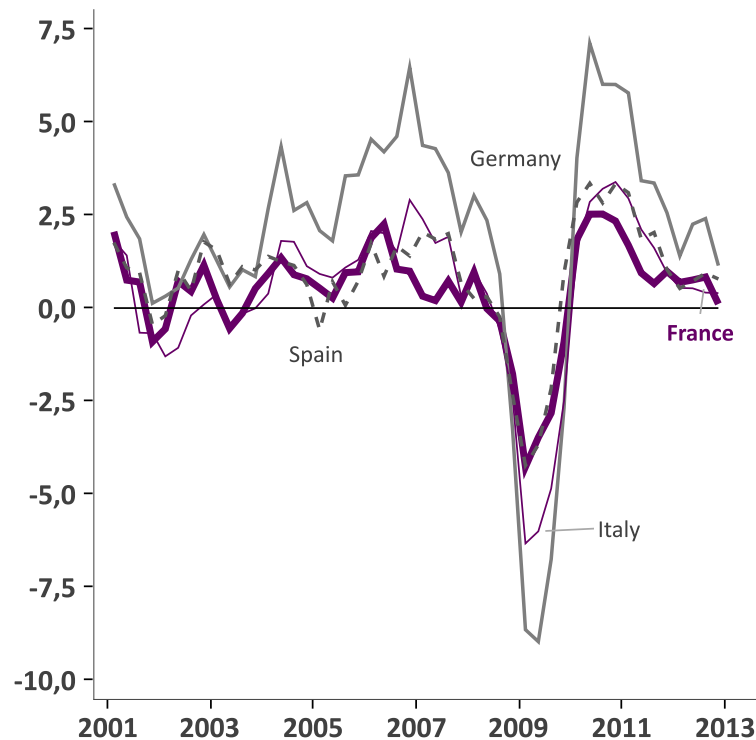
Production, large categories of goods



Sources: RichesFlores Research, Macrobond

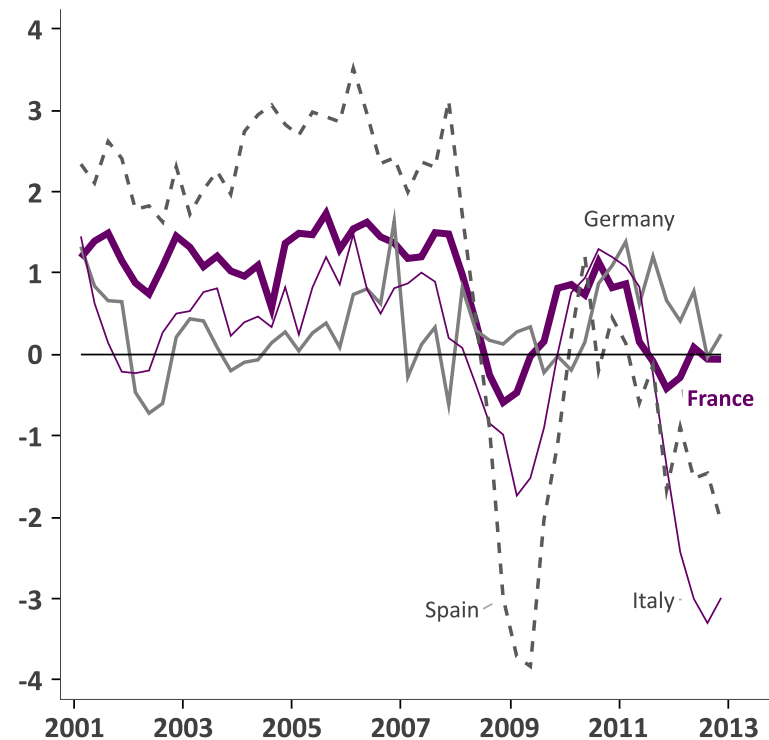
Exports stall, consumption drops back

Contribution of Exports of G&S to Real GDP Growth



Sources: RichesFlores Research, Macrobond

Contribution of Consumption to Real GDP growth

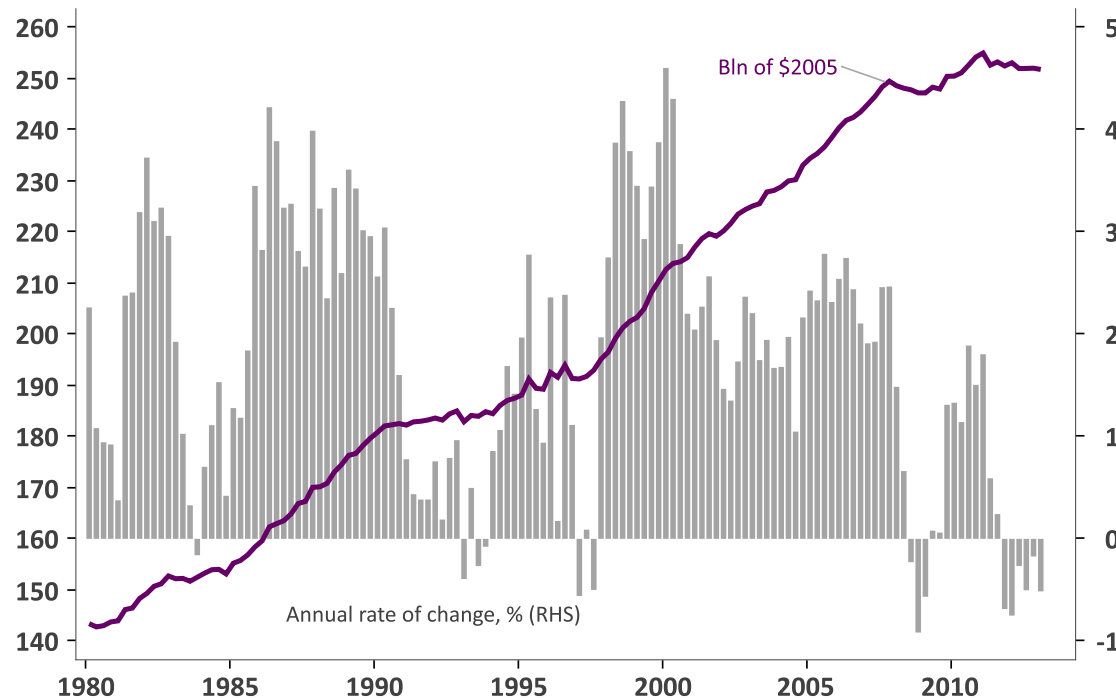


Sources: RichesFlores Research, Macrobond

Consumption, stalled since the 2008 crisis, shows an increasing weakness

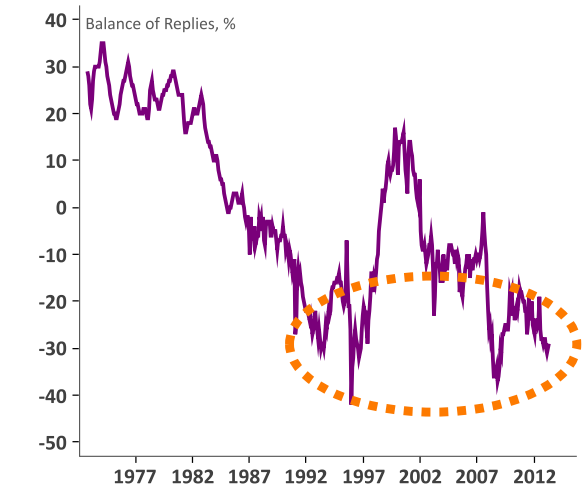
- The situation aggravated itself over the past few months

Real consumption expenditure of households



Sources: RichesFlores Research, Macrobond

Household major purchase intentions

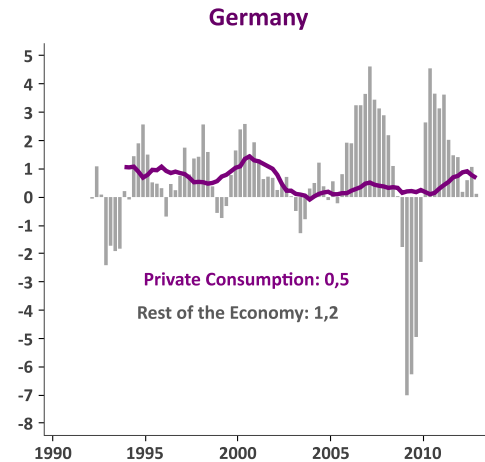


Sources: RichesFlores Research, Macrobond

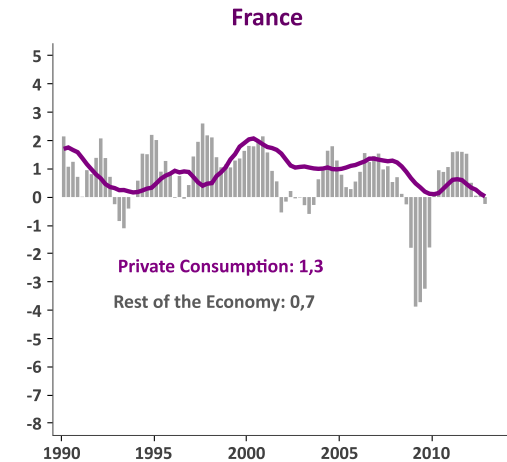
The lack of the support given by consumption eliminates all chances of growth comeback

French economy is more similar to the anglo-saxon than the German model. Household consumption has explained over two-thirds of the GDP growth between 2000 and 2008, while in Germany it represented less than one-third.

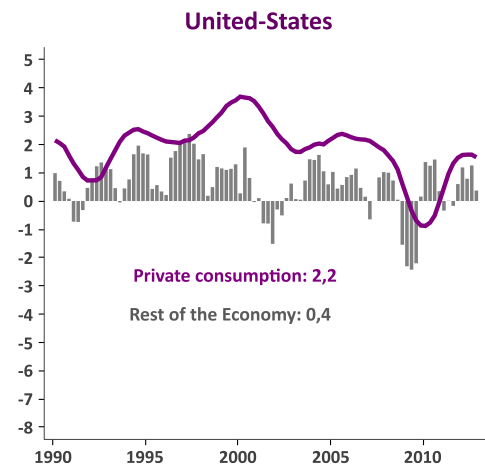
Contribution to Real GDP Growth (smoothed over 2 years) and Average 2000-08



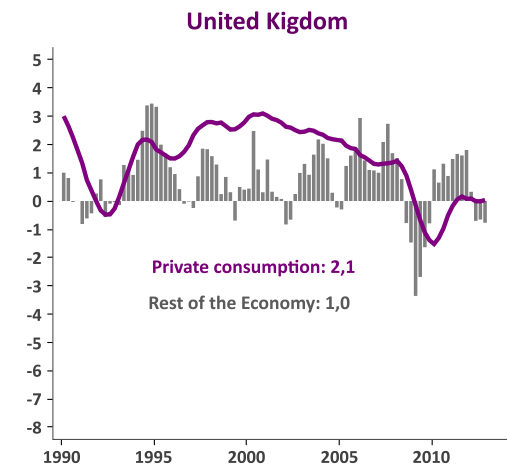
Sources: RichesFlores Research, Macrobond



Sources: RichesFlores Research, Macrobond



Sources: RichesFlores Research, Macrobond



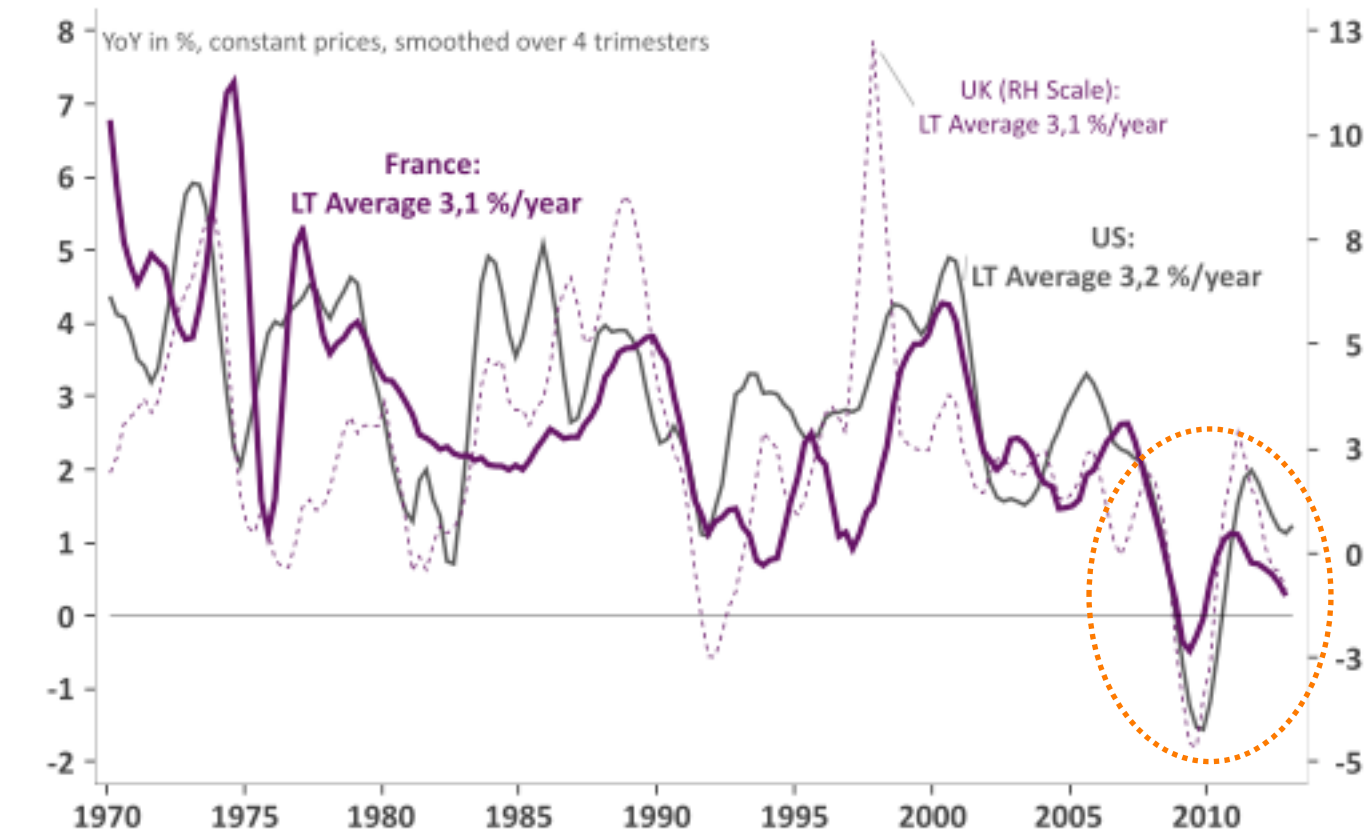
Sources: RichesFlores Research, Macrobond

The private services, primary source of growth, are the most impacted

Household private services expenditures has been the main growth driver for years in France, as well as in the Anglo-Saxon countries.

Demand stagnation now deteriorates the main source of growth and employment.

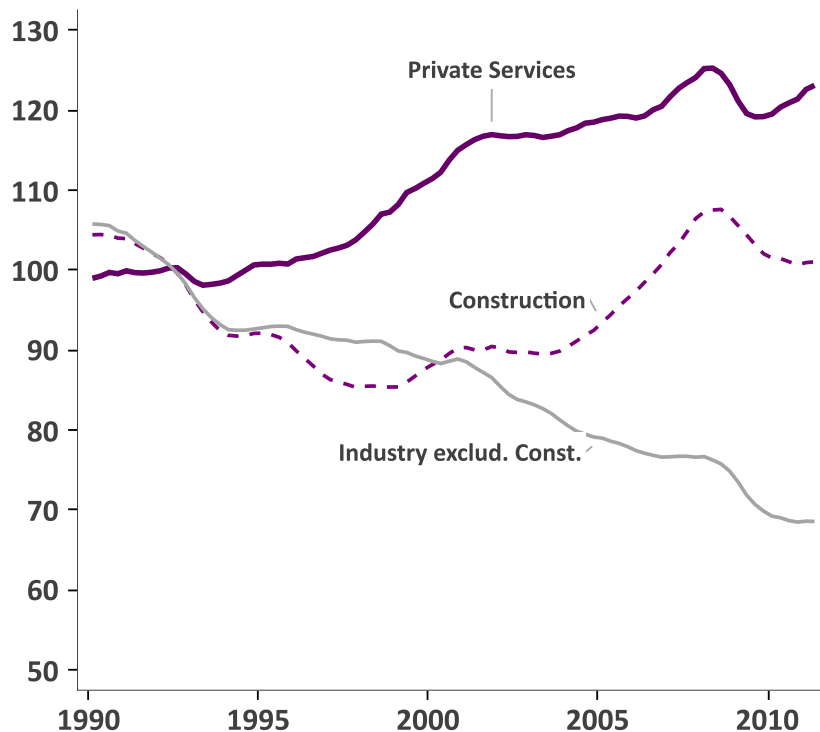
Real consumer spending on services



Sources: RichesFlores Research, Macrobond

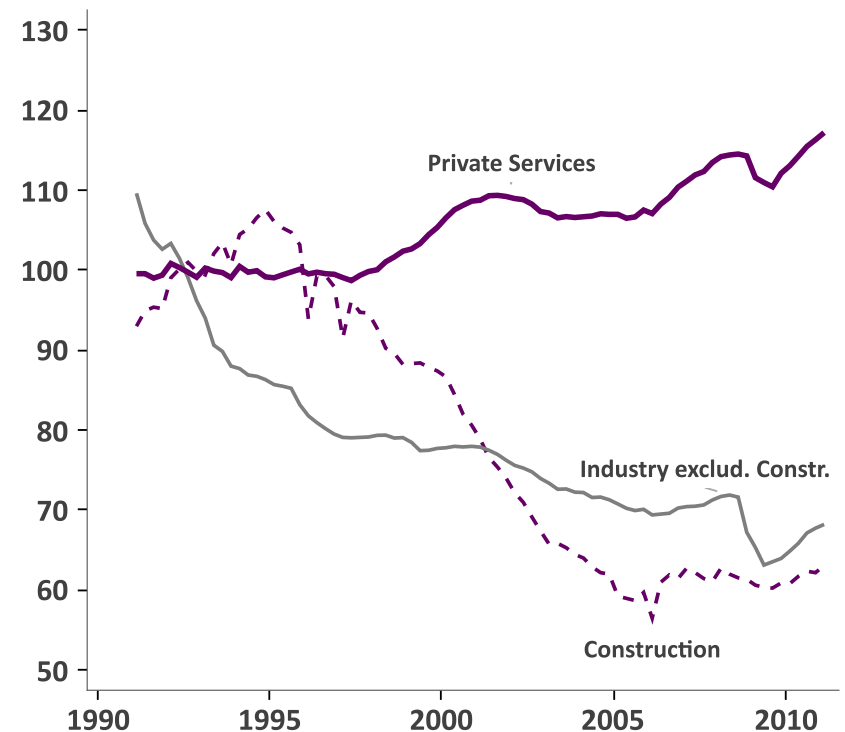
Consumption stall results in the fading out of the major source of employment creation

Employment by Sector, France, 1990-2011, 1992=100



Sources: RichesFlores Research, Macrobond

Employment by Sector, Germany, 1990-2011, 1992=100



Sources: RichesFlores Research, Macrobond

Another year of recession

- **Our forecast, which was recently considered « pessimistic », turns out to be increasingly plausible.**
 - In September, we estimated a -0.7% contraction of France's GDP in 2013, a figure that was revised in January to -0.5% in the hope of a radical change in the current EU economic policy.
 - Our hopes were dashed. Despite some advances, European policy remains pro-cyclical, an orientation from which France cannot escape.
 - The risks coupled with our previsions are once again increasing...
- **In these conditions, decreasing the budget deficit by 4% of GDP (against 4,8 % in 2012) would already be quite an achievement.**

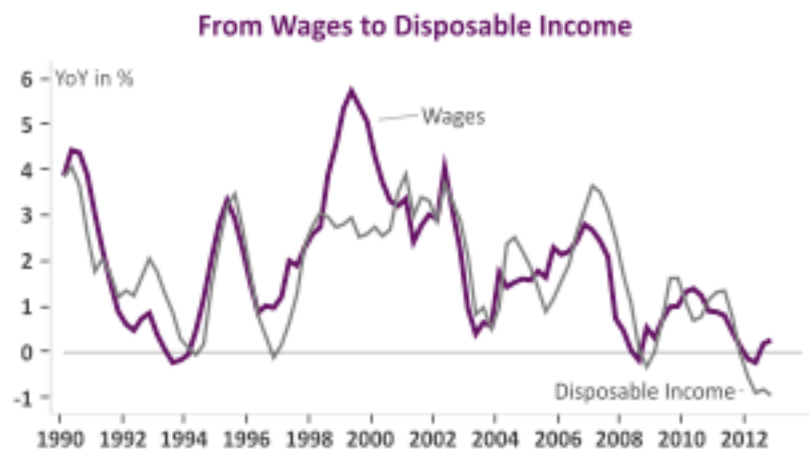
What should be done?

Competitive deflation?

- Economists are resigning themselves to the idea of a negative demand shock (drastic cuts in public spending and in wages), a measure that may be able to reduce public finance imbalances and to restore the weakening competitiveness.
- This recipe has already been tested. This policy leads to a dead end and is a major source of risk for France and, thus, to the whole Eurozone (whose fate is intrinsically linked to France's economy unfold).

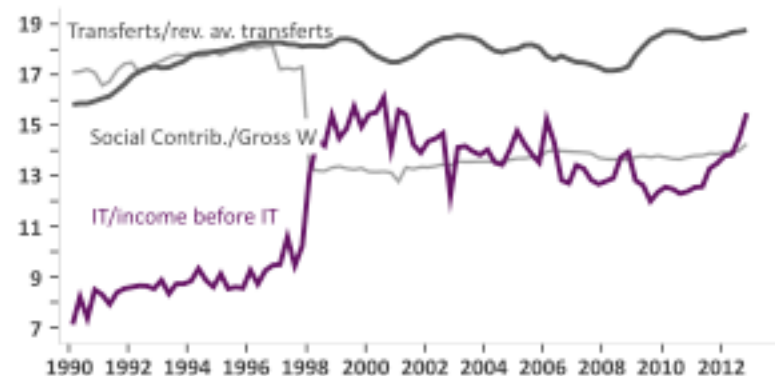
Same policies, same effects: a negative demand shock is the most dangerous route that could be taken.

The collapse of consumption is to a large extent the result of budgetary restriction



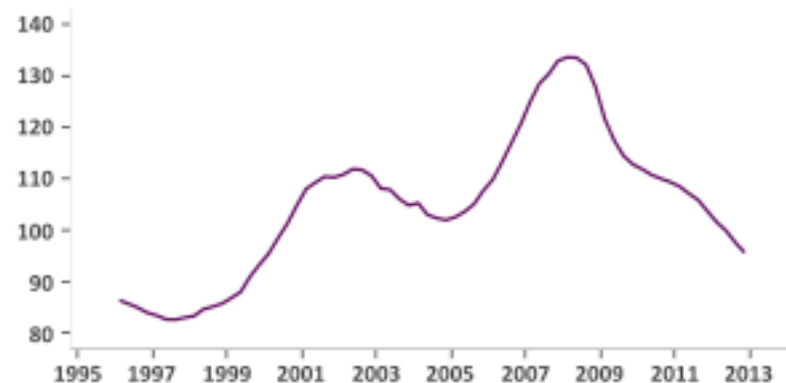
Sources: RichesFlores Research, Macrobond

Taxes, Social Contributions and Social Transfers in %



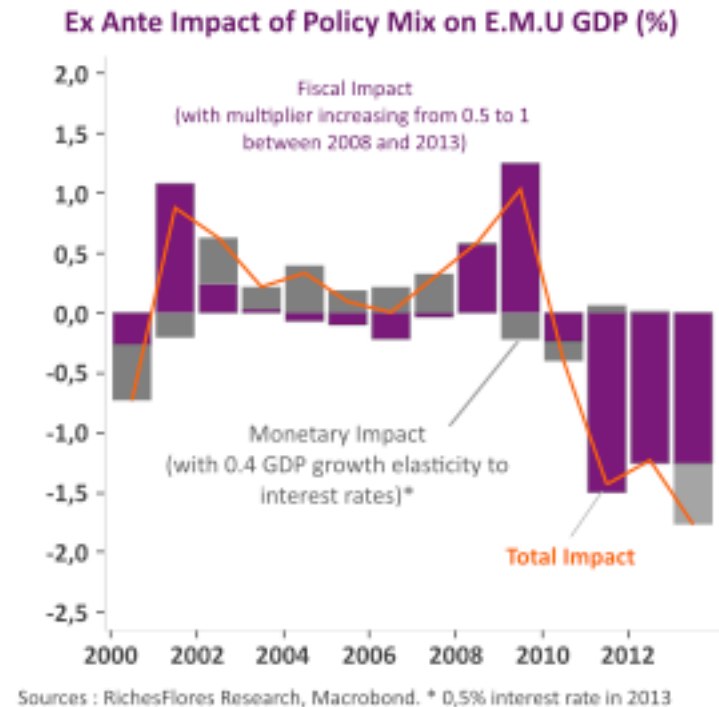
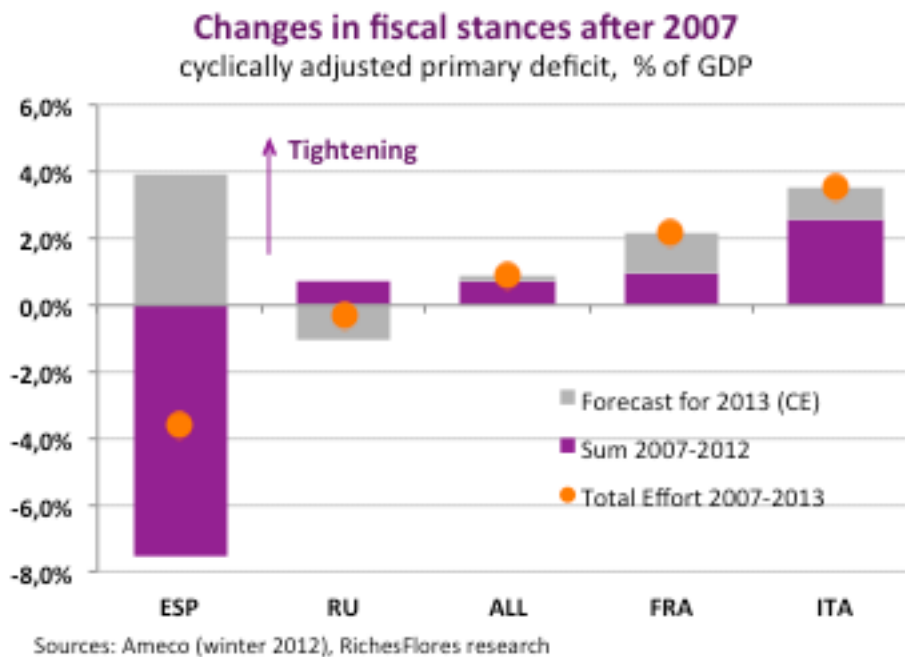
Sources: RichesFlores Research, Macrobond

Real Social Transfers/Unemployment, 2000=100



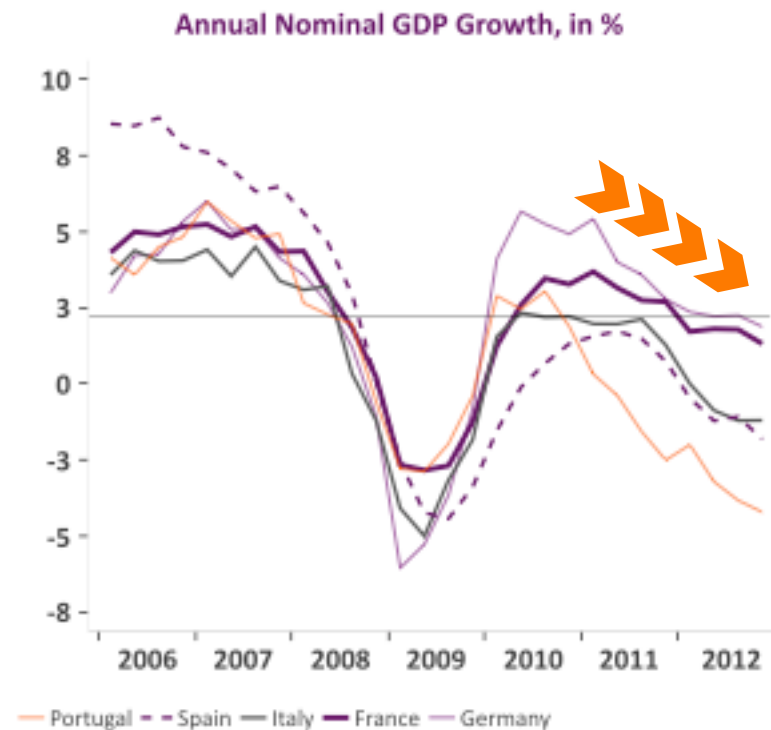
Sources: RichesFlores Research, Macrobond

Contrary to a common idea, France's budgetary policy is already extremely restrictive

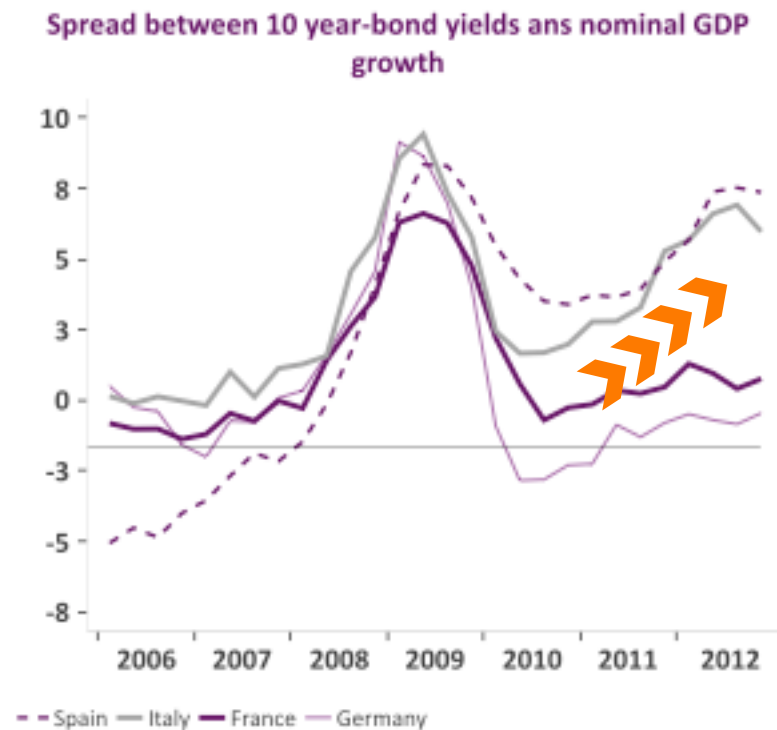


Be careful of the hidden traps...

- Economic decline and debt reduction are not compatible

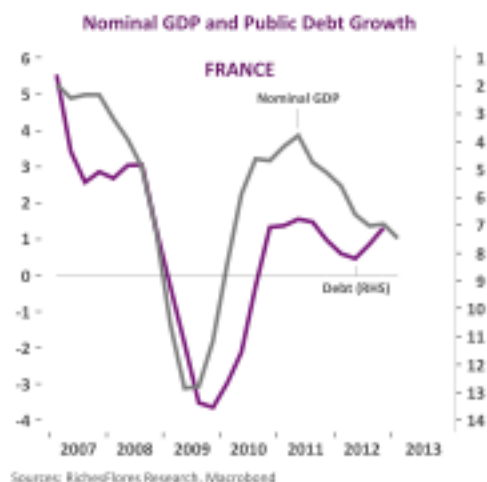
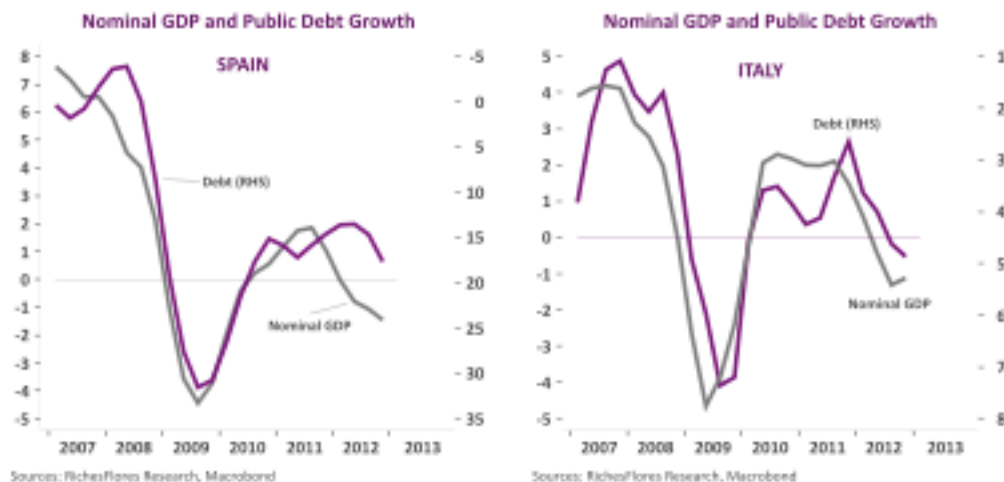


Sources: RichesFlores Research, Macrobond

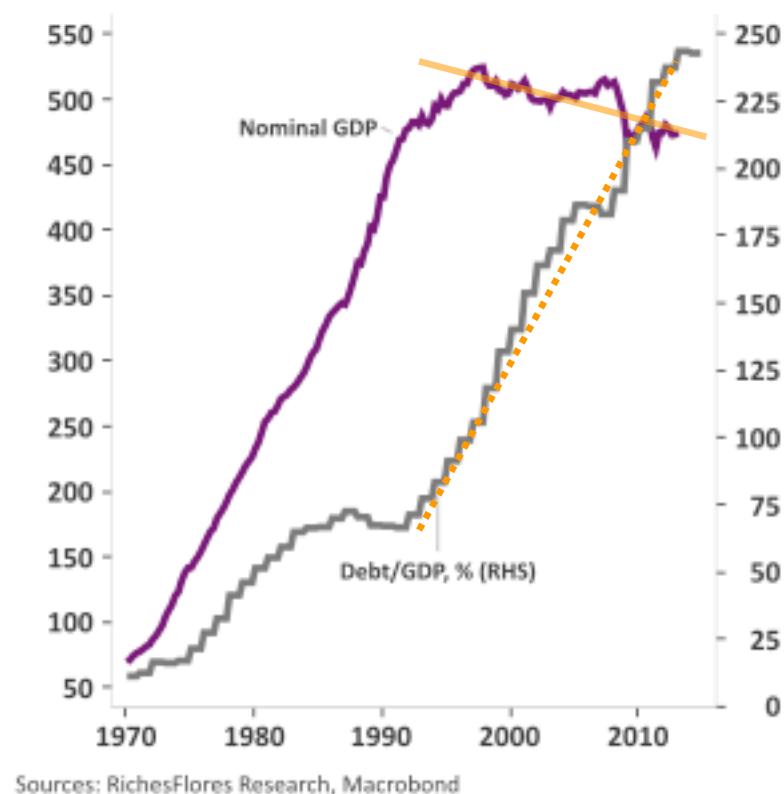


Sources: RichesFlores Research, Macrobond

You can't cure debt with austerity



Japanese Nominal GDP and Public Debt



Competitive deflation: five reasons why it won't work

- 1 Demography
 - **France cannot endure a decade of income stagnation:** Germany was able carry through it because its population had stagnated, a similar evolution in France would have made cut per capita disposable income by 10%.
- 2 German context and specificities
 - **Germany has benefited from exceptional conditions that don't exist in other countries:** regional dynamics; global capex boom; high specialization in machinery; company sizes; outsourcing to Eastern Europe ; overvalued yen....
- 3 Deceleration of International Trade
 - **Foreign trade is no longer the driving force it used to be, due to:**
 - debt reduction in developed countries
 - lower import content of Chinese growth
 - reappearance of external constraints in emerging countries
- 4 From competitive deflation to deflation
 - **This policy cannot work when every country uses it at the same time:**
 - one's gains are the other's net losses
 - the race will conduct to deflation in the Eurozone
- 5 France, is the only country that can stimulate EMU demand
 - **Second economy in the Eurozone, France has a major spill-over capacity:** depression in France would mean depression in the whole zone.
 - France is the only reserve of potential demand.

How to leverage France's advantages?

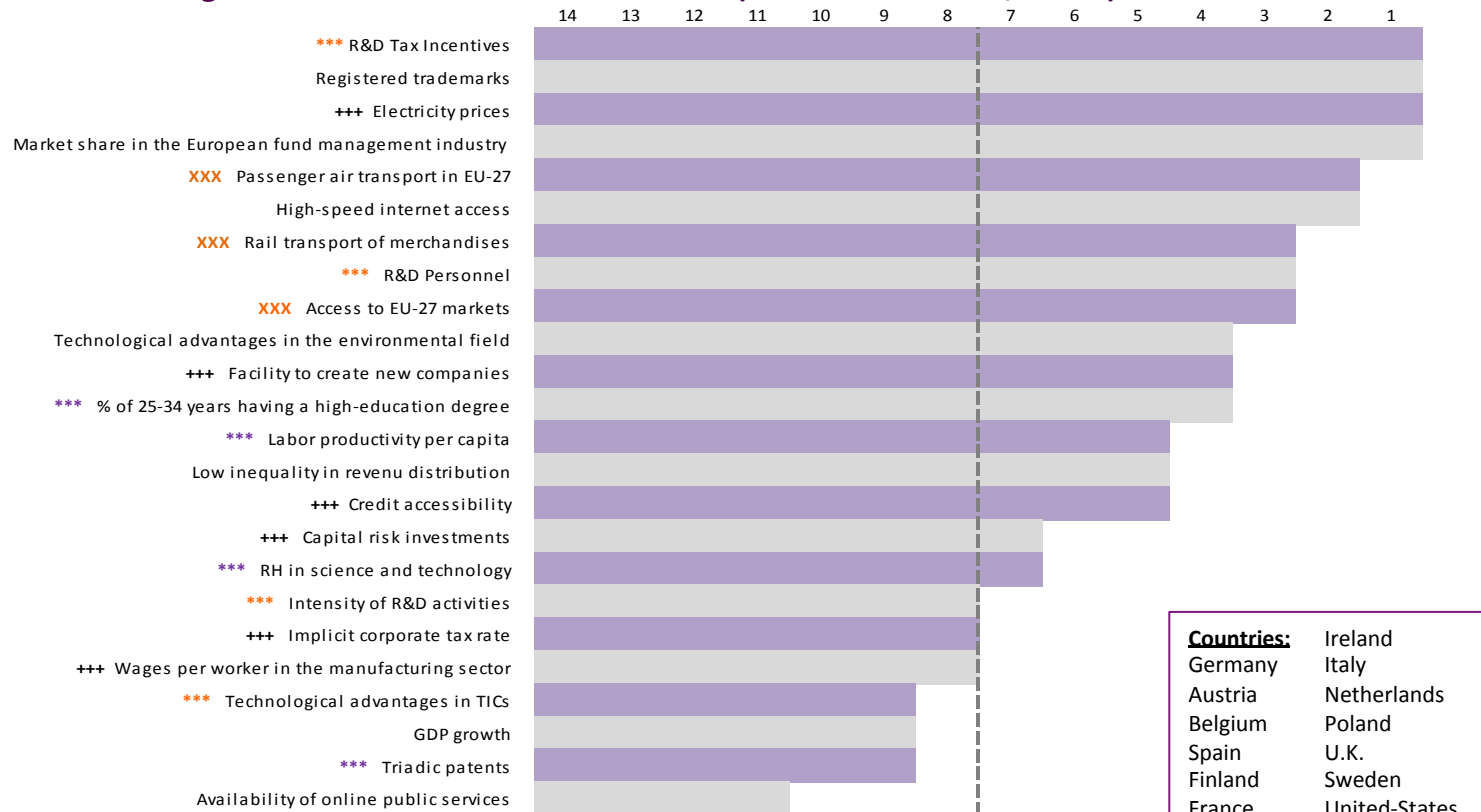
France cannot compare its industrial power to Germany, but it has nevertheless other important assets:

- Its demography
- Its productivity
- Its level of education
- Its geographical position
- Its diversity
- Its infrastructures
- Its image
- Its relatively low inequality level
- Its attractiveness

A great deal of assets that provoke other countries' envy. What is the best way to take advantage of them?

France's attractiveness: often where we wouldn't expect it...

France's ranking based on main attractiveness criteria (out of 14 countries,* 2012)



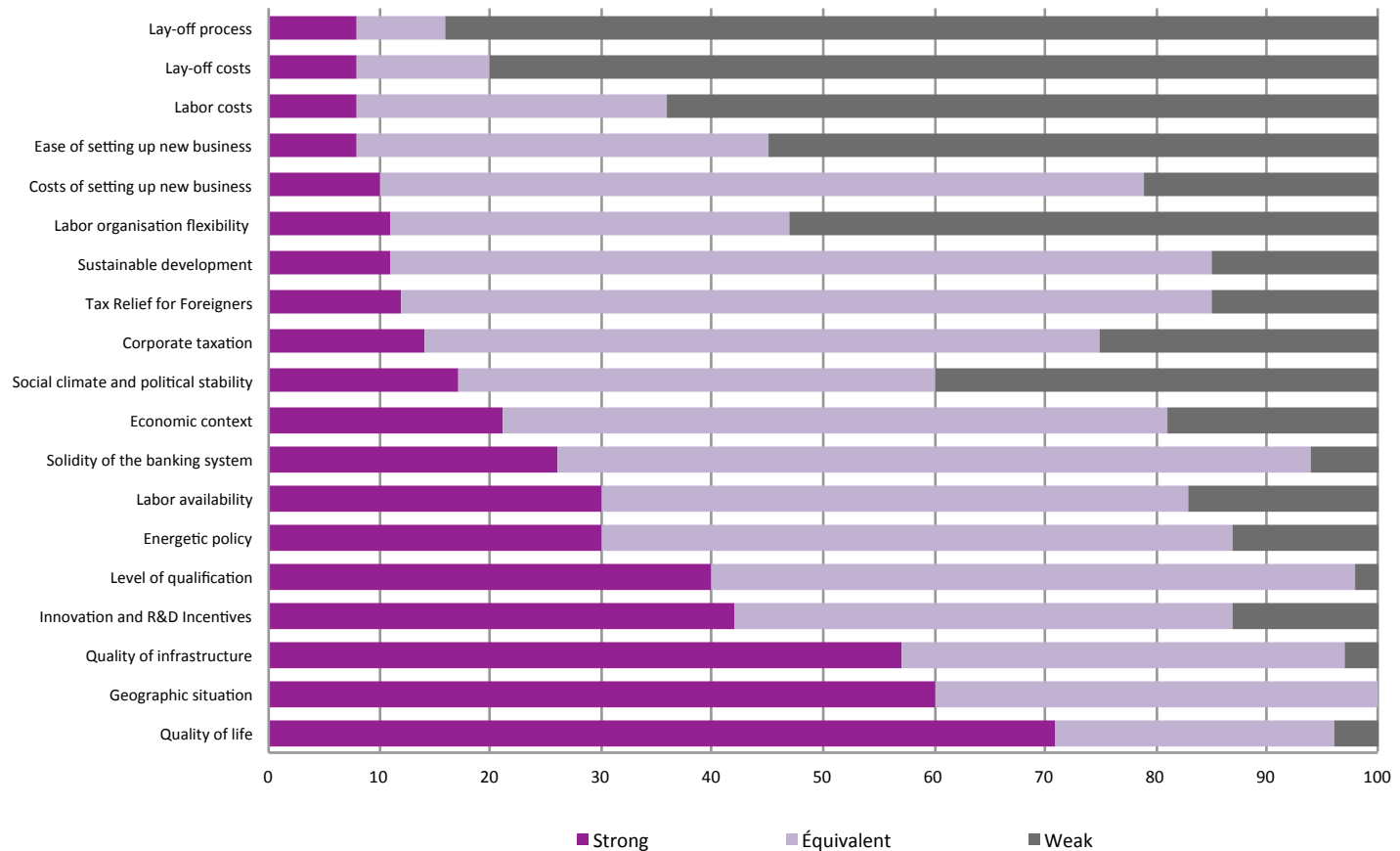
* France, Germany, Italy, Spain, Sweden, Belgium, Finland, UK, Ireland, Netherlands, Austria, Poland, U.S., Japan

*** research, *** professional skills, XXX geographical location, +++ competitiveness

Source: RichesFlores Research, France attractiveness dashboard, MEF 2012

Opinion of foreigners CEOs about France's attractiveness

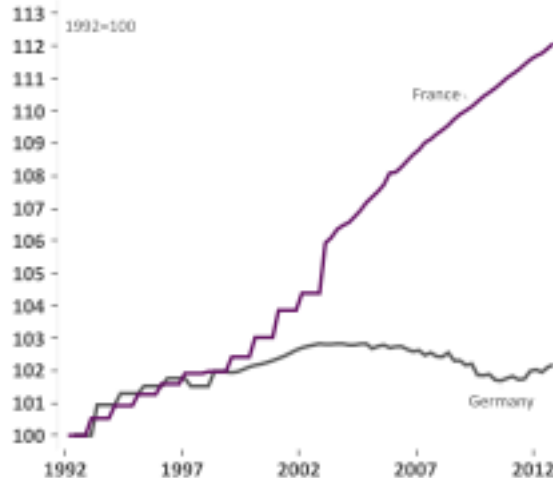
France in comparison to other European countries



Source: Opinion Survey, Sofres -AFII, 2011.

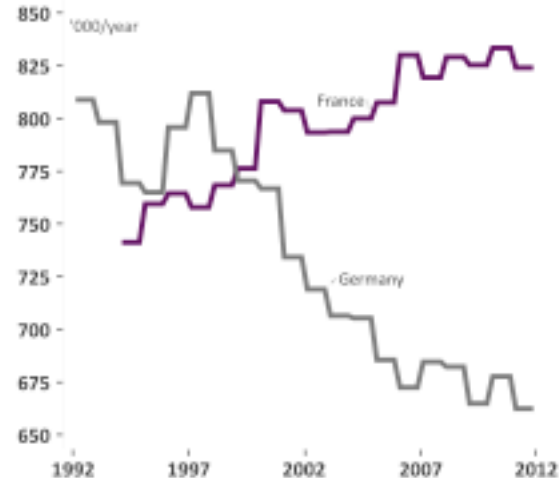
1- Demographic specificity: strong population growth and relative youthness

Population growth in France and Germany



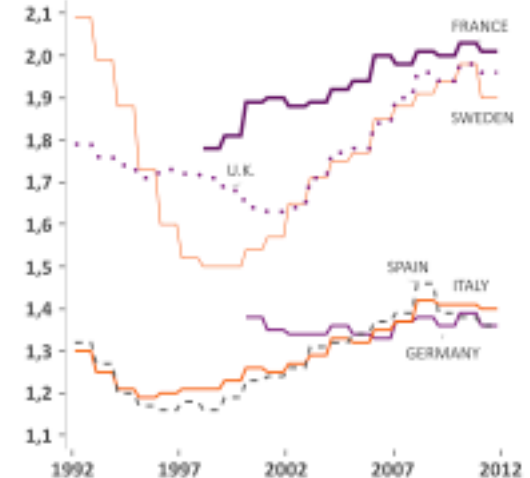
Sources: RichesFlores Research, Macrobond

Live Births per year in France and Germany



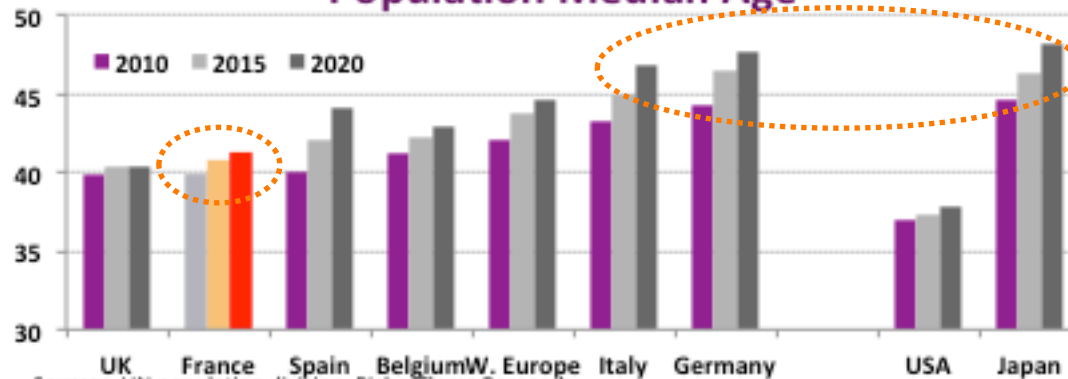
Sources: RichesFlores Research, Macrobond

Fertility Rate



Sources: RichesFlores Research, Macrobond

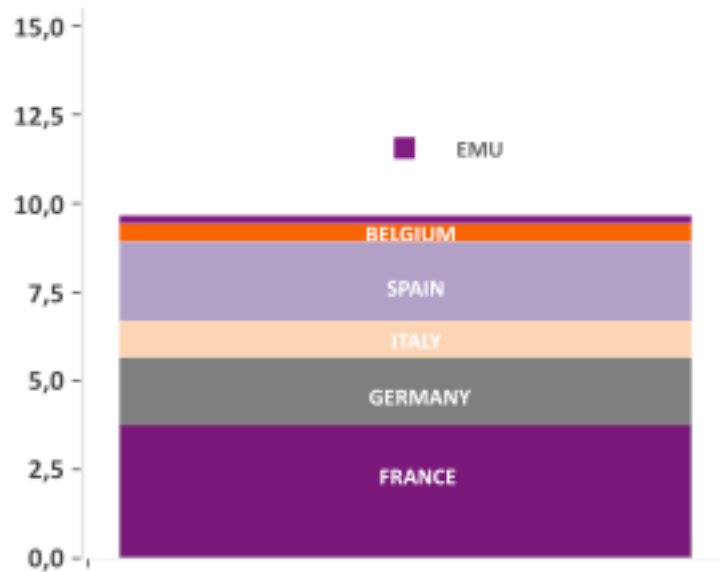
Population Median Age



Sources: UN population division, RichesFlores Research

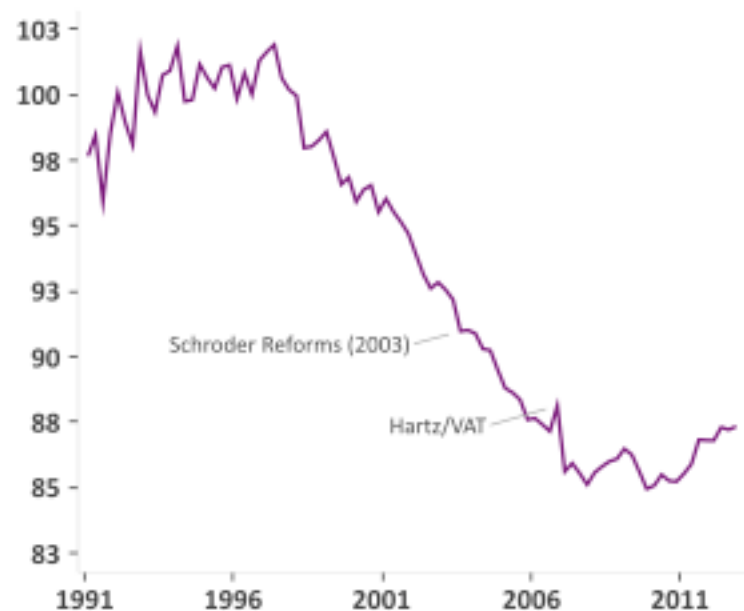
A privileged position within ageing Europe made France the main source of demand

Contribution to EMU Consumption Growth:
2000-2011



Sources: RichesFlores Research, Macrobond

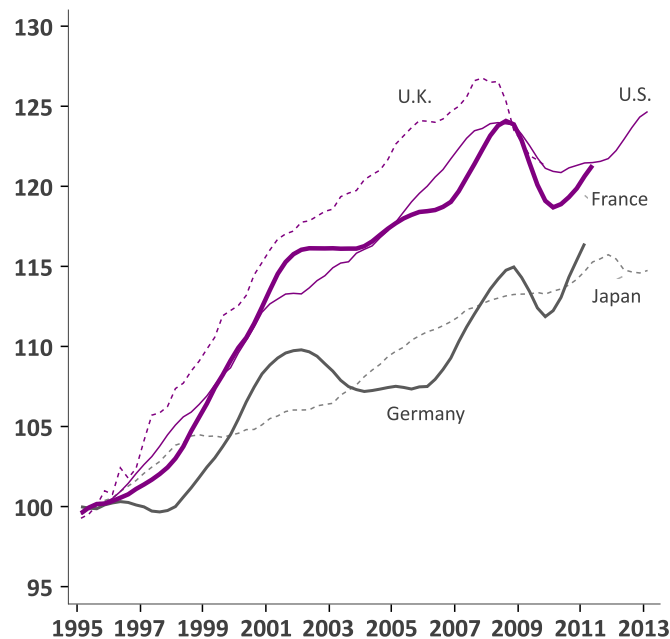
Household Consumption Germany/France,
1993=100



Sources: RichesFlores Research, Macrobond

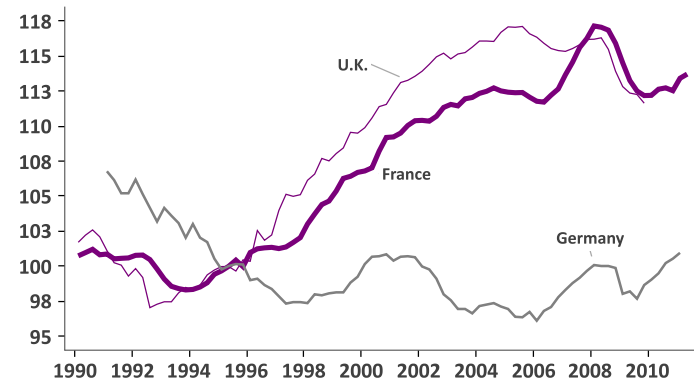
A specificity that reflect the gaps between different national labor markets

Employment in Private Services, 1995=100



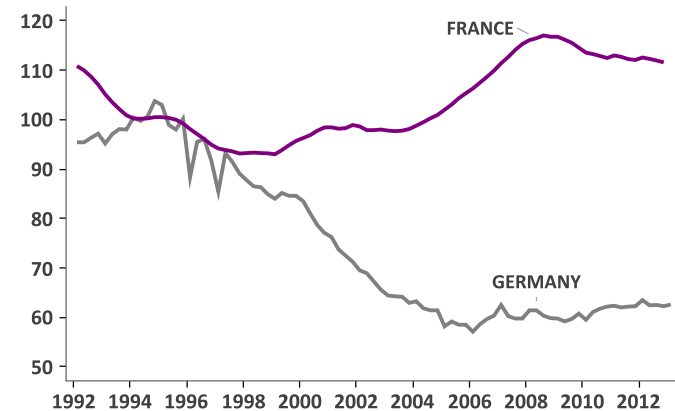
Sources: RichesFlores Research, Macrobond

Employment in Retail Trade, Catering, Transports & Communication



Sources: RichesFlores Research, Macrobond

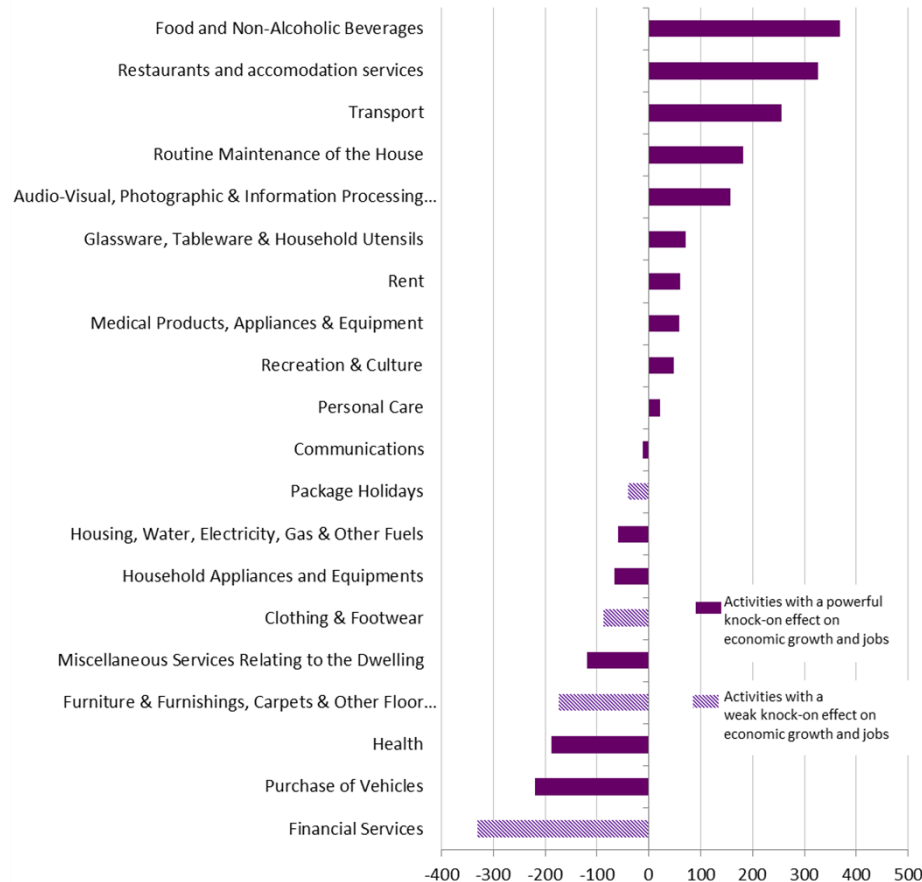
Employment in Construction, 1995=100



Sources: RichesFlores Research, Macrobond

Demographics: a source of diversification of demand and activity

Per capita consumption gap between France and Germany



Source: Eurostat, RichesFlores Research

The strengths and limits of a younger and more dynamic demographic

STRENGTHS

- A source of domestic demand growth
- A source of FDI attractiveness
- Higher savings and, consequently, financing capacity
- A reduced intergeneration income distribution shock...

LIMITS

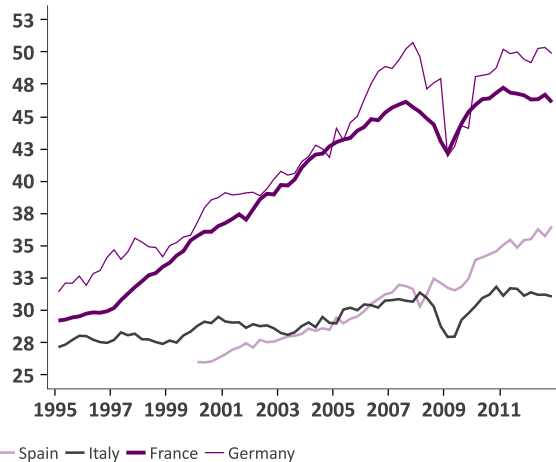
- A higher vulnerability to employment stagnation
- Inability to tolerate deflation...

2- Productivity

- France has the highest productivity level (output per hour worked) among the major European countries.
- France still enjoys a comfortable advance over its European peers for productivity in private sector services and scientific and technical fields

Industrial productivity (Excl. Construction)

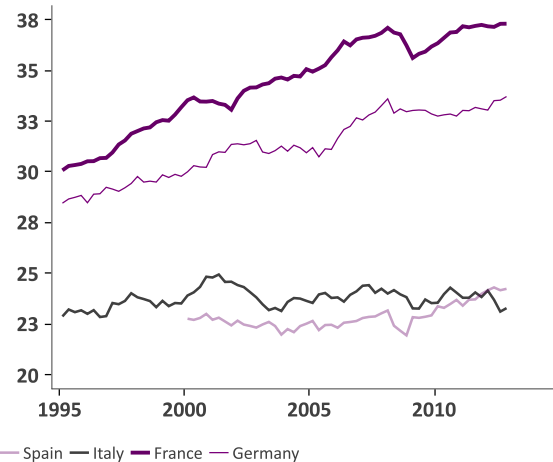
euros per hour worked



Sources: RichesFlores Research, Macrobond

Productivity in private sector services

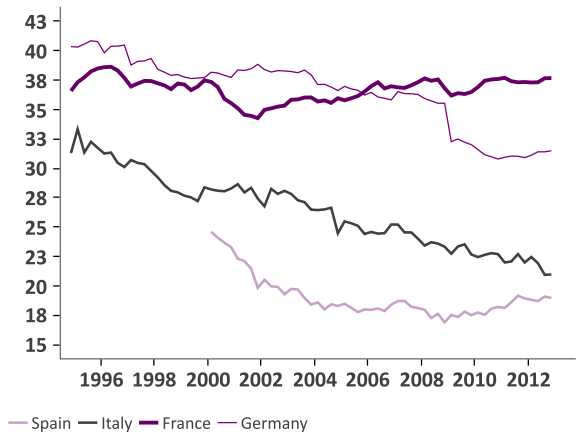
euros per hour worked, ex. real estate and public administration



Sources : RichesFlores Research, Macrobond

Productivity in specialized, scientific, and technical fields

euros per hour worked

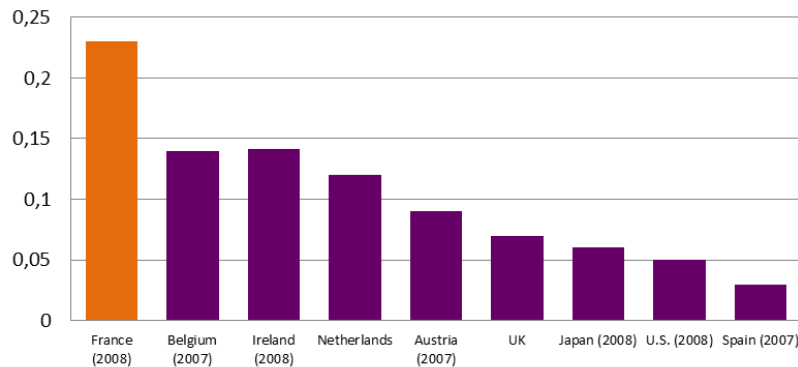


Sources : RichesFlores Research, Macrobond

3- Professional Education/Research

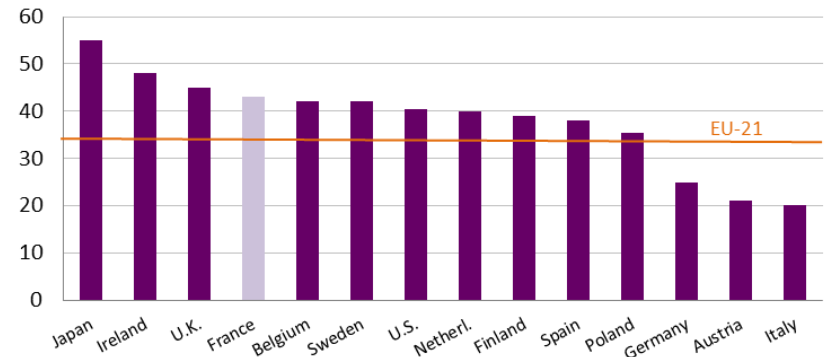
Tax incentives for corporate R&D (2009)

% of GDP



Source: RichesFlores Research, French Attractivity Dashboard, MEF 2012

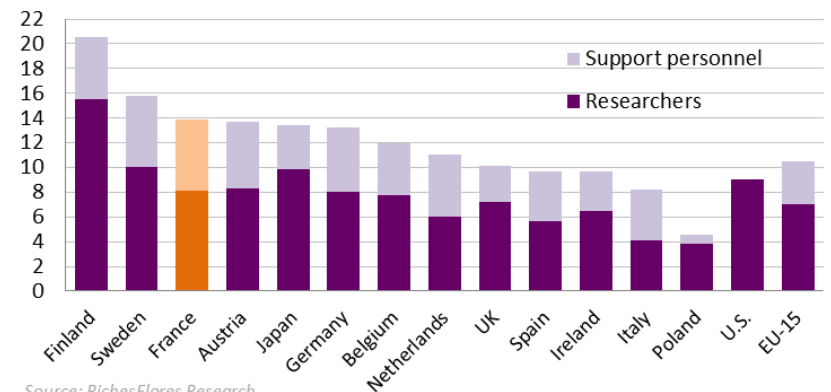
% of the 24-35 population having a high-education degree (2009)



Source: RichesFlores Research

R&D workforce (2010)

Per 1,000 people in the overall workforce

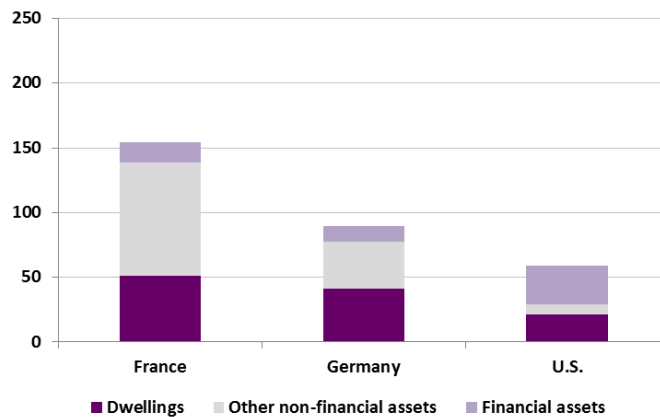


Source: RichesFlores Research

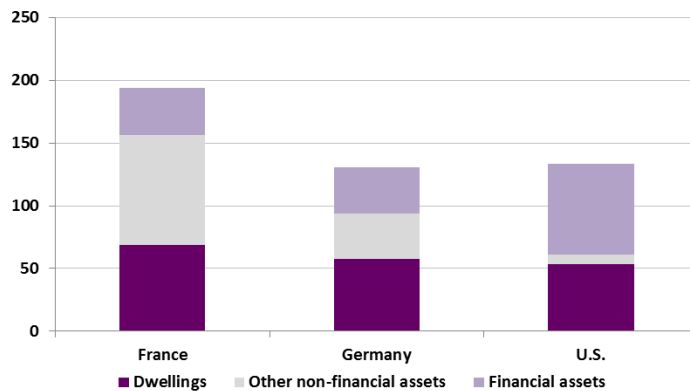
4- Household Wealth

- French households are among the richest ones, especially because of their non financial assets (dwellings and land).

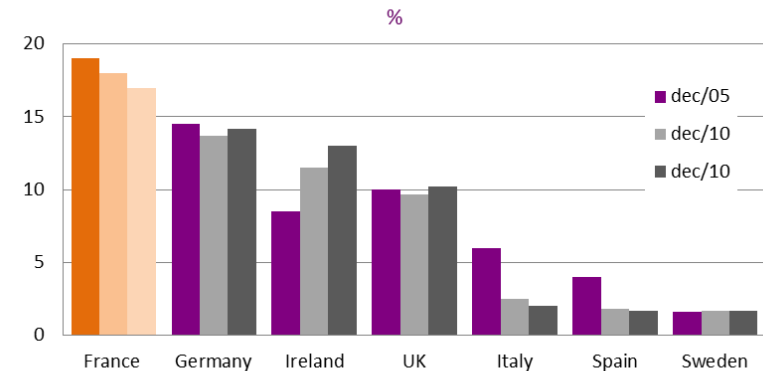
Net Household Assets per capita, '000 USD 2010



Gross Household Assets per capita, '000 USD 2010



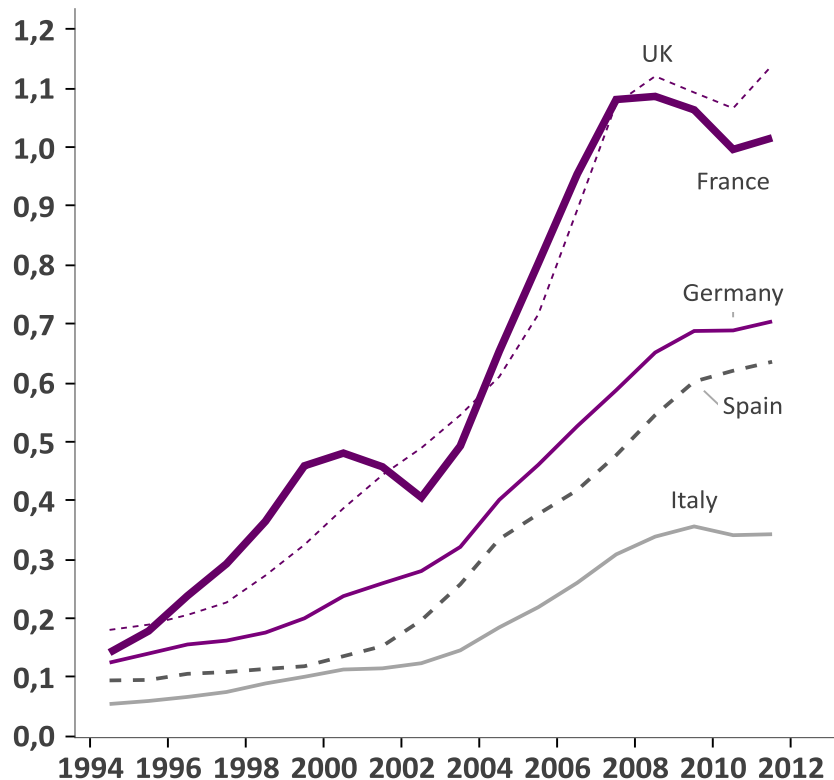
Market shares in the European Investment Fund Industry



Source: RichesFlores Research, "Tableau de Bord de l'Attractivité de la France, MEF"

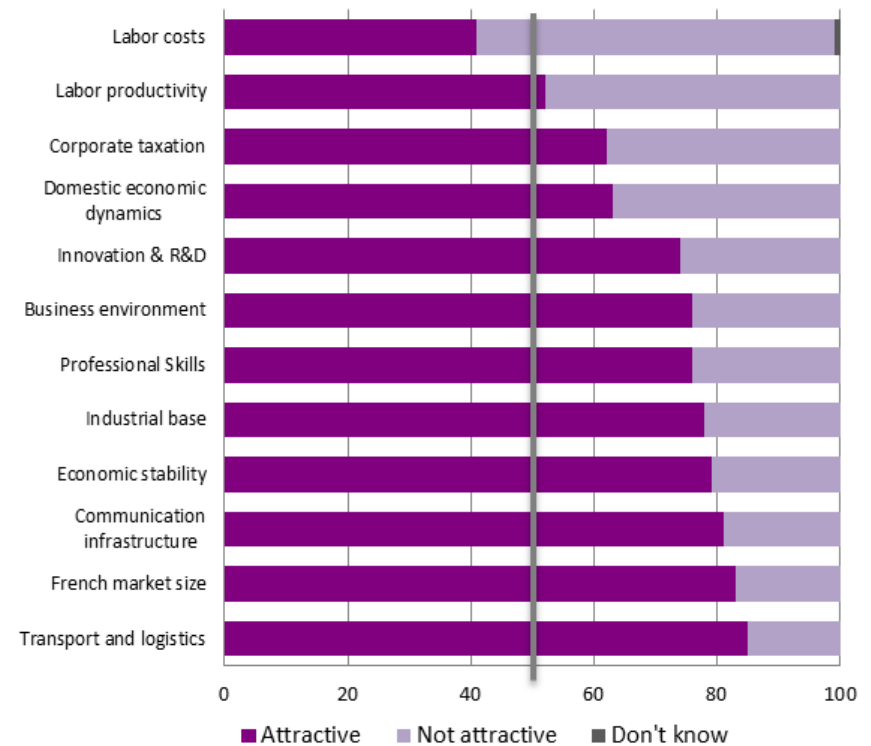
5- An attraction confirmed by numerous foreign investments...

FDI stock (\$trn)



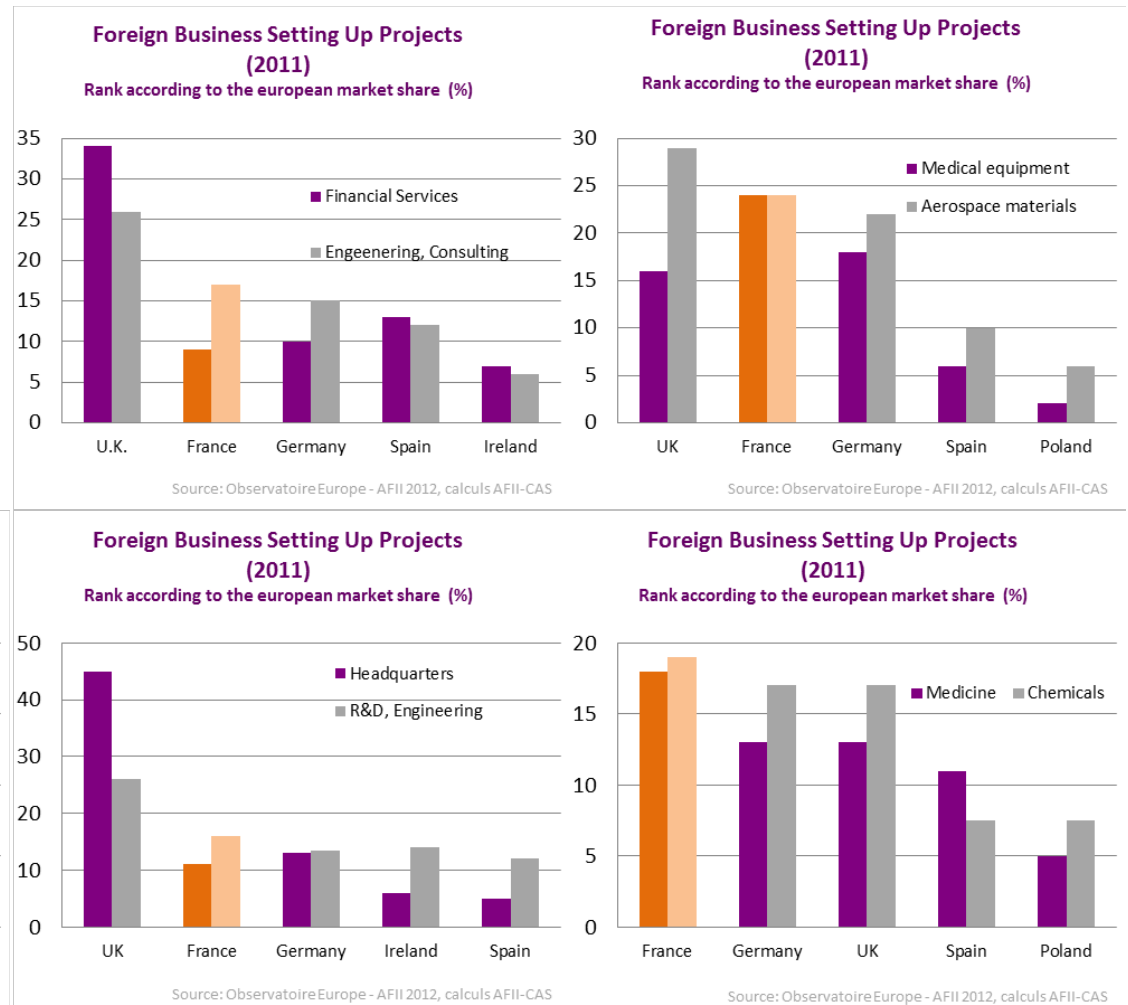
Sources: RichesFlores Research, Macrobond

For each of the following criteria, is France attractive to foreign investors?



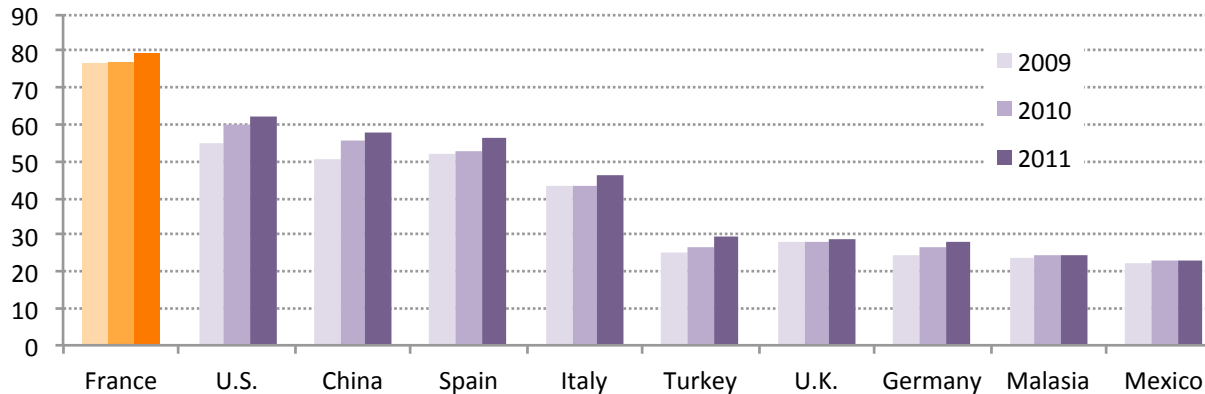
Source: Opinion survey Sofres -AFII, 2011.

... And by a diversity of investment sectors



6- Geographical position: tourism...

Foreign tourist arrivals (in millions of people)

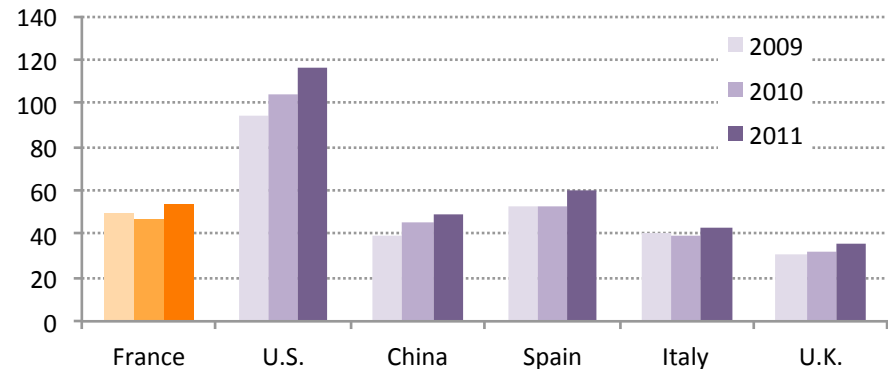


Source: UNWTO, RichesFlores Research

Transit country for Spain or Italy?
Deficient tourism infrastructure?

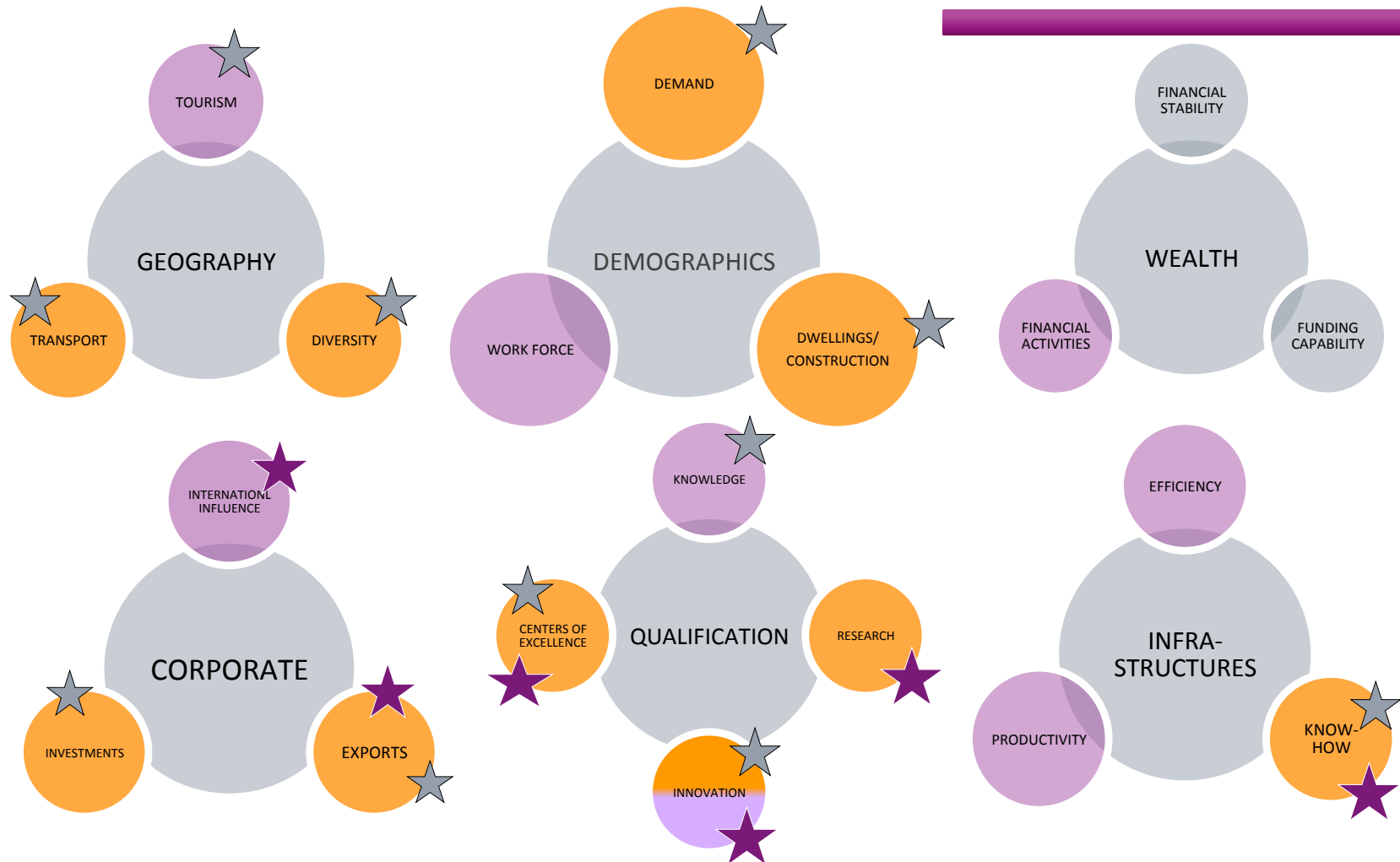
->> Considering that France receives 50% more tourists than China and has the same level of Tourism income, we can definitely say that something is going wrong...

Foreign receipts from tourism (\$bn)



Source: UNWTO, RichesFlores Research

Leveraging the French economy's strengths to follow an alternative path





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