RICHES FLORES RESEARCH

GLOBAL MACRO & THEMATIC INDEPENDENT RESEARCH

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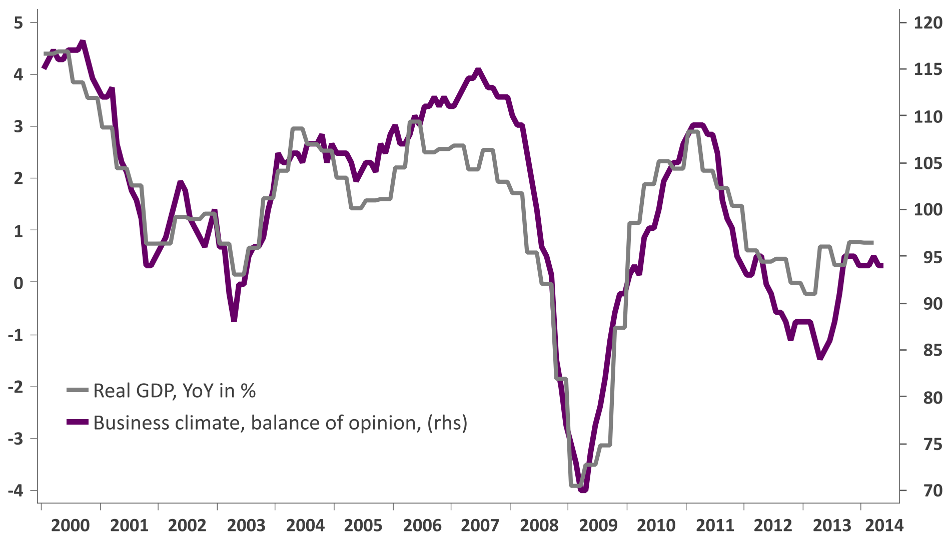
GLOBAL MACRO

France: survey results are converging… for the worst

Distortions from the end of the year between PMI polls, foreshadowing recession, and INSEE data, mostly reassuring, have evened out. Good news for starters, as PMIs made up for their lag, the present convergence has become worrying: all surveys, across the board, paint a decidedly ugly picture. And for two reasons: 1) the return of consumer concerns, 2) the lack of an export recovery. The whole picture is cause for concern. After zero growth in the first quarter, the downturn of the most recent indicators accentuates the risk of a fresh – and sustained - fall in economic activity. The more-or-less consensus forecast of 1 % French growth on average is now very "passé". In fact, French growth will struggle to do better than 0.5% this year! This is very bad news, for France and the rest of the euro area.

Business Climate and Real GDP in France



Sources: RichesFlores Research, Macrobond

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Halt to improvement in consumption, services and employment

Falling PMIs in May in industry and also services should be taken seriously this time around. Reassuring news was nowhere to be found: other INSEE data and numbers from the Banque de France were all negative. The brightening trend in the second half of last year has petered out in the start of 2014, with the domestic situation as well as exports struggling.

At the start of the year, the increase in indirect and direct taxes and renewed jobs destruction (-23.5K) have lopped 0.6% off purchasing power and hurt household consumption. However, what is more alarming is the precipitous drop in consumer confidence and its consequences, which are already being felt on domestic demand. French households are nervous and seem to be shook up by recent governmental statement. The improvement at the end of last year on financial and consumption prospects has wilted and results have been affected very quickly indeed, including services, on which all hopes of fresh jobs growth and investment are reliant. Against such a backdrop, the slight uptick in vehicle registrations seems precarious and, in any case, incapable of offsetting the erosion in demand in other sectors.

The deteriorating business climate for services reflects this turnaround, at a time when corporate demand seems threatened by fresh skittishness. No sub-sectors in the services industry seem to be doing well and the jobs outlook, after improving markedly last year, is down again to worrisome levels.

Employment Expectations in France by Sector

Balance of opinion, in %

Sources: RichesFlores Research, Macrobond

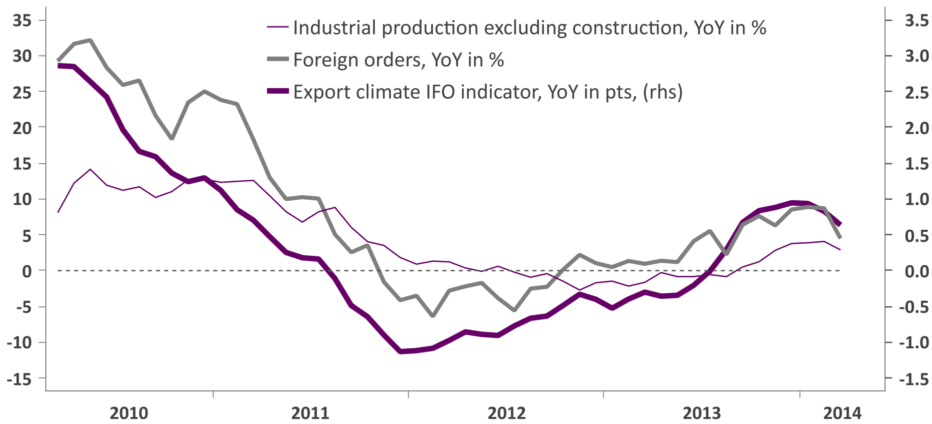
Deterioration of exports

Troubling signs are not, however, confined to domestic performance. Exports are hurting and could fall again shortly. For several months now, export orders have been stagnating. Although losses in France's economic competitiveness is partly to blame for these mediocre results, it would seem that fresh weakness in demand is coming from industrials. France is not the only country in the euro area to be suffering from deterioration in international demand trends (see German indicators in recent months). Heretofore in the shadow of the rebound in intra-regional trade, this deterioration is falling as the dynamic within the euro area sputters.

As such, we ought to be concerned about the consequences for France of the current shift in the German outlook, which has been the sole source of growth for French markets in recent months…

Orders, Export Climate and Industrial Production in Germany

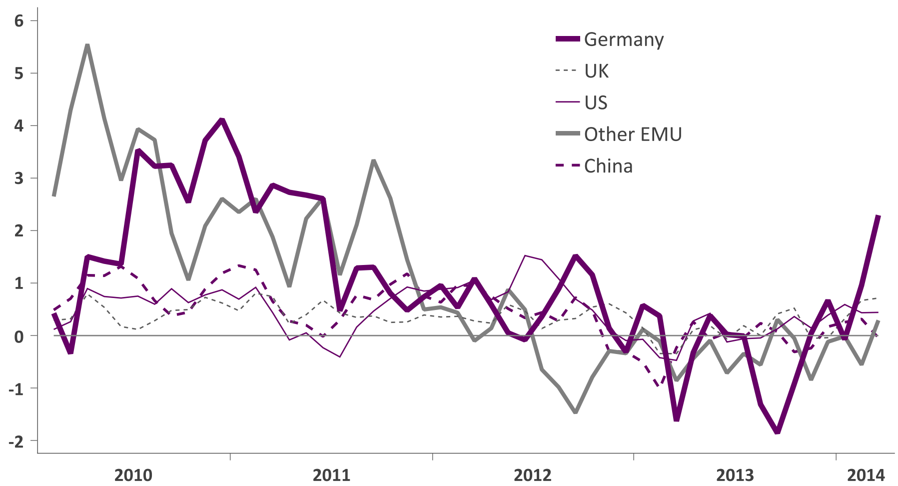
Changes over 12 months, 2MMA



Sources: RichesFlores Research, Macrobond

Contribution to Annual Growth of French Exports

In points of percentage, 2MMA



Sources: RichesFlores Research, Macrobond

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2014 growth: 0.5% looking real

Obviously, 2014 growth forecasts will have to be revised. Until now, the consensus had more or less agreed that the French economy would expand by 1% this year.

Fresh stagnation in real GDP in the second quarter could come out to 0.2 %-0.3%, a level that would require two straight quarters of a 1% rebound to reach the consensus target. This is not likely to play out and the risk that growth will do hardly better than last year (0.4%) seems higher every day, judging by our preliminary estimate, pending more detailed date on Q1 accounts and global trends.

Such an outlook is troubling for several reasons. Not only for France but for the outlook for the entire euro area, where France is the second biggest economy and, therefore, a key player.

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