Appendix B.

France: will the battle of the 3% take place?

As in the case of its European partners, economic developments in France since mid-2011 have been marked by austerity. Faced with the emergence of sovereign risk, as illustrated by the Greek default and the growing concern about the creditworthiness of major euro zone countries such as Spain and Italy, the member countries have implemented fiscal consolidation policies. France is no exception, and while its fiscal impulses are less negative than those of other countries, the policy established by the Fillon and then the Ayrault government is no less restrictive. The impact of austerity is all the more marked as it is being implemented simultaneously in all the countries of the euro zone, which means that the internal domestic restrictive effect is being compounded by a recessionary effect resulting from the slowdown in external demand. As 60% of France's exports are to the European Union, the external stimulus has virtually disappeared in 2012. French exports thus suffered a sharp deceleration in the first half of 2012, slowing from average growth of 1.4% in the second half of 2011 to a near standstill. This listlessness should continue up to the end of 2013, with the annual pace of export growth below 1%.

The actual trajectory of the French economy can be gauged by the yardstick of the French and European austerity programmes in comparison with what was possible without the austerity policies. Based on its past experiences with recovery, the French economy, which has been underperforming for the last four years, has a significant rebound potential, *i.e.* 2.1% in 2012 and 3.1% in 2013. One factor pushing it off this reference path is the programme of budget cuts implemented by the French government since 2011, which will reduce annual growth to 1.2% in 2012 and 1.8% in 2013. As France's trading partners have similar policies, any residue of growth that might survive the negative domestic fiscal impulse will disappear completely because of the policies of the other European countries. French GDP will thus stagnate in 2012 and 2013.

By setting a pace that is far from its potential, the expected growth will increase the output gap accumulated since 2008 and will lead to a further deterioration on the labour market. Moreover, the reduction of the budget deficit expected by the government due to the implementation of its consolidation strategy—the target for the general government deficit is 3% of GDP in 2013—will be partially undermined by the shortfall in tax revenue due to weak growth. The government deficit will come to 3.5% in 2013, after 4.4% in 2012, bringing the public debt to 90.6% of GDP in 2012 and to 93.1% in 2013, compared with 86% in 2011. If the government wants at all costs to achieve its goal of a deficit of 3% of GDP in 2013, a new wave of austerity will be necessary, which would then push the French economy over into an outright recession.

The series of shocks suffered by companies has led to a chronic underutilization of production capacity in the last four years. While the utilization rate of production capacity has recovered some of the ground it lost following the recession of 2008-09, after being down to levels not seen since the 1970's, it fell again in mid-2011. As for the workforce, labour productivity has been unable to regain its trend level and is in a similar situation of underutilization of resources, as companies are constantly overstaffed.

This situation pushes labour costs up considerably and hurts business margins, which are once again at their low point of the early 1980s. This is expected to result in new net job losses, as it no longer seems possible to absorb the negative impact of the austerity measures on employment through the productivity cycle, except by extending the collapse in margins into 2013. The low level of margins is also holding back investment, in addition to the existence of this excess capacity fuelled by the austerity policies. And, since this policy is itself forcing business to contribute through higher taxes and contributions, it is also directly contributing to drying up self-financing margins.

As companies are generating fewer internal resources, they are more dependent on external financing. But the instability on the financial markets and the banking credit crunch are rendering access to credit more difficult. Business investment, which rebounded by 6.4% and 5.3% respectively in 2010 and 2011, is likely to once again taper off, with stagnation in 2012 and a slight decline in 2013 of -1.4%.

The rising tax burden will reduce household income in 2012 and 2013. Consumers have already been hit in 2011 by the fiscal consolidation plans decided by the Fillon government. For this year and next, a greater effort will be required from households, as the new majority falls in line with the previous one. In total in 2012 and 2013, the bite out of households should be approximately 1 point of gross disposable income in each year.

In a context where uncertainty prevails, particularly the risk of unemployment, households perceive savings as a refuge, and nothing is likely to convince them to change their view in 2012 and 2013. By 2013, the savings rate will thus return to the level of 2011. Coupled with the decline in real gross disposable income, the loss of jobs and the increased government levies on households, this stability in savings will lead to a decline in consumption this year and next.

After the recession of 2008/2009, employment enjoyed a relative upswing that slowed the restoration of productivity. The turnaround in activity in the second half of 2011 has increased the delay. Employment is thus expected to be more sensitive than usual to fluctuations in activity, unless this atypical trajectory of productivity is to be continued. The cessation of growth should therefore result in a new wave of net job losses in the market sectors (-0.2 % and -0.8 % in 2012 and 2013, respectively). Active labour market policies, including subsidized jobs in the non-profit sector, will buffer the deteriorating situation in the labour market between now and

2013, but it will not prevent a further rise in unemployment. As the unemployment rate hits 11% of the workforce at end 2013, it will exceed the previous record of 10.8% set in the first half of 1997.

Table B. OFCE, ECLM, IMK macroeconomic forecasts

France

%	2010	2011	2012	2013
GDP	1.6	1.7	0.1	0.1
Private consumption	1.5	0.3	-0.1	-0.6
Investment	1.0	3.5	0.6	0.3
Public consumption	1.7	0.2	1.3	1.0
Exports	9.2	5.5	2.6	2.1
Imports	8.4	5.2	0.2	0.8
Contribution to growth				
Internal demand	1.5	0.9	0.4	-0.1
External trade	0.0	0.0	0.7	0.4
Inventories	0.1	0.9	-1.0	-0.2
Unemployment rate	9.8	9.6	10.2	10.9
Inflation	1.7	2.3	2.4	1.7
Public deficit	-7.1	-5.2	-4.4	-3.5
Fiscal impulse	-0.6	-2.1	-1.6	-1.8
Public debt % GDP	82.4	86.0	90.0	93.1
Current account % GDP	-1.6	-2.0	-2.5	-2.5
Unit labour costs	0.5	1.7	1.8	1.5

Source: National accounts, OFCE, ECLM, IMK.