



Economy

Focus France

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France: what terror, the budgetary constraints!

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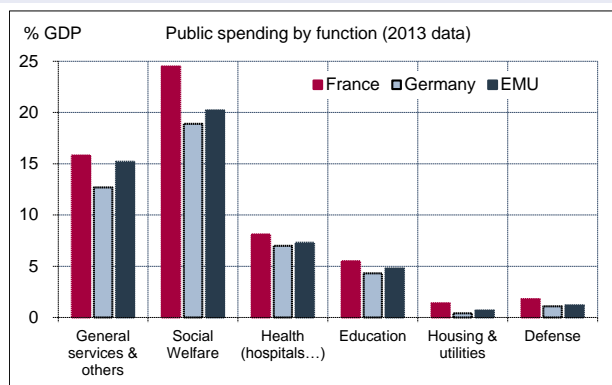
This twice-monthly note on the state of the French economy cannot ignore the deadly terrorist attacks which have struck Paris for the second time this year. This type of incident generally does not have a lasting impact on the economy. This is the working assumption retained in our scenario. However, in the present case, we cannot rule out an impact on activity and confidence in the short term. Zero growth in Q4 is a possibility. The attacks also affect the political and budget debate. They relegate economic topics (reforms, taxes) to the background behind security issues. They could also (unfortunately) be used as a pretext to delay, yet again, the efforts needed to reduce and reorganise public spending in France.

The fortnight's focus

The crime scene was still fresh when François Hollande rushed to declare that the "security pact takes precedence over the stability pact" (speech of 16 November before an emergency joint session of parliament). In other words, France will have to earmark additional security and defence spending, and consequently, suspend its European budget commitments. There is no valid reason for linking these two issues, in our view. A country should be able to ensure its defence without compromising its public finances. Implying that Europe would be an obstacle to security is particularly telling with regard to the difficulty of the French government – current and previous ones – in accepting as a rule of good management the limits that must be set on public deficits. A rule, for those who need reminding, which is enshrined in a Treaty ratified by a referendum.

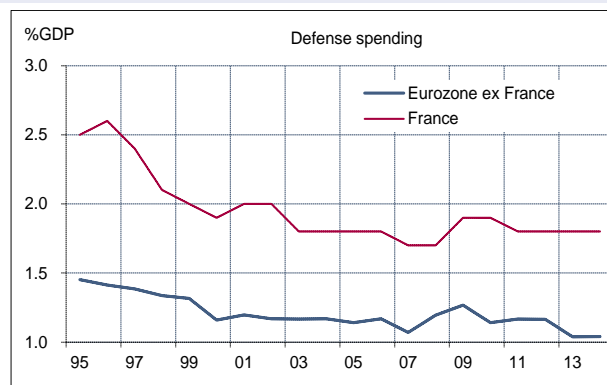
Some key data on public spending in France may be useful here. First, its level (57.2% of GDP) is completely unjustified given the standards of neighbouring countries (43.5% in Germany) with a very similar social model. Second, this difference is only marginally attributable to defence spending. Admittedly, France spends more in this domain, as it is a nuclear power, but France exceeds the average of the Eurozone in all spending categories, especially social transfers (chart lhs). Third, France has reduced its military spending over the past twenty years by slightly more than its neighbours (chart rhs). There is no proof that this is primarily due to the need to reduce government deficits. In any case, the security risk does not justify postponing efforts to control local public spending, nor, as rumour would have it, does it justify the uptrend in public-sector employees' wages in the year preceding elections.

Breakdown of public spending by function



Sources: European Commission, Oddo Securities

Defence spending



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The fortnight's economic newsflow

- Three coordinated attacks by ISIS-affiliated terrorists were launched on Paris and its suburbs on **13 November**. The human toll of these attacks is at least 130 dead and dozens of injured. The scale of the attack is without precedent in Western countries since those launched on London (2005), Madrid (2004) and New York/Washington (2001). To varying degrees, all areas of our society have been shaken, amongst which the economy. Amongst other goals, terrorist attacks aim to sap the confidence of those targeted. They increase, at least temporarily, the cost of transactions due to heightened security and restrictions on the free circulation of people and goods. These attacks came only ten months after the mass-casualty attacks in the heart of Paris. This magnifies the psychological shock by demonstrating that even a major capital that is already on a heightened state of vigilance is not immune. The very military tone taken by François Hollande in the wake of these events ("*We are at war*") is double-edged. On the one hand, this demonstrates a determined response at a domestic (police operations in the suburbs) and international level (military strikes in Syria, plans for an anti-Islamic State coalition). On the other, it could exacerbate uncertainty, exposing weaknesses in the intelligence services which failed to prevent these attacks.
- Past experience shows us that this type of event tends to have no lasting effect on economic activity, at least in the Western world, but the impact in the short terms is unlikely to be negligible. The aim, as it was in Egypt and Tunisia where Islamic State has also carried out terrorist attacks this year, is to disrupt the country and to destroy certain areas of economic activity, such as tourism. Compared with these economies, France is fortunately more diversified, but several sources suggest that this shock has been far stronger than that of January for sectors such as hotel, leisure and shopping centres, in the run up to Christmas season. In France, tourism contributes 9% of GDP if we include its direct and indirect channels (see our *Economy Flash* of 24 July: "Impact of euro depreciation on tourism in Europe?"). The Greater Paris region accounts for 30% of French GDP. If Paris were to suffer a 10% decline in tourist activity over several weeks, this would cost the country three-tenths of a point of GDP. For the past year, the average rate of growth has been 0.3% per quarter. Therefore we cannot rule out the possibility that growth in France will temporarily fall to zero in Q4. A correction could follow once the perception of security risk has normalised.
- No major infrastructure was damaged. The effect on the economy will therefore mainly depend on the psychological impact on economic agents. The confidence surveys published since the attacks only give a partial indication of the effects since a large section of the responses were collected previously. According to Markit, some service providers have noted a negative impact on activity. Overall, the PMI-composite dropped 1.3 points in **November** after an increase spanning two months. Its level is similar to Q3. The INSEE surveys are a little more positive with the business climate index at its highest point since July 2011. Confidence is a shade higher than its long-term average in industry, service and wholesale and considerably higher in retail. It is nevertheless much lower in construction. This sector is still showing very low order levels and its production capacity continues to be vastly under-utilised. For households, the INSEE confidence index was flat in **November** but just 7% of the responses were given after 13 November.

Forthcoming events

- Following the attacks, all political parties suspended for one week their campaigns for the regional elections on **6 and 13 December**. In January, under similar circumstances, President Hollande saw his popularity rise significantly for several weeks before falling back to record lows. This time, the reflexive response of countering the attacks by a show of national unity was much less clear. There was no major march bringing together millions of people. It has also been established that several terrorists entered Europe as "refugees" of the civil war in Syria, which supports those criticising France's foreign policy and Europe's attitude to this humanitarian crisis. Unsurprisingly, the three polls carried out after the attacks place the Front National in the lead in the first round of the regional elections with 27-30% of the national vote. These predictions should be viewed with caution since the attacks have changed the terms of the election campaigns (security is taking precedence over the economy) and might prompt abstainers to return to the ballot box (this is often a source of errors in the opinion polls).

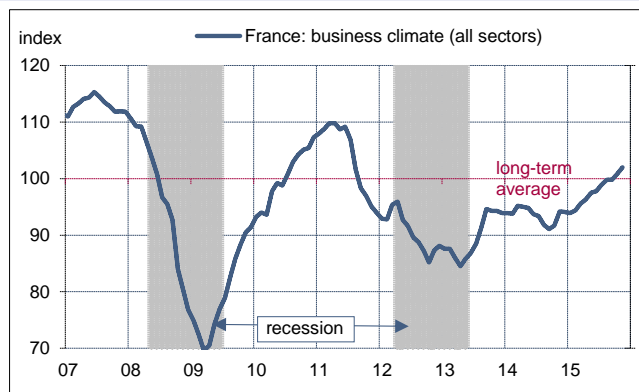
Appendix chart: business climate, confidence, households

Confidence indicators

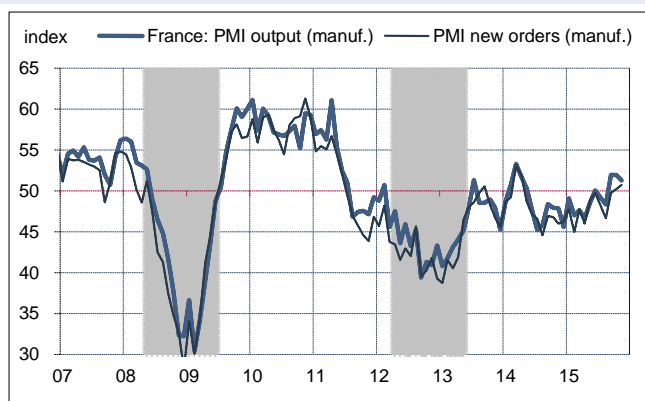
France: survey data and the business cycle							
Index	Current			Expansion	Recession*		
	Nov	Oct.	Sep		2008-09	1992-93	
PMI manufacturing	50.8	50.6	50.6	52.2	42.6	-	
PMI services (output)	51.3	52.7	51.9	56.0	46.8	-	
PMI composite (output)	51.3	52.6	51.9	55.1	44.9	-	
INSEE manufacturing	102	103	104	102.7	85.3	82.7	
INSEE services	101	101	97	102.8	85.0	86.1	
INSEE construction	91	90	91	103.0	101.0	83.0	
INSEE retail sector	111	110	109	101.6	88.5	86.7	
INSEE wholesale sector	101	100	100	101.7	85.8	87.7	
INSEE consumer conf.	96	96	97	101.3	84.6	100.5	
BdF manufacturing	-	99	98	103.5	80.0	85.8	
BdF services	-	98	97	102.0	91.3	83.9	

*from Q2 2008 to Q2 2009; and from Q2 1992 to Q2 1993

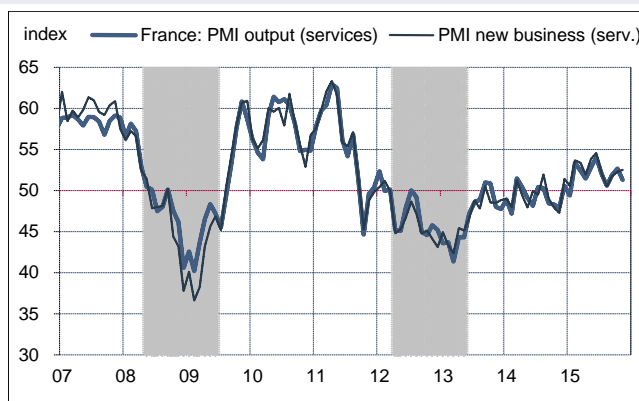
Business climate



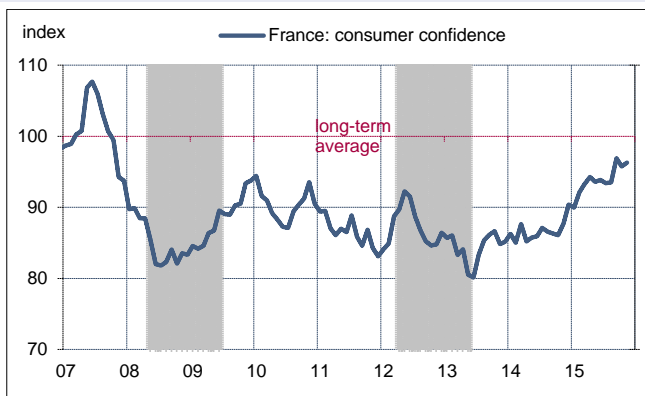
PMI-manufacturing survey



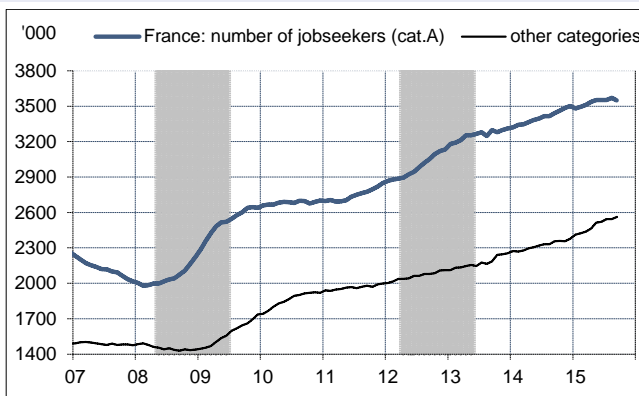
PMI services survey



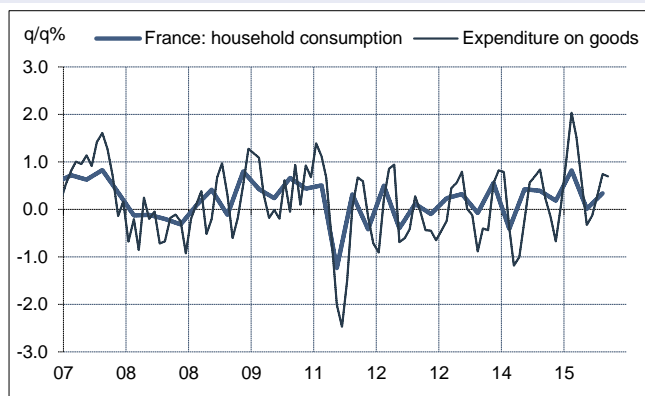
Consumer confidence



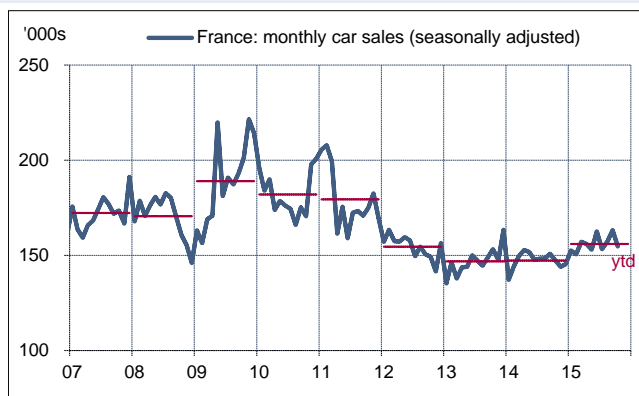
Jobless claims



Household spending



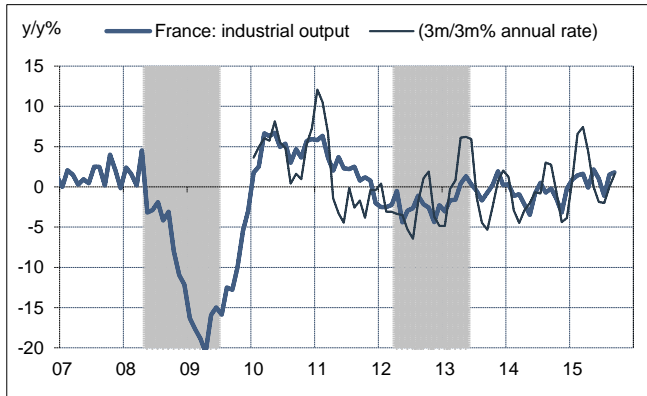
Vehicle sales



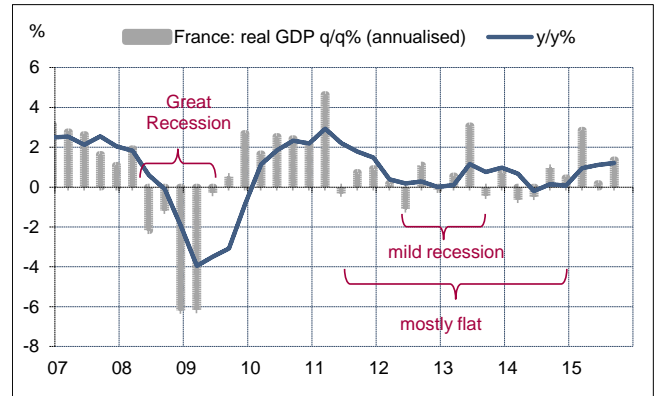
Sources : Thomson Reuters, Markit, Odso Securities

Appendix chart: activity, inflation, credit, finances

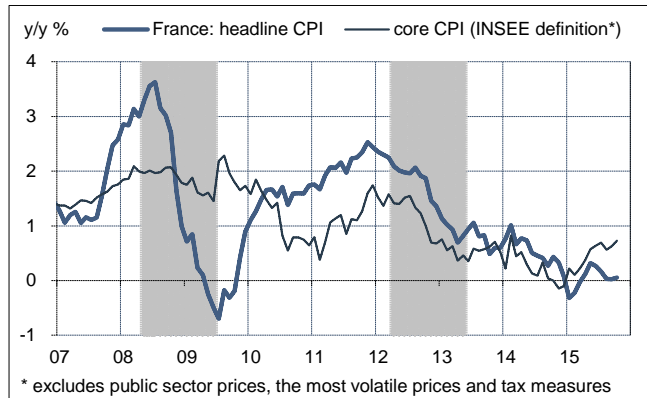
Industrial output



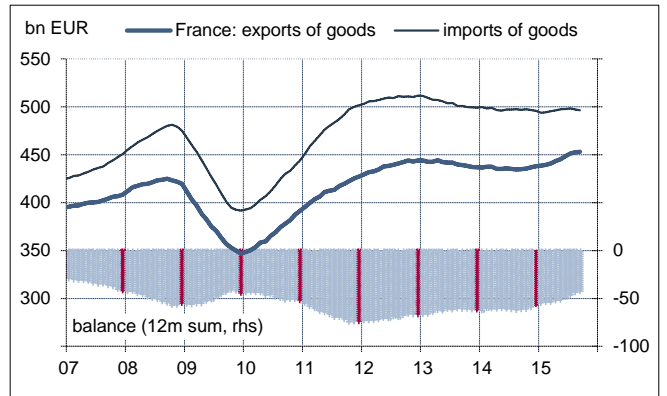
Real GDP



Headline and core inflation



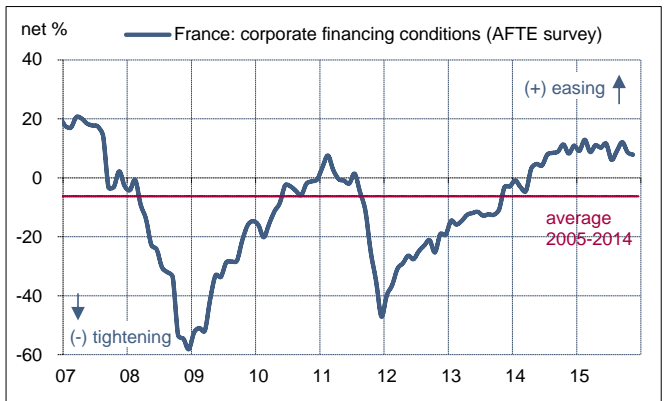
Trades of goods



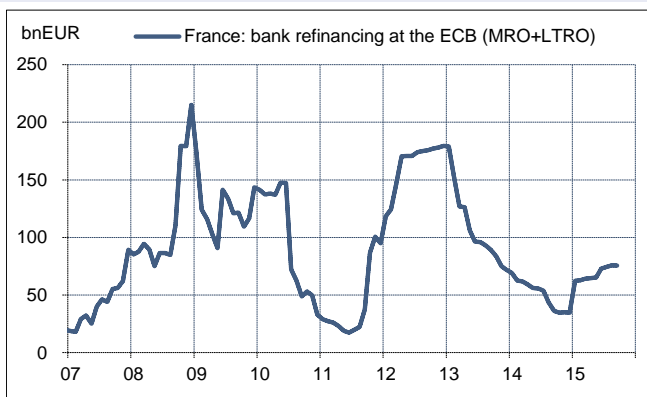
Private sector credit



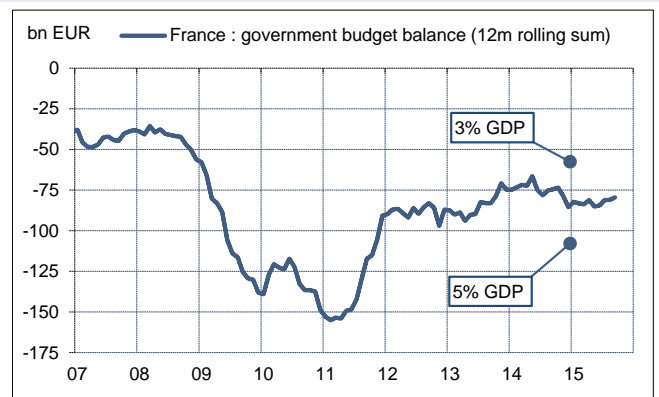
Credit conditions for businesses



Bank refinancing at the ECB



Government budget



Sources : Thomson Reuters, AFTE, Odso Securities

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