

France Business Forecast Report Q4 2014

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Abstracts

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Core Views

While the rest of the eurozone is showing early signs of recovery, the French economy continues to lag behind the region. While the improving regional economic outlook may provide some limited upside potential, this might not be sufficient to drive a recovery in French manufacturing unless the country first addresses its outstanding competitiveness issues.

While we are likely to see a gradual increase in positive rhetoric towards structural reforms, Hollande is unlikely to become an ambitious reformer of the French model. While we expect some reformers will take baby steps in the right direction, the ability of Hollande to implement sweeping reforms will be restrained by divisions within his own party and core support base, and resistance from the proliferation of special interest groups which will make unilateral reform a troublesome and compromised process.

We expect pressures on the government to engage in more concerted fiscal consolidation to mount over the coming quarters, particularly as lower growth begins to translate into lower government revenues. While France has thus far not fallen prey to the bond vigilantes like the peripheral countries of the eurozone, the country nonetheless has one of the largest public sector debt piles in Europe and remains susceptible to contagion effects.

Major Forecast Changes

We have downgraded our government budget forecasts for France and now expect the fiscal deficit to arrive at 4.0% of GDP in 2014 and 3.7% in 2015, from 3.4% and 3.1%

previously.

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SWOT Analysis

BMI Political Risk Ratings

Domestic Politics

Le Pen Likely To Reach Presidential Runoff In 2017

High unemployment, low growth and a fractured political centre ground are increasing the probability that far-right Front National leader Marine Le Pen will make it through to the second round of the presidential election in 2017.

Table: Political Overview

Long-Term Political Outlook

A Tumultuous Decade Could Lie Ahead

We expect several dynamics to come to the forefront of France's political scene in the coming decade. These include France's role in the world, economic reforms, the challenge of demographics and the potential resurgence of left-wing parties after years in the political wilderness.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Consumers No Longer Offsetting Weak Corporate Activity

There is a growing risk that France's economic recovery will fail to materialise, as rising unemployment and declining consumer confidence begin to weaken household consumption, which has historically been the dominant engine of growth. Fixed investment is being constrained by weak business confidence, arising from mixed signals from the government, while the government is coming under growing pressure from the EU Commission to step up austerity measures ahead of the

2015 deadline.

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The failure of President Francois Hollande to undertake meaningful reform of the French economy will ensure that the country continues to run a steady current account deficit for the foreseeable future.

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On Track For Collision With Germany

We have downgraded our government budget forecasts for France and now expect the fiscal deficit to arrive at 4.0% of GDP in 2014 and 3.7% in 2015, from 3.4% and 3.1% previously. While low inflation the ECB's commitment to backstopping sovereigns has kept borrowing costs down, low growth and deflation remain salient risks for the steadily rising debt load.

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Assessing The Aftermath Of ECB Policy Action

The European Central Bank (ECB) has delivered on nearly all of the policy options that we were expecting for the June 5 meeting. This is a step in the right direction in terms of warding off the risk of deflation and will be positive for European equities and sovereign bonds. However, we warn - as we have done countless times during previous easing rounds - that the efficacy of ECB policy action will be limited absent structural reforms in the eurozone at the national and federal level.

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The French Economy To 2023

A Difficult Decade

The French economic model is looking increasingly threatened over the coming decade, with tepid growth, rising debt loads and persistent unemployment expected to characterise the country's long-term outlook. Despite this somewhat bleak prognosis, we highlight that we expect France to outperform relative to most of its regional peers.

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