+44 20 8123 2220
info@marketpublishers.com

# France Business Forecast Report Q2 2014

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## Abstracts

**Core Views**

While the rest of the eurozone is showing early signs of recovery, the French economy continues to stagnate. 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, President François 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 limited by divisions within his own party and core support base, and resistance from the proliferation of special interest groups that will make unilateral reform a troublesome and compromised process.

We expect pressure 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 revised up our 2013 real GDP growth estimate for France to 0.2%, from a previous forecast of 0.0%, on the back of strongerthan- expected household consumption.

## Key Risks To Outlook

Downside Risks To Fiscal Forecast: The possibility of a further intensification of the eurozone sovereign debt crisis and the potential need for state-led capital injections in the domestic banking sector keeps the risks to our fiscal deficits over the medium term firmly to the downside.

Rising Debt Loads Could Weigh On Growth: We see continued possible hazards to the fiscal outlook, including the potential for interest rate shocks, further fiscal slippage and a stagnant growth environment, and caution that the next 24 months will be extremely important in determining France's long-run debt trajectory.

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result of a sustained decline in cost competitiveness and robust household consumption supported by social transfers and comparably low levels of household debt. While we expect the current account deficit to remain wide over 2014 and 2015, as the lack of economic reform that has been undertaken continues to stifle potential productivity gains for exports, we expect some slight further narrowing owing to weaker household consumption.

Table: BALANCE OF PAYMENTS

Fiscal Policy

Social Debt Ceiling Adds To Fiscal Woes

The government is struggling to rein in the fiscal deficit, and growing domestic opposition to tax hikes has forced reversals on a number of planned revenue-raising measures. However, with unemployment rising and growth still stagnant, spending cuts remain equally controversial. While we have long argued the need for new competitiveness measures for France, including reduced labour tax wedges, these will bring their own challenges, potentially forcing the government to shift the burden to households or face a widening of the increasingly unsustainable social security deficit.

Table: FISCAL POLICY

Regional Exchange Rate Policy

Euro Strength Unsettling The ECB

Passive monetary tightening and improved investor sentiment will compound policy inertia from the European Central Bank (ECB), which has kept the euro strong heading into 2014. However, weak economic growth, high unemployment, euro strength, deflation risks, a potential long-term refinancing operation (LTRO) cliff and anaemic structural reform are becoming increasingly unpalatable for policymakers. As such, we expect substantial monetary intervention in 2014. If this comes in the form of an LTRO top-up, then the euro will initially hold firm before sliding by end-year as growth will remain weak. If, however, the ECB opts for negative deposit rates (a far more extreme option), we expect a sharp and disorderly euro correction.

Table: Eurozone Currency Forecast

Regional Monetary Policy

ECB Cut: Pushing On A String

**CHAPTER 3: 10-YEAR FORECAST**

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.



## CHAPTER 4: BUSINESS ENVIRONMENT



## CHAPTER 5: KEY SECTORS



## CHAPTER 6: BMI GLOBAL ASSUMPTIONS

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