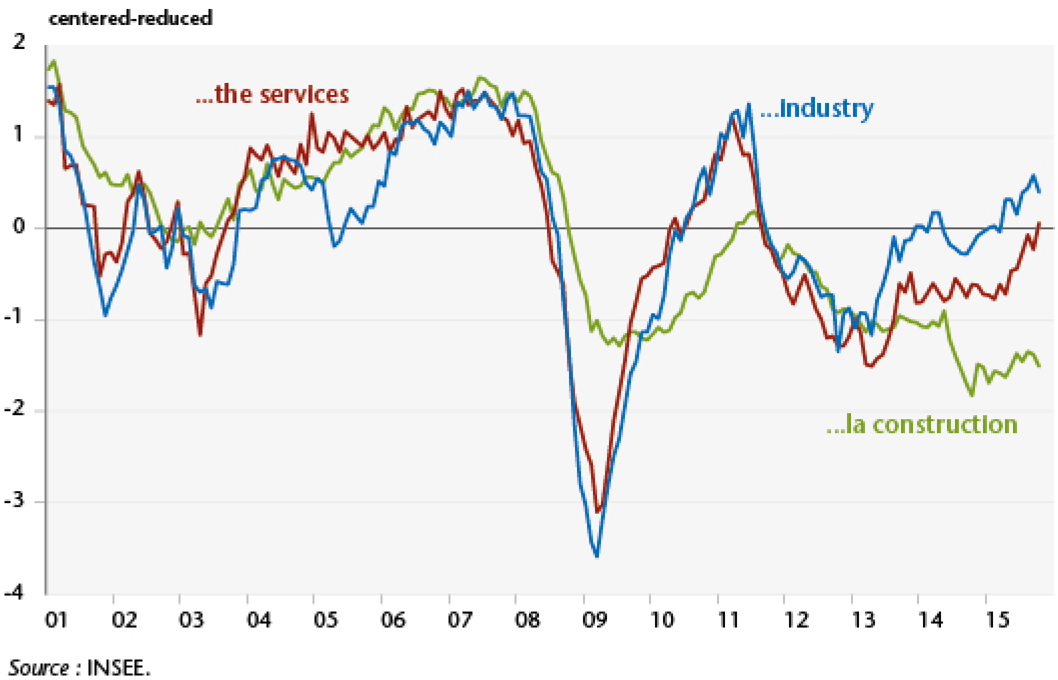
The French economy on the road to recovery

by Hervé Péléraux

The publication of the INSEE's business surveys on October 22 confirms the French economy's positive situation in the second half of 2015, suggesting that the negative performance in the second quarter of 2015 (0%) will turn out to have been merely "an air pocket" after the strong growth seen in the first quarter (+0.7%). The business climate in industry has exceeded its long-term average for the seventh month in a row, and the service sector has been recovering rapidly since May 2015 and has climbed back to its average, the highest level in four years (Figure 1). The business climate in the construction sector nevertheless is still suffering from the crisis that hit it, but its downward trend halted at the end of 2014; despite monthly hiccups, the sector has begun a slow recovery that could signal the end of its woes in the coming quarters.

Figure 1. Business climate in …

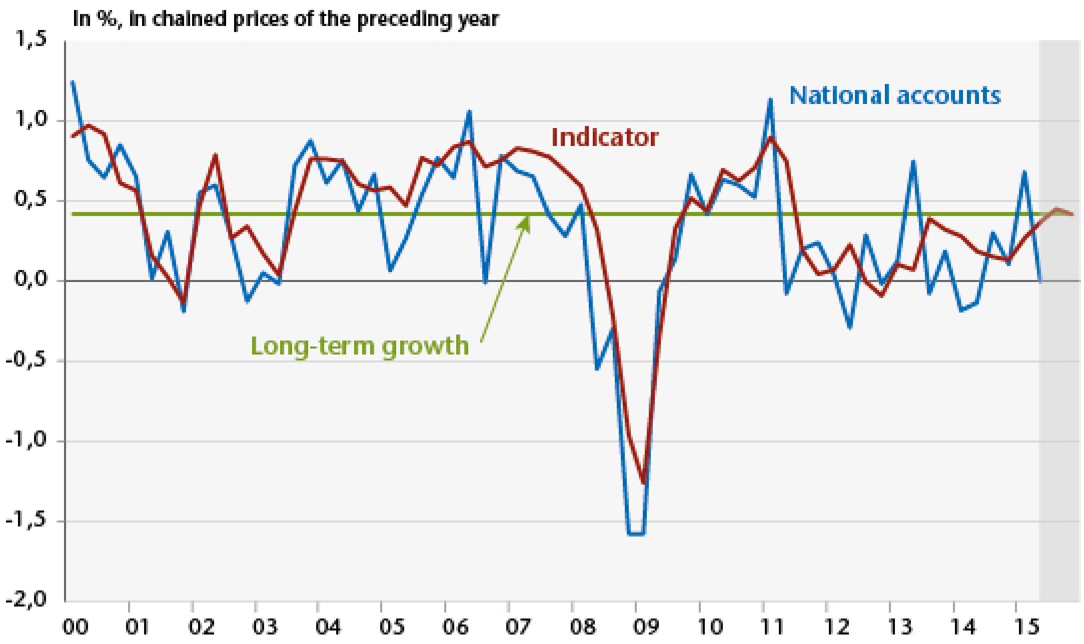


The confidence indicators, which provide qualitative information summarizing the balance of opinion on the various questions posed about business activity, consumer confidence and the situation in commerce, can be converted into quantitative information by means of an econometric equation linking these to the quarterly GDP growth rate[1]. Doing this makes it possible to use these purely qualitative data to estimate the GDP growth rate in the past and near future (two quarters), given that the publication of the surveys precede that for GDP. Among the sectoral indicators available, only the business climate in industry, services and construction provide econometrically useful information to trace the trajectory of the GDP growth rate. The other series are not significant, in particular the indexes for consumer confidence and for confidence in the retail and wholesale trade.

The leading index, which has a significantly more smoothed profile than GDP growth rates, cannot fully capture the volatility of activity and therefore should not strictly speaking be considered a predictor of growth (Figure 2). On the other hand, from a more qualitative viewpoint, it manages to delineate quite correctly the phases during which growth is above or below average (or the long-term) determined by the estimate. From this perspective, the indicator can be seen as marking a turning point in the economic cycle. Since the second quarter 2011, the indicator has not depicted any crossing of the long-term growth rate, despite the false signs of recovery raised by the quarterly GDP figures for Q2 2013 and Q1 2015.

Based on the survey data available up to October, the growth foreseen by the indicator is 0.4% in the third and fourth quarter of 2015, exactly equal to long-term growth[2]. While a signal of recovery is not yet clearly given by the indicator, it should be noted that the information on the fourth quarter, which is limited to the October surveys, is quite partial. The confidence climates, which are extrapolated to the end of the year, are based on conservative assumptions and are likely to be upgraded if the surveys continue to improve from now to December.

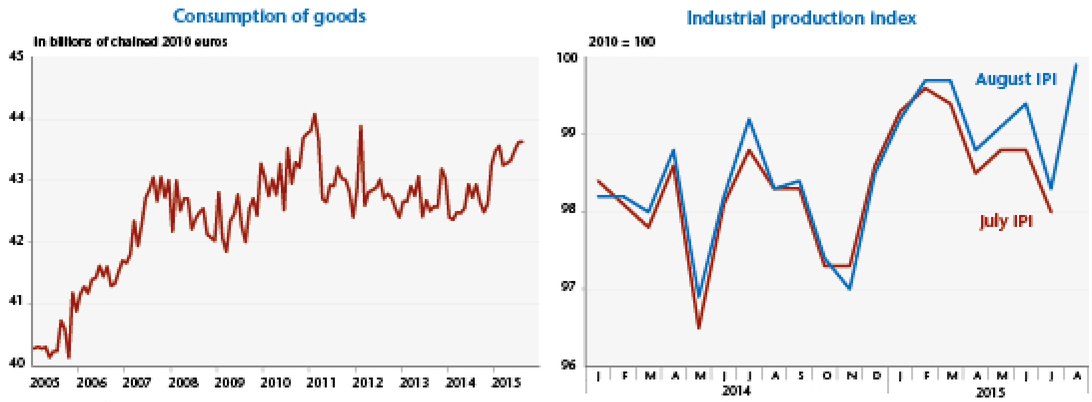
Figure 2. GDP growth rate observed and estimated by the indicator



Source : INSEE, OFCE calculations and forecasts.

The quantitative information available at this time for the third quarter of 2015 also gives cause for optimism, after the disappointment of the second quarter. Under the impact of the disinflation brought on by lower energy prices, which enabled a sharp rebound in purchasing power, household consumption of goods recovered sharply at the beginning of the year (Figure 3). The rise was interrupted in the second quarter, due to poor sales in March, which pulled down the figures, but consumption has resumed its upward trajectory continually since then. The carry-over in August for the third quarter was clearly positive (+0.6%), which suggests that the consumption of goods will again contribute positively to GDP growth for the quarter.

Figure 3. Household consumption of goods and industrial production index



Source : INSEE.

The projection of a return to growth in the third quarter is also confirmed by trends in the industrial production index (IPI), which rose sharply in August (+1.6% for the total IPI, and +2.2% for the manufacturing index itself). This rebound followed a drop in production after the peak in February-March 2015[3], which contributed to the poor performance of GDP in the second quarter (Figure 3), and nourished the idea that the second quarter was not an “air pocket” but the continuation of a long phase of stagnation for a France that was unable to take advantage of the favourable winds blowing from outside[4]. The carry-over in industrial production in August now stands at 0.3%, while it was -0.7% in the old series available in July.

The recent trends in the monthly indicators augur a renewal of growth in the third quarter of 2015. The extrapolation of GDP growth using the leading indicator, supplemented by the already available quantitative data, also points to a 0.4% increase in activity in the third quarter, which, if it is realized, would then put the economy on a firm track to finally initiate a recovery.

---

[1] For greater detail, see: « France : retour sur désinvestissement, Perspectives 2015-2017 pour l’économie

française » [The 2015-2017 forecast for the French economy], pp. 34-37.

[2] The long-term growth considered here is not the potential growth estimated by its structural determinants using a production function, but the average GDP growth rate as reflected in the estimate of the indicator.

[3] It should be noted that the statistical revisions can change the perception of the economy's dynamics in the very short term. The IPI series published on 9 October 2015 by the INSEE has revised the level of the index significantly upwards compared to the previous publication. The IPI is still on a downward trend between February and July 2015, but the trajectory described is less negative, and the quarterly average of the index in the second quarter of 2015 is affected: according to the old series, it stood at -0.7%, compared with -0.4% according to the revised series.

[4] See Heyer E. and R. Sampognaro, 2015, « L'impact des chocs économiques sur la croissance des pays développés depuis 2011 », [The impact of economic shocks on the growth of the developed countries since 2011], *Revue de l'OFCE*, no. 138, June 2015.

The labour market on the road to recovery

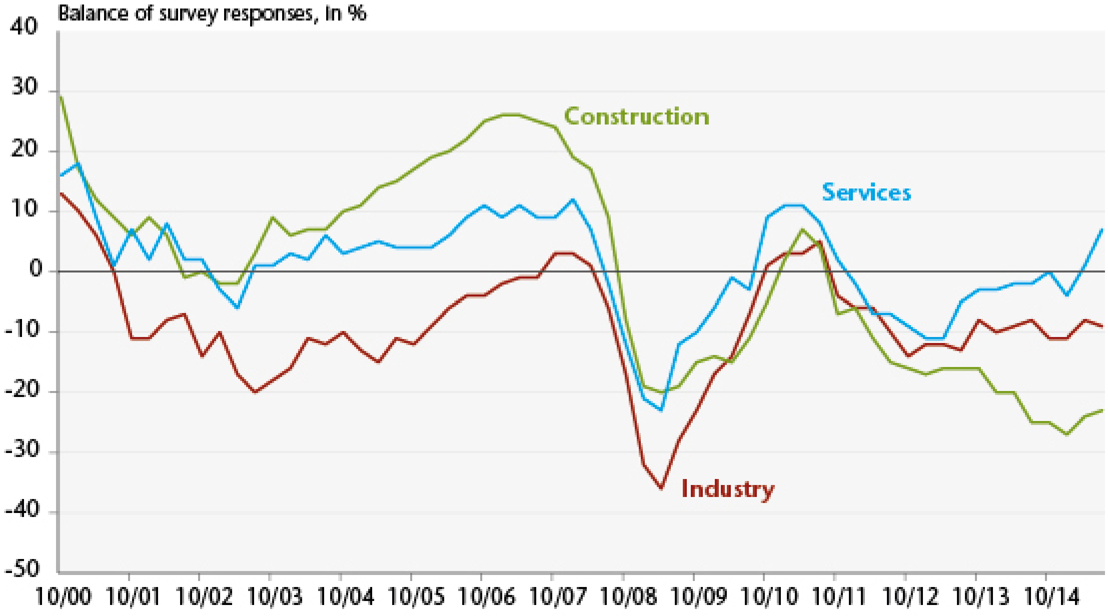
By Bruno Ducoudré

A look at the figures just published by France's Pôle Emploi job centre for the month of September 2015 shows that the number of job seekers who were registered and inactive (category A) has declined significantly (-23,800), following an increase in August (+20,000). While this is encouraging news, the decrease has to be compared with the increases seen in categories B and C (+25,600). So while employment has indeed picked up, this has not resulted in the numbers of people exiting unemployment as measured by the job centre, *i.e.* it has not put a stop to the continuing rise in the number of long-term unemployed (+10.4% in one year). Nevertheless, these trends do support the conclusions drawn from current analysis which indicate that a recovery has indeed begun.

After seeing 76,000 jobs created in France in 2014 due to growth in non-commercial jobs, the first half of 2015 was marked by an increase in the workforce in the commercial sector (+26,000), which resulted in an acceleration of job creation in the economy overall (+45,000) over the first half of the year. The recently released statistics on employment confirm the accelerating trend in the third quarter of 2015: hence, over a year, declarations on job hires of over one month recorded by ACOSS rose by 3.7%, following 0.7% in the previous quarter. Business surveys also point to an increase in hiring intentions in the third quarter; these have turned positive in the service sector since the year started, which is also when the low point seen in construction was probably reached (see Figure 1).

Our analysis of the labour market up to 2017, which was spelled out in the latest OFCE forecasts of October 2015, indicates that the commercial sector will continue to generate jobs up to the end of 2015 (+0.1% in the third and fourth quarters). The pace of job creation will nevertheless remain too low to foresee a fall in the unemployment rate by year end, particularly in light of our forecast for the GDP growth rate (0.3% in Q3 2015 and 0.4% in Q4) and the existence of overstaffing in companies, which we estimate at 100,000 in Q2 2015. The unemployment rate should remain stable at 10% until year end. With GDP growth of 1.8% in 2016, job creation will pick up markedly in the commercial sector once the overstaffing has been absorbed by companies, allowing the unemployment rate to fall starting in the second quarter of 2016. This decline will continue until the end of 2017.

Figure 1. Forecast of labour force trends



Sources: INSEE, business surveys.

The last three years of weak growth have hurt employment in the commercial sector (-73,000 jobs between the start of 2012 and the end of 2014, cf. the Table). The strength of employment in the non-commercial sector, supported by the ramp-up of subsidized contracts (the “jobs for the future” programme and non-commercial job integration contracts) helped to offset the loss of commercial sector jobs, with total employment rising by 164,000 over the same period, which slowed the increase in the ILO unemployment rate: this figure for mainland France rose from 9% of the labour force in late 2011 to 10.1% at end 2014, i.e. a 1.1 point increase.

Tableau. Employment and unemployment

Annual change in 1000s, at last quarter

Year on year	2012	2013	2014	2015*	2016*	2017*
Observed labour force	265	46	203	62	134	139
Total employment	31	57	76	103	193	242
– Commercial sector	0	-38	-35	73	238	245
Employed	-63	-58	-43	60	209	216
Unemployed	63	20	8	14	28	29
– Non commercial sector	31	95	111	29	-45	-3
Subsidized jobs	5	60	21	17	-54	-4
Non-subsidized jobs	26	35	90	12	10	1
Unemployment	234	-11	127	-41	-58	-103
Unemployment rate at Q4 (%)	9,7	9,7	10,1	10,0	9,8	9,4
GDP growth rate (%)	0,3	0,8	0,2	1,1	1,8	2,0

* OFCE forecast

Sources : INSEE and Ministry of Labour, OFCE forecasts, e-mod.fr 2015-2017, October 2015.

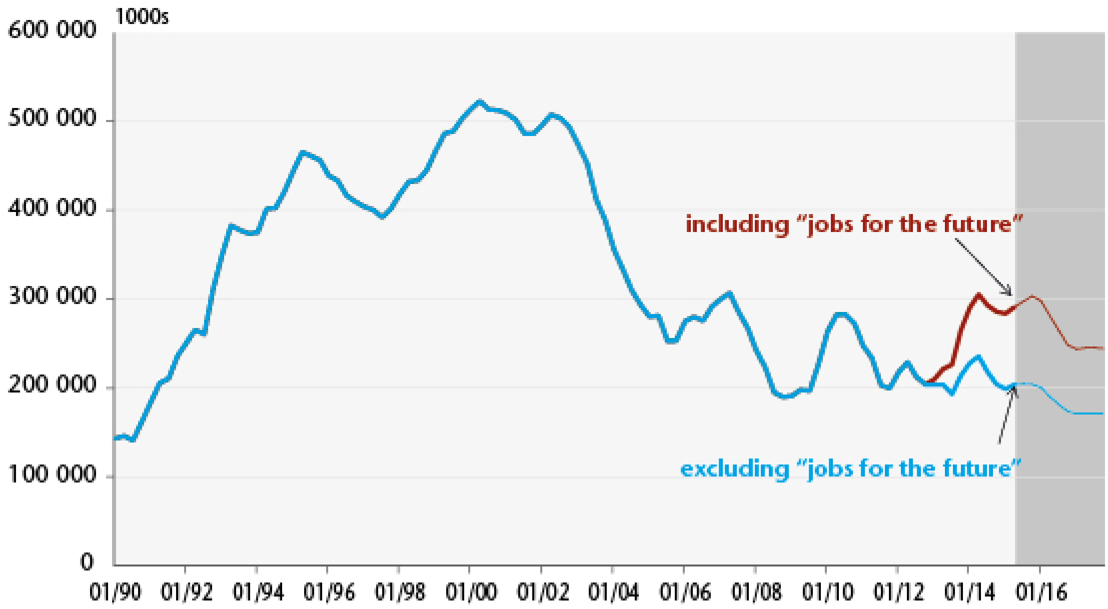
2015 is a year of transition, with a resumption of job creation in the commercial sector (+73,000 expected for the year as a whole) but less dynamic job creation in the non-commercial sector. For the full year, job creation will be boosted by the acceleration of growth (an annual average of +1.1% expected in 2015 but 1.4% yoy) and the implementation of policies to cut labour costs (CICE tax credit and the Responsibility Pact). The cumulative impact of the CICE and the Responsibility Pact, after taking into account the effect of financing, will create or save 42,000 jobs in 2015. However, job creation will be hampered by the presence of overstaffing[1]: as economic activity picks up pace, companies typically absorb underutilized labour before increasing the volume of employment.

As for the non-commercial sector, employment policy is continuing to support the labour market in 2015 through the increase in subsidized job contracts. This increase has nevertheless been slower than in previous years, with the number of “jobs for the future” contracts peaking in 2015 (Figure 2). Ultimately, total employment will increase by 103,000 in 2015, with the unemployment rate remaining stable at 10% till year end.

For 2016 and 2017, the acceleration of growth (at respectively

1.8% and 2%) combined with the ongoing implementation of policies to cut labour costs and the closing of the productivity cycle in the course of 2016 will lead to accelerating job creation in the commercial sector. This will increase, year on year, to 238,000 in 2016 and 245,000 in 2017 for the commercial sector alone, a rate comparable to what was seen between mid-2010 and mid-2011 (234,000 jobs created). However, in 2016, the number of subsidized contracts in the non-commercial sector set out in the 2016 Finance Bill will be down from previous years (200,000 CUI-CAE jobs and 25,000 “jobs for the future” in 2016, compared with 270,000 and 65,000 respectively for 2015). For 2017, we are assuming stability in the stock of subsidized non-commercial job contracts (see Figure 2). Overall, the long-term return of job creation by business will trigger a decline in the unemployment rate starting in the second quarter of 2016. Although sluggish, this fall should be sustainable, with the unemployment rate down to 9.8% of the labour force at end 2016 and 9.4% by end 2017.

Figure 2. Subsidized contracts in the non-commercial sector



Note :The fall in CUI-CAE contracts seen in the second half of 2014 comes from the switch from CAE job integration contracts to CDD fixed-term contracts.
Scope: Mainland France.
Sources : DARES, OFCE forecasts *emod.fr* 2015-2017, October 2015.

---

[1] The presence of overstaffing in businesses derives from the gap between labour productivity and its long-term trend, called the productivity cycle. This reflects the time employment takes to adjust to economic activity. See Ducoudré and Plane, 2015, « Les demandes de facteurs de production en France » [The demand for production factors in France], *Revue de l'OFCE*, no.142.

An ever so fragile recovery

By the Department of Analysis and Forecasting, under the direction of Eric Heyer and Xavier Timbeau

This text summarizes the OFCE's economic forecast for 2015-2017 for the euro zone and the rest of the world.

The figures for euro zone growth in the first half of 2015 have confirmed the upswing glimpsed at the end of 2014. While the zone's return to growth might once have been taken to indicate the end of the global economic and financial crisis that struck in 2008, the turbulence hitting the emerging countries, particularly over the summer in China, is a reminder that the crisis ultimately seems to be continuing. China's economic weight and its role in world trade are now so substantial that, even in the case of a soft landing, the impact on growth in the developed countries would be significant. We nevertheless anticipate that the scenario for a recovery need not be called into question, and that euro zone growth will be broadly supported by favourable factors (lower oil prices and ECB monetary support) and by some weakening of unfavourable factors (easing of fiscal policies). But the fact remains that the situation in the developing world will add new uncertainty to an already fragile recovery.

Between 2012 and 2014, the euro zone economies stagnated at the very time that the United States turned in average GDP growth of 2%. The recovery that got underway after the sharp contraction in 2008-2009 was quickly cut short in the euro zone by the sovereign debt crisis, which led almost immediately to the uncontrolled tightening of financial conditions and the reinforcement of the fiscal consolidation being implemented in the Member States, as they searched for market credibility.

The euro zone then plunged into a new recession. In 2015, these economic policy shocks are no longer weighing on demand. The ECB helped to reduce sovereign debt risk premiums by announcing the Outright Monetary Transaction programme (OMT) in September 2012 and then by implementing quantitative easing so as to improve financial conditions and promote a fall in the euro. In terms of fiscal policy, while in some countries the consolidation phase is far from over, the measures being taken are smaller in scale and frequency. Furthermore, growth will also be helped by the fall in oil prices, which should last, and the resulting gains in household purchasing power should in turn fuel private consumption. These factors thus reflect an environment that is much more favourable and propitious for growth.

However, it is clear that this scenario depends on some volatile elements, such as the fall in oil prices and the weaker euro. The Chinese slowdown adds another element of risk to the scenario, which is based on the assumption that China will make a smooth transition from an export-oriented growth model to one driven by domestic demand. We expect the euro zone to grow at a rate of 1.5% in 2015 and 1.8% in 2016 and

2017. The main short-term risks to this scenario are negative. If oil prices go up and the euro doesn't stay down, and if the slowdown in the emerging countries turns into an economic and financial crisis, then growth worldwide and in the euro zone will be significantly lower. This risk is particularly critical given the very high level of unemployment still plaguing the zone (11% in August 2015). Nevertheless, given the pace of anticipated growth, we expect the unemployment rate to fall in 2016-2017 by around 0.6 percentage point per year. At this pace, it will take almost seven years to bring the rate back to its pre-crisis level. So while the prospects for recovery from the 2008 crisis are uncertain, the social crisis undoubtedly has a long time to run.

Investing in the zero carbon economy in order to escape secular stagnation

By Xavier Timbeau

What the downward revisions of various forecasts (IMF, OECD, OFCE) presented in early autumn 2015 tell us about the euro zone is not very comforting. A recovery is underway, but it is both sluggish and fragile (see: "A very fragile recovery"). The unemployment rate in the euro zone is still very high (almost 11% of the labour force in the second quarter), and a sluggish recovery means such a slow fall (0.6 point per year) that it will take more than seven years to return to the 2007 level. Meanwhile, the European Central Bank's unconventional monetary policy is having difficulty re-anchoring inflation expectations. The announcement of quantitative easing in early 2015 pushed up the 5-year/5-year forward inflation rate [1], but since July 2015 the soufflé has collapsed once again and medium-term expectations are 0.8% per year, below the ECB target (2% per year). Underlying inflation has settled in at a low level (0.9% per year), and there is a high risk that the euro zone will be frozen in a state of low inflation or deflation, strangely resembling what Japan has experienced from the mid-1990s to today. Low inflation is not good news because it is triggered by high unemployment and slowly rising nominal wages. The result is real wages growing more slowly than productivity. Little or no inflation means both real interest rates that remain high, which increases the burden of debt and paralyzes investment, but also an unconventional monetary policy that undermines the ability to measure risks and which gradually loses its credibility for maintaining price stability, i.e. to keep inflation within declared targets. At the Jackson Hole Symposium in August 2014, Mario Draghi announced that, in the face of persistent unemployment, monetary policy cannot do everything. Structural reforms are necessary (what else could a central banker say?). But a demand policy is also needed. Not having one means running the risk of secular stagnation, as was formulated by Hansen in the late 1930s and recently brought up to date by Larry Summers.

Europe does not, however, lack investment opportunities. The COP21 commitments, though timid, assume a reduction in CO2 emissions (equivalent) per capita from 9 tons to 6 tons within 15 years, and investment will need to pick up pace in a big way if the change in global temperature is not to exceed 2°C. This means aiming to put an end to the use of petroleum and coal (or the large-scale development of carbon capture and storage) within 35 years. Achieving this will require investment on a massive scale, which is estimated in the

European Commission's Energy Road Map at over 260 billion euros (nearly 2% of GDP) per year by 2050. The social profitability of such investments is substantial (since it helps to avoid climate catastrophe and makes it possible to meet the EU's commitments to the world's other countries), but – and this is the problem posed by our sluggish recovery – their private profitability is low, and uncertainty about future demand together with poor coordination could give pause to the "animal spirits" of our entrepreneurs. Secular stagnation results from the very low profitability of investments, particularly after taking into account the real rates anticipated and the risk of a more serious depression. To avoid this trap, the social returns on investment in a zero carbon economy need to become evident to all, and in particular they need to coincide with private returns. There are numerous tools that can do this. We can use carbon pricing and markets for trading in emission rights; we can use a carbon tax; we can develop certificates for new investments (assuming we know how to ensure that they reduce CO_2 emissions compared to an opposing counterfactual) or impose standards (if these are followed!). The difficulties of the transition and the acceptance of a relatively painful change in prices can be eased by compensatory measures (which have a budgetary cost, see Chapter 4 of the IAGS 2015 report, but are part of the stimulation package). It might also be desirable to draw on monetary policy to amplify the stimulus (see this proposal by Michel Aglietta and Etienne Spain). The implementation of artillery like this to reduce emissions and boost the European economy is not straightforward and would require wrenching the institutional framework. But that's the price to pay in order to avoid sinking into a long period of stagnation which, with the inequalities and impoverishment that it would generate, would certainly break up the European project.

This text was published on *Alterecoplus* on 22 October 2015.