

# [Impact of the global financial crisis on france economics essay](https://assignbuster.com/impact-of-the-global-financial-crisis-on-france-economics-essay/)

With about 65 million inhabitants, France is the 20th most populous country in the world. The largest sector in the economy is services (e. g. banking, energy, tourism, transport and health) providing 78. 9 % of GDP; the manufacturing sector accounts for 19. 3% and the agriculture for less than 2%. These resources lead to the 5th largest economy by nominal GDP and the 9th largest economy by purchasing power parity. International trade is strong, France being the 6th-largest exporter and the 4th-largest importer of manufactured goods [source: France June 2010, CIA-the world fact book].

The specific composition of the French economy is a combination of an extensive private sector with strong government intervention. Government expenditure represents 53% of GDP(the highest percentage within the G7 countries). It owns shares in many large corporations involved in the banking, energy, transport, automobile and telecommunication sectors. With 21% of the working population employed by the Government there is a natural protection from sudden job losses. Education from primary school to university is almost free and family welfare support is strong (e. g. a “ Baby Bonus” of 900Euros). The government also controls a generous healthcare system (health care is almost free for all citizens with an annual budget of the Social Security voted by the parliament), unfunded pensions and unemployment benefits up to 75% of previous salary for the first year (these three systems created after World War II are mainly financed by a deduction on salaries and a contribution by employers and are co-administrated by representatives of the employees and of the employers). The strong support of most of the needs of the citizens is relatively specific to the French (“ l’exception française”). Despite strong regulation of labour conditions (lay-offs are controlled) and the wages (with a minimal salary), the productivity per hour worked ($ 53. 2 in 2008; GER: 50. 5, UK: 44. 9, US: 55. 3, AUS: 44. 5) is surprisingly high as results of a skilled work force and technological advances [source OECD statistics, June 2010].

The flipside of this mixed economy is a chronic public deficit (3. 3% of GDP in 2008; 3. 16%±0. 67 for 2003-07) responsible for a high public debt (67. 5% of GDP in 2008) and unbalanced social costs (part of the government spending is for supporting healthcare, pension and unemployment). The rate of unemployment is high (7. 8% in 2008; 9. 3%±0. 6 for 2003-07) mainly due to a chronic structural unemployment consequent of the de-industrialization of France in the 80s (closure of most of the mining, steel and textile firms).

In 2008, the economic growth was only 0. 4% (1. 92%±0. 55 for 2003-07), below most of other European countries and the recent performance of France (2. 6% growth from 1950 to 2000). The growth was mainly supported by a sustained domestic demand and private investments facilitated by the mixed economy. Inflation was 3. 2% (2. 0%±0. 3). The trade balance was deteriorating with an increasing deficit from 2004 up to 3% of GDP in 2008 whereas it was beneficial the 1990s. The deficit was due to a reduction in exports as a result of the strength of the euro but mainly because of a loss in competitiveness [source: IMF 2007 article IV consultation; updated for 2007 and 2008 by INSEE statistics].

The financial system was quite solid in 2008. Banks were well-capitalized and highly consolidated (French Banks make up 10% of the Global Banking system and 9 banks make up 75% of the total banking assets). They were mainly orientated to the European Union and exposure to US subprime debt was limited. The French Banking regulator has a stated recommendation that Banks should not lend to borrowers if the interest payments make up more than one-third of the borrower’s income (Xiao 2009). Banks are also subject to legal obligations that do not allow them to push borrowers into more debt than they can manage. Overall the regulation of the financial system in France was a major factor in limiting the debt exposure of Banks. This is highlighted by the following table showing the percentage of GDP that Household mortgages make up – note France is significantly lower than most countries

Country

Mortgage Debt as % of GDP in 2007

France

35%

Germany

48%

Ireland

75%

Britain

86%

Spain

62%

Source: European Mortgage Federation

However by mid-late 2007, corporate credit was reducing, the private real-estate market was cooling-off and a recent fraud at Société Générale revealed some poor management issues.

## In Summary, at dawn of the GFC, the economic drivers of France were a sustained domestic demand and private investment facilitated by the mixed economy, a low inflation and a quite solid financial system. Its weaknesses were a high rate of unemployment, a chronic public deficit responsible for an increasing public debt and a deterioration of the trade balance.

## II. The impact of the Global Financial Crisis: the ‘ buffer’ effect of sustained domestic consumption

Any Government has 2 economic instruments at their disposal – Monetary and Fiscal. Given the ECB were late in cutting rates to help stimulate the economy (only cutting to below 3% on 12 Nov 2008), the French could just use Fiscal policy. The Government announced a €26b stimulus plan on 3rd Feb 2009 relying heavily on front-loaded investments in infrastructure. These include upgrades to ports, trains & motorways along with more typically “ Gaellic” pursuits such as cleaning and restoring Cathedrals and churches. France also introduced a car-scrappage scheme (similar to the US “ cash-for-clunkers” program) offering an incentive of €1000 on new cars if old cars were scrapped. Car sales went up 12% in May 2009 (compared to declines the first four months of 2009)[2]The Government also rushed forward €11. 5b worth of credits and tax breaks for 2009 that were originally planned over 3 years.[3]

## II. 1. Existing ‘ automatic stabilizers’ and government stimuli buffered the impact of the GFC

As explained in part I, the traditional French economic model had a number of “ automatic stabilisers” or “ shock absorbers”. These acted as a good buffer to the downturn in activity as proved by Consumption holding comparatively well. Retail Sales figures for year ending March 2009 were -3. 9% in France, vs the US of -10%[4]

## II. 2. Government supports and a well-capitalized banking system prevented major failures of banks

During the GFC no French Banks had to be rescued or nationalised (the Government did help bail out Dexia – a Franco-Belgian Bank- though at a cost of €3b). The French Government did however offer support to the Banks thru a refinancing and a recapitalisation scheme. They created 2 separate agencies to provide guarantees for these. Recapitalisation was the SPPE (100%-French Govt owned) and the Refinancing was done through the SFEF (34% Govt-owned and 66% owned by leading French Banks). Due to the lack of leverage highlighted above, total capital raised by French Banks accounted for around 4% of what was raised globally – (Xiao 2009))

The SPPE put aside €40b of funds of which €10. 5b was injected into 6 French Banks, boosting their Tier 1 ratios by about 50bps. A second tranche was announced but only taken by some of the Banks.

The SFEF provided liquidity support through issuing state-guaranteed bonds which were lent to banks. They could issue upto €265b of AAA-rated Govt-guaranteed debt (max term 5 years). They ended up issuing only €15b of this at the end of 2009. (Harrison 2009)

The SFEF also issued a guarantee on Dexia’s obligations upto €5b.

French Banks were some of the least affected as we see the direct cost of the crisis on large international banks of about 18% of Tier 1 Capital, vs Germany (33%), the UK (37%), the US (86%) and Switzerland (87%) (Xiao 2009)

## II. 3. So statiscally what happened?

We can see below GDP declined, but not to the level of other more “ exposed” countries such as Germany. We believe this is more because of the nature of the French economy and the “ automatic stabilisers” rather than the fiscal stimulus. An interesting comparison is Sweden, another high social welfare economy, yet their recession was far deeper than the French. This could be explained by Sweden being far more trade-dependent than France (48% of GDP vs France 27%)[5]

However when we look at Unemployment, France jumps to one of the highest levels. This is due to the higher starting point – caused by restrictive Labour regulations explained previously – and the large percentage that services (mentioned in part 1) make up of the economy. Services are most likely to get hit on a global slowdown.

We can see below Household Consumption was moving lower virtually as soon as the GFC hit, with a low of -4% in Dec 2008. The move higher from Sep 2009 to Dec 2009 can be e

Trade Balance is interesting, though does tend to get skewed by Aircraft orders from Airbus. You can see the delayed reaction through 2008 (perhaps highlighting that the “ buffers” were working as the French were importing faster than exporting), which then turned around in Nov 2008 just as Household Consumption was nearing its lows. Again more recently, perhaps the Trade Balance weakening is another sign of recent Global demand softening, again with the French somewhat protected

The Current Account Deficit has a very similar chart to the Trade Balance (no surprise there), however what is interesting is that it nearly gets back to a surplus in January 2008 and Dec 2008 (could do with a better comment)

## III. The recovery: an exit from recession but challenges of fiscal deficit and high unemployment remain in a turbulent European Economy

After a 2. 5% decrease of GDP, the economy has started to grow with a projection of 1. 7% growth in 2010 and 2. 1% in 2011. The growth is driven by the sustainability of the private consumption (projection: + 1. 2% in 2010, +1. 5% in 2011), a growing level of investment (projection: -1. 6% in 2010, + 4% in 2011) and an improvement of the balance trade that is no more in deficit (projection: stabilisation at a 0 level for 2010 and 2011). The counterpart is the persistence of a consequent public deficit (-7. 8% in 2010, – 6. 9% in 2011) and a high unemployment rate (9. 8% in 2010, 9. 5% in 2011).

Looking at the Macro

Growth has recovered, led by business Investment, Exports and stockbuilding. The OECD in their Economic Outlook believes “ The stimulatory macroeconomic policies, which were appropriate to address the crisis, should be steadily unwound, and the government must design and transparently communicate a credible medium term plan for significant fiscal consolidation”

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Public Debt is becoming an issue. In 2010 it has risen to 80% of GDP and is concerning the Bank of France President Noyer who has issued a warning to President Sarkozy[6]. Whilst high, we can see on the table below that it is relatively inline if-not lower than other world economies.

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## III. 1. The challenges of stabilising Public finance and solving the forthcoming pension issue

France is looking at stabilising its deficit and Public finances, but is still one of the few European countries to spell out how exactly they are going to do this. One of their major problems is a shortfall in the State Pension fund that is expected to be €45b by 2020. On June 16 2010 they began to tackle this by raising the Pension age from 60 to 62, and increasing the top rate of income tax next year to 41% (from 40%). The French Prime Minister has announced €100b worth of savings by 2013, half of which will come from increased forecasted economic growth. He has yet to spell out how exactly they will save the other €50b, apart from freezing the 2011 Budget in real terms. The 2010 Budget Deficit forecast is 8% of GDP (was 3. 3% in 2008 & Greece is 9%) and Public Debt is a high 84%. They are relying on GDP growth of 2. 5% in 2011 to get their Budget Deficit back to 3% of GDP (EU Mandate level) – a forecast the European Commission has already called “ wildly optimistic” and the IMF has warned “ risks significantly underestimating the size of the required fiscal efforts”[7]

Why is there such a reluctance to cut spending? History tells us – from Mitterand in 1983 introducing austerity to try to remain competitive in the European Monetary Union after 3 devaluations of the French Franc (are arguably cost them 1983 municipal elections) to PM Juppe in 1995 trying to reform welfare and pensions , resulting in weeks’ worth of strikes that virtually stopped the country.

## III. 2. Threats from the turbulence in the European Economy

The other point we have to consider is the management of the EU and Euro. Recently we have seen rising tensions between the members (most notable France and Germany) which was highlighted with Germany’s reluctant support of the Er750b plan to support the Euro and the ECB buying back Eurozone Government Debt (thereby bailing Greece out), breaking the tradition of monetary conservatism inherited from the German Bundesbank. France has been a major supporter of both schemes, following its traditional “ relaxed” attitude towards inflation and risk

French Banks remain more exposed than their European counterparts to debts in Greece and other concerns continue to be raised with Eurozone “ Stress-testing” for Sovereign Bonds being discussed at present (ref FT article), plus there is talk of European Banks cutting back lending to each other – as they did in 2008 (ref Newsweek article)- on concerns of non-payments of Debts. The original problem of sub-prime exposure of US Banks is being compared to the PIIGS (Portugal, Ireland, Italy, Greece and Spain) exposure for European Banks. Since the start of the financial crisis French banks according to BIS numbers, increased their lending to Greece by 23 percent, to Spain by 11 percent, and to Portugal by 26 percent (ref Newsweek article).

## IV. Conclusions

## A mixed economy and a well-capitalised banking system helped France get through the GFC better than most peers. The forthcoming main challenges are to reduce the fiscal deficit and to improve the chronic natural unemployment. The weakness of the demand and the exposure to financial turbulence in Europe render their achievement at high risk.

Quarterly GDP from 2008 to 2010 with its main drivers (M = imports; C = consumption; G = government spending; I = investments; X = exports)