MACRO PERSPECTIVE

France and Germany : running at different speeds

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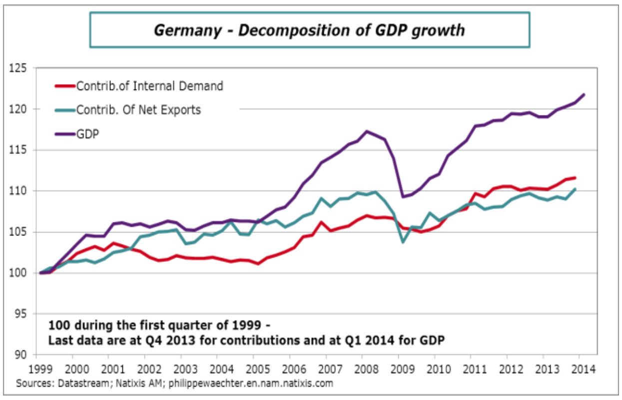
Are the dynamics of the French economy really very different from Germany? Recent history has proven that this is the case. Since the low point of the recession in 2009, Germany has effectively outpaced France in terms of performance. The German economy has expanded by 2.2% on an annualized basis, whereas business in France has grown only half as fast, by 1.1%. However, the opposite was true at the beginning of the 2000s.

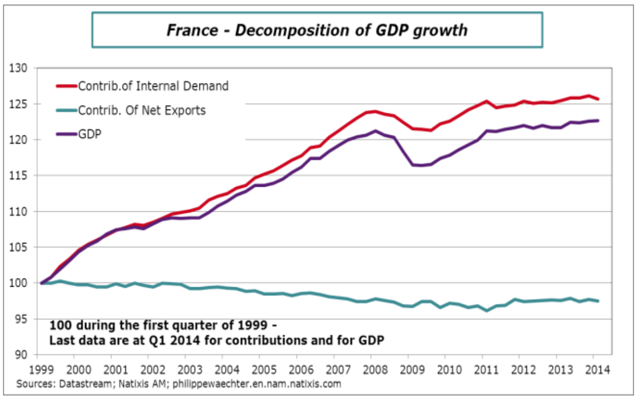
The two economies are on an equal footing, over a reference period starting with the launch of the euro in Q1 1999. From this date until Q1 2014, French GDP grew 22.7%, whereas Germany increased by 21.8%

France and Germany function according to a different logic however. They are therefore on divergent trajectories. In order to rekindle growth, France is obliged to draw on internal demand, whereas Germany can count either on domestic demand, or on its trade with the rest of the world. The difference between the two economies therefore lies in their growth drivers.

Distinct catalysts

To understand the difference between the two countries, I have broken down GDP into internal (excluding inventories) and external demand. I then calculated the cumulative contribution of each of these components since 1999. The divergences between the two economies, as illustrated in the two charts, are striking.





In France, internal demand has been progressing more rapidly than GDP for a long time now. This trend reflects a negative contribution from external trade, which is attributable to two factors. Firstly, as internal demand is strong, it is in the interest of companies to focus on the domestic market rather than on exports, which are more erratic. Furthermore, as demand is strong, imports progress rapidly, particularly goods manufactured outside of France.

On the other hand, in Germany, input is similar from both components. The German economy is more sensitive to global trade, which provides further momentum. Growth no longer depends solely on internal demand, which is a considerable advantage. These two growth drivers are currently generating stronger growth in the German economy than in France. This has not always been the case, particularly at the beginning of the 2000s, as can be observed by comparing the two charts.

Short-term trends

Uncertainty, reflected by various consumer and corporate surveys in France, is weighing on internal demand and curbing French growth. This trend was observable during the first quarter.

In order to improve growth outlook, major reforms are required among internal demand drivers. For this reason, it is vital to reduce uncertainty and place the French economy on a more predictable trajectory. Such a move could have a self-fulfilling effect and re-launch the economy. This has not been the case so far.

With two irons in the fire, the German economy enjoys more stable growth trends. During the deep global crisis at the end of 2008, German trade contracted and contributed negatively, whereas internal demand did not weaken sharply, unlike in France and almost all other industrialized countries. Germany is therefore fully benefiting from an upswing in global trade, with the economic recovery now complementing internal demand, which has remained steady.

Lasting divergence

The two charts clearly demonstrate that performance divergence is not a recent phenomenon. This also means that economic policy aiming to imitate Germany would be difficult to implement and would be a protracted process. It would have to weigh durably on internal demand, in order to encourage companies to export more. This type of rebalancing would prove costly for the economy in the short term.

Which economic policy for France ?

The two economies have diverged spectacularly recently. To apprehend the challenges faced by French economic policy, another major factor must also be taken into account. Private internal demand in France is contracting. Due to the relatively neutral impact of external trade, economic growth is therefore highly dependent on government expenditure.

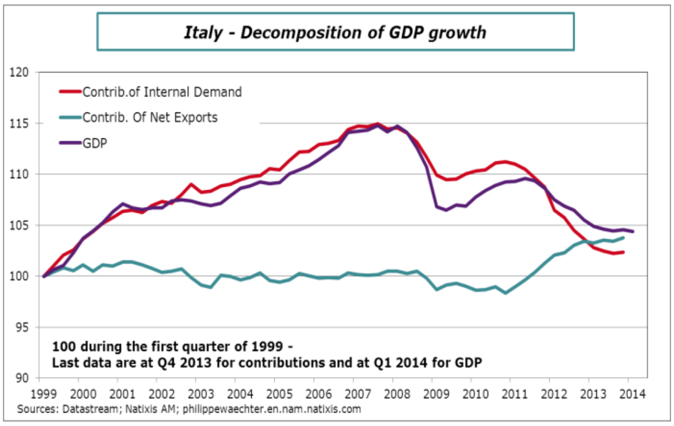
The difficulty facing French economic policy is that private internal demand has to be stimulated (household consumer spending and investment and corporate capex) but public expenditure cannot be reduced too rapidly, as GDP growth depends on this driver. Economic policy must therefore aim to boost private demand, whilst moderating public spending. However, a heavy-handed approach would jeopardize French growth for the long term. The announced reduction of over EUR 100 billion is therefore undoubtedly counter-productive.

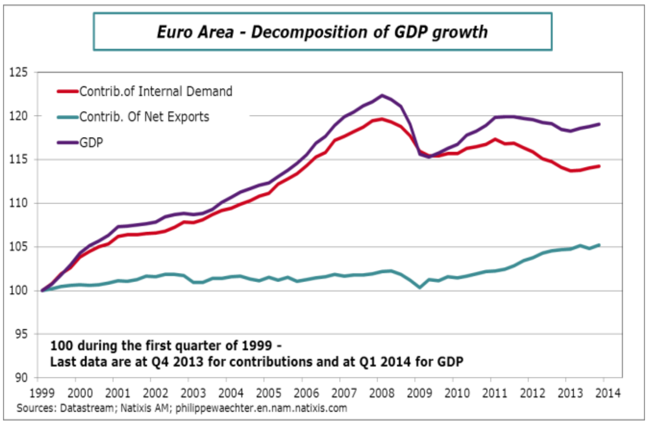
Germany adopts a different economic policy approach. With the global economic cycle assuming an increasingly stable trajectory, there is sufficient economic momentum to stimulate growth. The employment market and wage increases also provide a relay to complete the growth cycle.

These two growth drivers often complement each other, giving Germany a major advantage. This does not mean that we have to copy Germany, but we nevertheless need to find a growth model, driven by two potential catalysts. Until now, private and public demand have been complementary forces, but the divergence between the two has been insufficient to stimulate economic momentum over time. This is the model that has to be invented.

Extending the comparison to the euro zone and Italy

In the euro zone and in Italy, internal demand also plays a major role in determining the economic cycle, as can be observed in the case of Italy in particular.





Internal demand has clearly been undermined by austerity policies, tipping the Italian economy in to a very long recession. Compared to French and German GDP growth (22.7% and 21.8% respectively) Italy is lagging far behind, posting economic growth of only 4.4% since 1999.

The improvement in the external trade balance is due essentially to a sharp fall in imports, resulting from the downturn in internal demand and austerity policies.

Can the ECB turn the situation around ?

The ECB must intervene. Inflation remaining durably below the target rate weighs on spending, particularly among indebted households. The ECB must intervene, as it could also provide further support to internal demand via credit and therefore enable the vast majority of euro zone economies to gain momentum. We have demonstrated the importance of internal demand in France and Italy as a growth driver, and the euro zone is in a similar situation. Immediate firm intervention by the ECB will support growth momentum in the euro zone. For this reason, the introduction of a massive liquidity provision will be essential. The ECB could provide widespread hope by taking courageous decisions.

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