Purchasing power, debt and jobs – the impossible French equation *

Careful observation of the French economy provides some insight into the swift escalation in social unrest since November. The initial question of purchasing power sparked off the movement in November. At the start of the financial crisis, purchasing power was not too severely hit initially due to the hefty impact of automatic stabilizers, i.e. economic mechanisms that help even out the effects of shocks over time via redistribution. This system had worked fairly well in the past, keeping GDP fluctuations down during economic downturns. This is one of the key aspects of the French redistributive model.

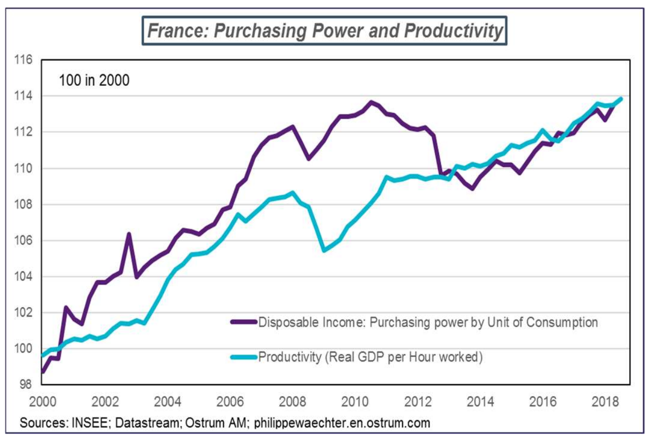
With a continued weaker macroeconomic situation than in the past, the economy adapted. Three major changes can help shed some light on the social strife that has been dragging down the French economy.

The first problem is that French economic trend growth is now more sluggish than before the 2008/2009 crisis, and this has an impact on purchasing power trends.

We can analyze this situation using the chart below, providing an overview of purchasing power trends on the one hand (demand) and productivity data on the other (supply).

The purple line shows the trend in purchasing power per consumption unit and the blue line plots productivity (GDP per hour worked).

We can see that these two indicators ran parallel before the 2007 crisis, then diverged until 2012/2013 before converging again, although with weaker trend growth than before the crisis. Under normal circumstances, these two indicators should move at a similar pace, and a long-lasting divergence is not feasible i.e. wages cannot be disconnected from income creation via the production process.

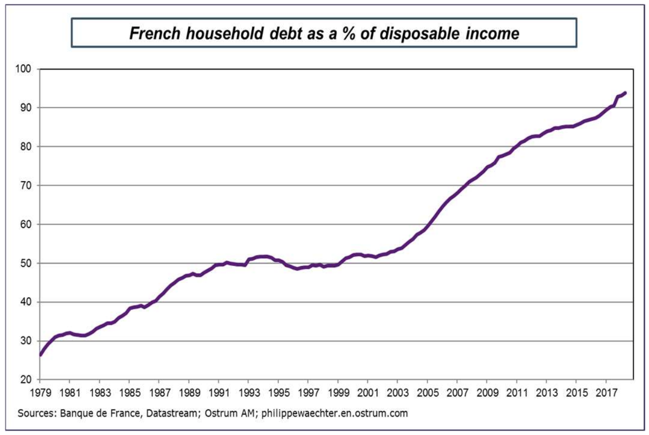


Automatic stabilizers were effective, as we can see until 2011/2012, and purchasing power was maintained. This would have continued had growth as measured by the supply indicator returned to its pre-crisis trend. However, this was not the case, and productivity is now increasing at a slower pace. Convergence of the two markers meant severe fiscal adjustments in 2012/2013.

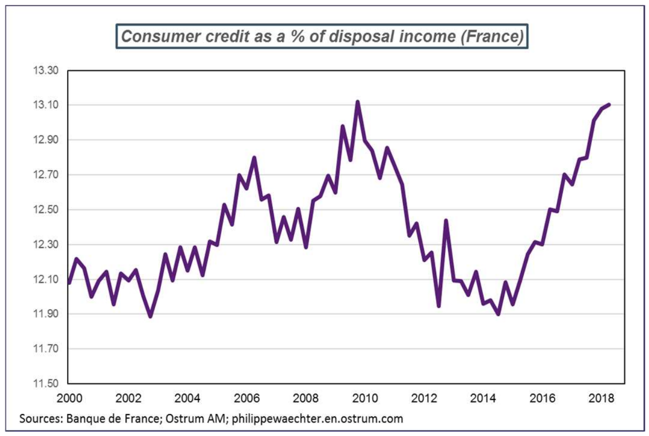
Economic trend growth is now set on a weaker rate than before the crisis, at 1.3% vs 2% for GDP, while productivity has moved from average annual growth of 1.1% to 0.7% since 2014. The redistribution model probably needs to be reviewed to take on board this watershed.

*English version of a post on Forbes.fr

The second issue is household debt, which continues to surge swiftly.

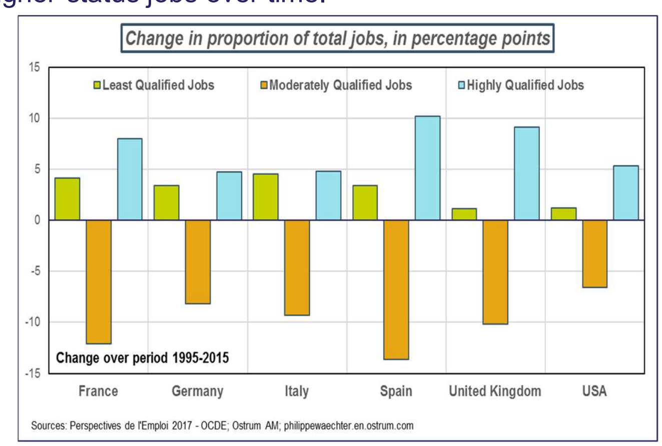


Debt came out close to 93.9% of disposable income in the second quarter of 2018, reflecting high real estate debt (77%) which is also indicative of lofty property prices in France.
But consumer credit has also taken an upturn as shown in the third chart, where debt went from 11.9% of disposable income at its lowest in 2014 to 13.1% in the second quarter of 2018, growing at a fast clip and probably being used to make up for inadequate income growth.



This issue of debt acting as a substitute for insufficient income was already raised before the 2008 crisis, with growth in income deemed insufficient to meet household spending needs. This situation has already been seen in other countries.
Rising consumer credit reflects the implicit assumption that income will increase in the future, thereby resolving consumers' cashflow shortages. Yet in view of the expected pace of GDP growth, which we mention above, these expectations are perhaps too ambitious.
Income difficulties are eased when households can take on debt in the short term, but the situation gets out of hand when purchasing power is more restricted e.g. by a hike in taxes.

The third source of concern is the situation on the labor market, and in particular its polarization. This is a recent trend, where qualified workers are able to find a job, those with few qualifications are able to find a job – albeit often in a less secure situation – while a whole other group in the middle is losing out i.e. those with intermediate jobs that do not require a lot of qualifications initially, but can develop into better-paid and higher-status jobs over time.



These jobs are where the labor market's transformation is really happening, as they are hit by competition resulting from innovation and technology. The number of these roles is dwindling, having been occupied by a large middle class. Wage momentum is also therefore weaker on this market segment.
This middle class is therefore suffering from a less secure situation for themselves on a long-term basis, as well as for their children. This insecure situation restricts these workers' ability to improve their own lives and invest in

their children's future, as they could have done in the past. The outlook is bleak, and no-one expects this labor market segment to improve in view of today's technological transformations.

So all this sheds some light on the recent social turmoil. Structural changes on the labor market are set to continue and further ramp up due to the impact of innovation and technological chances. This situation is not set to change any time soon, even if the government embarks on considerable training efforts. Alongside this gloomy situation, we are seeing greater pressure on income than in the past – firstly as the French economy is not as strong and also because households' resort to loans to make ends meet, and this total debt is now very high. Shocks on purchasing power can thus have a vast impact – with many feeling unable to keep their heads above water – and even trigger long-lasting social unrest. Against this backdrop, getting rid of the French ISF wealth tax – and thereby easing budget pressure on those who were not in difficulty – is viewed as unfair, although from an economic standpoint it is probably necessary to eliminate this tax.

Training efforts must form the crux of economic policy if each French citizen is to find their way forward, while also upgrading productivity trends and improving the ability to distribute income for the entire economy. This will also encourage investment.

In light of recent events, the French economy is walking the tight rope between questions on the country's institutions on one hand and the risk of an economic watershed on the other. All sides need to try to avoid a political crisis, which would jeopardize social stability and the economy's ability to create wealth and jobs.

Legal information

Ostrum Asset Management
Asset management company regulated by AMF under n° GP-18000014 – Limited company with a share capital of 27 772 359 euros – Trade register n°525 192 753 Paris – VAT: FR 93 525 192 753 – Registered Office: 43, avenue Pierre Mendès-France, 75013 Paris – www.ostrum.com

This document is intended for professional clients in accordance with MIFID. It may not be used for any purpose other than that for which it was conceived and may not be copied, distributed or communicated to third parties, in part or in whole, without the prior written authorization of Ostrum Asset Management.

None of the information contained in this document should be interpreted as having any contractual value. This document is produced purely for the purposes of providing indicative information.

This document consists of a presentation created and prepared by Ostrum Asset Management based on sources it considers to be reliable. Ostrum Asset Management reserves the right to modify the information presented in this document at any time without notice, and in particular anything relating to the description of the investment process, which under no circumstances constitutes a commitment from Ostrum Asset Management.

Ostrum Asset Management will not be held responsible for any decision taken or not taken on the basis of the information contained in this document, nor in the use that a third party might make of the information.

Figures mentioned refer to previous years. Past performance does not guarantee future results. Any reference to a ranking, a rating or an award provides no guarantee for future performance and is not constant over time. Reference to a ranking and/or an award does not indicate the future performance of the UCITS/AIF or the fund manager.

Under Ostrum Asset Management's social responsibility policy, and in accordance with the treaties signed by the French government, the funds directly managed by Ostrum Asset Management do not invest in any company that manufactures, sells or stocks anti-personnel mines and cluster bombs.