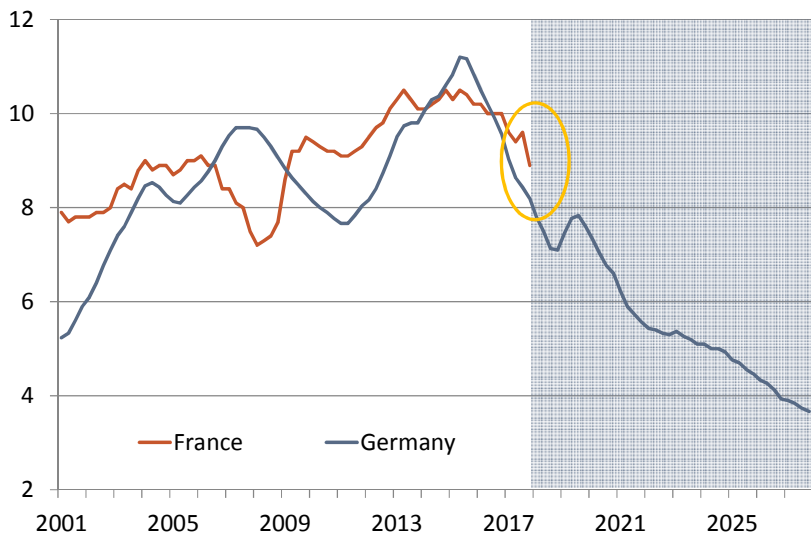


16 February 2018

Unlocking France's potential

France now following the German example: French and German unemployment rate (%)



Unemployment rate in %. National data for France (metropolitan and overseas). EU-harmonised data for Germany, quarterly average of monthly series, advanced by 10 years. Sources: INSEE, Eurostat

- It's the labour market, stupid:** In Q4 2017, French unemployment dropped the most since 1975 on the back of strong employment gains. Falling from 9.6% to 8.9%, the unemployment rate reached a ratio last seen in Q1 2009. It also undershot the long-term average (2001-2016) and the European Commission's estimate of the long-term equilibrium rate (NAIRU) of 9%. More jobs are good for the economy. After years of moderate growth, the French economic expansion accelerated significantly in 2017.
- A rising French tide:** The global cyclical upswing has boosted French investment and exports. A rising tide lifts all boats. Yet, the acceleration in economic activity can not only be attributed to cyclical dynamics elsewhere. France has improved its supply side over the past few years. In 2015/2016, it introduced more structural reforms than any other major advanced country, according to the OECD. In 2017, it overhauled the 3,342-pages long labour code. A tax reform provides additional incentives for companies to hire and invest and for potential workers to find a job. These reforms are largely the brainchild of Emmanuel Macron, first as economics minister, now as president. Mr Macron is taking France down the reform path that Germany took more than a decade ago.
- Reforms matter:** After four decades of rising joblessness, German employment took off after the "Agenda 2010" reforms spearheaded by then-chancellor Gerhard Schröder in 2004. Since 2005, Germany has created more than 6m jobs, bringing the unemployment rate down from a peak of 11.2% to 3.6% in December 2017. Some 10 years later, France could repeat the German turnaround. The gap between French and German unemployment rates (5.2ppt in Q4 2017 after 6.1ppt in Q4 2016) indicates the potential which France could unlock with its reforms.
- Challenges remain, but Mr Macron has just started:** Mr Macron wants to cut 120,000 of the 5m public servant jobs during his presidency, allow for more temporary contracts and link pay closer to performance. The unemployment insurance system should become cheaper and more efficient by closely monitoring jobseekers' efforts to find a job and by limiting the number of job offers they can refuse. Apprentice and (re-)training schemes will be upgraded to overcome the skill mismatches many employers complain about. This could lower structural unemployment further towards the German level. Mr Macron also plans to streamline the pension system by merging 37 separate schemes.
- Golden decade – our top macro call:** Of course, it is still early days. Turning France around will take time. So far, however, Macron seems to be on track. In the 2020s, a resurgent France can outshine a Germany that remains strong but is becoming more complacent with every election. If Mr Macron continues to fix France's roof and strengthen its foundations, France is heading towards a golden decade with GDP and job growth beyond that of Germany.

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