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# PANORAMA

SEPTEMBER 2016

## FRANCE

### Growth takes a time-out

COFACE ECONOMIC PUBLICATIONS

By Coface Group Economists



**F**rench growth has taken a time-out in Q2. The political uncertainties in the United Kingdom, the strikes in May and the floods affecting Ile-de-France are all likely suspects responsible for this surprise halt. However, the figures are expected to recover in Q3. The extent of the negative impact of stocks in the second quarter suggests we can forecast a particularly good rebound. Household confidence grew in August, and business confidence continues to outperform its long-term average. The risks facing the French economy remain primarily external, originating mainly from our trading partners who one by one are taking the

tricky step of planning a referendum. Coming just a few weeks after Brexit, the Italian government would not survive if the electorate decides to vote against its proposed reforms to the Senate. There is every likelihood that France will suffer a significant economic fallout from any prolonged period of political uncertainty in Italy (even though this risk has not yet actually materialised in the case of the UK). Despite these uncertainties, Coface predicts growth of 1.6% in 2016 (followed by 1.3% in 2017). This should be sufficient to lower the rate of company insolvencies by 3.4% this year, with Ile de France, Centre and Corsica being the only regions to not benefit from

this improvement. The rise in insolvencies in the agri-food sector is in turn evidence of the heightened risk for companies still reeling from a poor harvest. There is good news, however, with automotive having been downgraded to low risk in our sector analysis. France is making up for lost time in terms of new car registrations, which is providing upstream benefits for the sector. The overseas expansion of vehicle and parts manufacturers, affecting areas with the highest added value, will however have a substantial impact on the suppliers of the companies only in the mid-term.

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 FOR SAFER TRADE

SEPTEMBER 2016

FRANCE OVERVIEW 3<sup>RD</sup> QUARTER 2016

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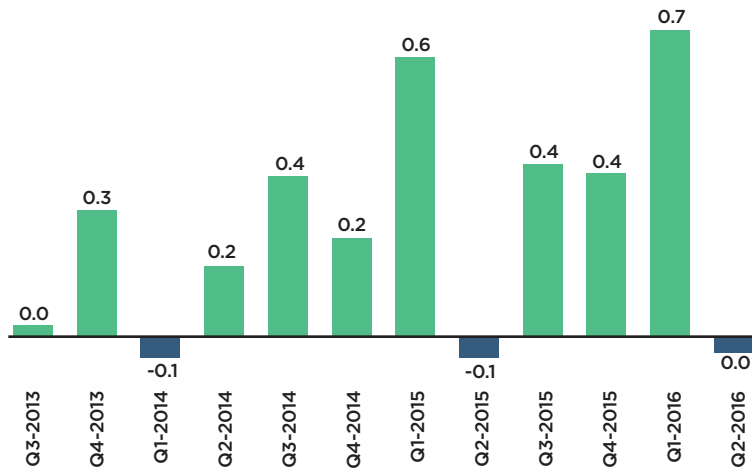
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Economist

## 1 MACROECONOMIC SITUATION

Graph n°1.1  
Quarterly growth in France (quarter-on-quarter change)



Source: Insee

### Growth hits the brakes in Q2

After the pleasant surprise of the first quarter, France posted null growth between April and June 2016 (see *graph n°1.1*) and thus experienced a halt in its economic recovery. This halt is partly due to the major strike action against labour law reforms in May, the floods that hit Ile-de-France in June and fears of terrorist attacks. The regional tourism committee for Paris and Ile-de-France announced a 6.4% fall in hotel occupancy in the first half of 2016.

Household spending, a key indicator of economic performance (55% of GDP), stagnated with zero growth in Q2, after a highly dynamic first quarter (up 1.2%). Fixed asset investments fell by 0.2%, particularly due to a 0.4% reduction in corporate investment following a 2.1% rise in the previous quarter. At a time when domestic demand is struggling, international trade has contributed positively to this growth, despite a 2% drop in imports and a 0.1% fall in exports which have failed to recover.

That said, the initial confidence and employment indicators for the summer suggest this is nothing more than a blip.

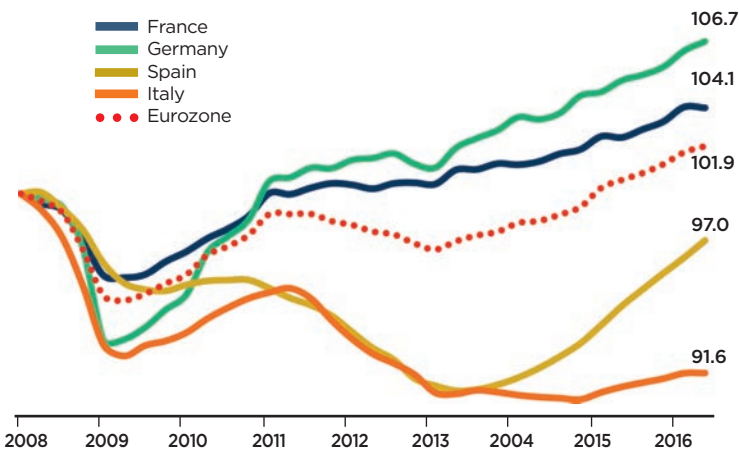
Although business confidence experienced a slight downturn in August (101), it remains close to its long-term average (100). And although the extent of the negative contribution of stocks (-0.7 points) took us by surprise, the figures ought to correct themselves during Q3.

Graph n°1.2  
Quarterly growth in France (quarter-on-quarter change)



Source: Insee

Graph n°1.3  
Eurozone GDP, 100 = 2008



Sources: National Statistical Institutes, Coface

### A malfunction in market services

Market services (see graph n°1.2 p. 2), which account for 56% of the French economy, made a negative contribution to growth (0.1%) in Q2. In retail, the biggest decrease came from household services (-1.1%) and trade (-0.4%). On the other hand, IT and telecoms experienced a 0.8% rise.

Industry, which accounts for 14% of the total, is down 0.3%. The agri-food sector has been particularly badly hit (-1.4%), whereas transport materials grew by 0.7%, after a 2.9% increase in Q1. Construction has suffered a further downturn (-0.2%). However, return to growth is still possible in Q3 (see Part 3 p. 8).

### Growth forecasts

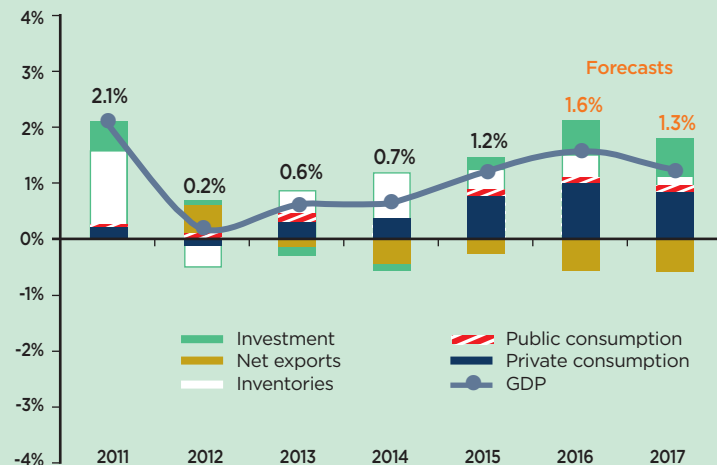
Our model over-reacted to the disappointing result of the second quarter of 2016. It has led us to predict a 0.2% fall in consumption in Q3, before a 0.3% recovery in Q4. This risk scenario would mean consumption contributes 0.8 percentage points to GDP growth in 2016. However,

this is not our main scenario because external shocks are the primary reason for France's poor performance in the second quarter.

We expect a correction in Q2 and even predict that growth could reach 1.6% in 2016. Household consumption will be the biggest factor (one percentage point), followed by investment (0.6 percentage point). In Q2 2016, stocks heavily penalised growth (by 0.7 percentage point) and should mechanically make a positive contribution during the third quarter. This recovery is expected against a backdrop of relatively high business confidence and increased pressures on production. Production capacity utilisation rates at the end of the second quarter were at 78% on average, compared to 77% in 2015 and 76% in 2014. In July 2016, heads of companies in the manufacturing industries continued to predict a clear growth (6%) in their investments this year, compared to 2015.

In 2017, Coface expects a slight slowdown in activity (+1.3%), again buoyed by consumer confidence (0.8 points). At the same time, investments ought to retain their momentum. Only net exports will continue to hold things back.

Graph n°1.4  
French growth forecasts



Source: Coface

### METHODOLOGY

Coface predicts each component of GDP demand. Quarterly consumption is estimated on a monthly basis using two vector autoregression (VAR) models. In the first, the explanatory variables are consumption (consm) for the past two months along with job vacancies (Emp) and consumer confidence (Conf) in the previous month.

$$Consm_t = a_1 Consm_{t-1} + a_2 Consm_{t-2} + a_3 Emp_{t-1} + a_4 Conf_{t-1} + \xi$$

In the second, quarterly consumption is explained using the two previous quarters and estimated consumption (cons3m) for the three months comprising the quarter by model 1.

$$Consq_t = a_1 Consq_{t-1} + a_2 Consq_{t-2} + a_2 Cons3m_t + \xi$$

## Box 1

## A not worrying sizeable corporate indebtedness at this stage

The global financial crisis of 2008-2009 was triggered partly by massive private debt. The countries which experienced the greatest rise in this debt prior to 2008 are the ones which have suffered the worst recessions (Spain, USA, UK).

Between 2008 and 2016, France is the only large euro area country whose non-financial business debt has risen (by 14.8 percentage points). It was at 68.7% GDP at the end of Q1 2016, a record high. At the same time, there was only a marginal rise in investment by French companies (2.5%), whilst their saving rate fell from 20% to 17% of added value between 2007 and 2014. Although this additional debt was neither invested nor saved, it probably helped companies by enabling them to weather out the temporary effects of the crisis.

Unlike other countries in Europe (especially in the south), this debt was made possible primarily thanks to the relative resilience demonstrated by the French banking sector. Both Spain and Italy had the highest rate of non-performing loans (NPL) on their bank's balance sheets (12% of assets in Italy in 2011 and 6% in Spain) and they were therefore more likely to experience a considerable tightening of credit terms. On 22 July 2016, the European Banking Authority (EBA) published a report on the state of

NPLs in the European Union (EU). Although the average ratio of non-performing loans on the balance sheets of European banks was 5.7%, the figure for France was 4%.

Benefiting from the incentives offered by the European Central Bank and the economic climate, the terms and conditions are favourable for both loan supply and demand according to the ECB<sup>(1)</sup>. In fact, in the second quarter 2016, these terms were eased according to French banks in relation to strong competition between banks anticipating a further rise in loan applications in the third quarter. French companies are telling banks they need credit to invest and above all to fund their mergers and acquisitions.

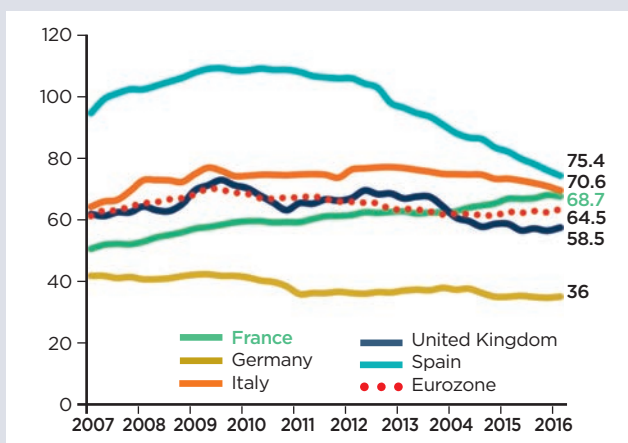
As well as bank credit, bond issues also encouraged French business debt. They represented €566 billion in June 2016 and 39% of the debt. For the eurozone as a whole, the average interest rate on a 5-year bond from an AA-rated company fell from 4.98% at the start of 2008 to 0.03% on 22 August! The European Central Bank (ECB), which began buying up corporate bonds (€510 billion) after numerous financial easing measures, is clearly partly to blame for this trend. Half of the total outstanding value of French company bonds is eligible. Between 2008 and 2015, the debt

they issued rose by 104%, confirming their appetite for this method of funding. Although we are seeing the same trend in the south of Europe, with +115% in Italy and +100% in Spain, their debt totals are much lower (€144 bn and €28 bn respectively). On the other hand, Germany companies are relying less on the marketplace (+22%, €152 bn).

In any event, this rise in debt is causing little concern at this stage. In fact, the CICE<sup>(2)</sup> tax credit and the economic recovery both bolstered the self-financing rate for companies to 92% in the first quarter 2016, and Coface predicts margins could reach 32.7% in 2016. In other words, companies have almost enough revenue to avoid having to rely on credit or the marketplace, although they may nevertheless wish to benefit from the low rates currently on offer such as the attractive cost of credit (1.89% on average for a mid/long-term loan). Their debt therefore ought to continue to grow at a steady rate, as was seen between the first quarters of 2015 and 2016 (+0.8%). Although this rise in business debt needs monitoring, it remains 20 points below the so-called critical debt threshold for companies<sup>(3)</sup> (90% GDP). Above this limit, and any growth in debt is in fact linked to a fall in GDP growth.

Graph n°1.5

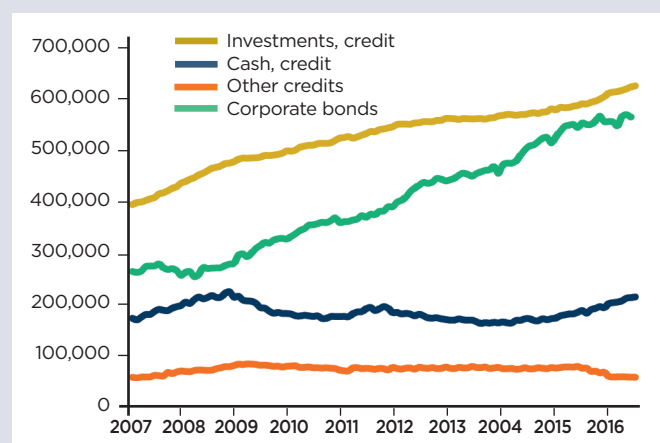
Non-financial business debt in Europe, % GDP



Source: Banque de France

Graph n°1.6

Non-financial business debt by component, in €k



Sources: Banque de France

(1) The Euro Area Bank Lending Survey, Second quarter of 2016

(2) *Crédit impôt compétitivité emploi*(3) For more on this topic, see the Coface Panorama from March 2015 <http://www.coface.com/var/cofaweb/storage/images/media/files/group/miniature-panorama-coface-fr2/1671263-1-fre-FR/Miniature-panorama-coface-FR.jpg>

Box 2

## Italy

**Live animals, iron/steel and plastics would be the sectors most vulnerable to a halt in Italian growth following the potential victory of the “no” vote in the referendum.**

France’s fifth largest export trading partner (6.2% of all French exports by value in 2015), Italy continues to be a major market for France, although it is losing momentum. Exports to the country (see *graph n°1.5*) grew by only 1.2% in 2015 compared to the 2001-2014 average, whereas exports to Germany (leading trading partner) rose by 24.4%, with a 37.7% increase in worldwide exports over that same period. Should there be a “no” vote in the Italian referendum<sup>(4)</sup>, which is due to be held by the end of the year, we cannot rule out the risk of long-term political uncertainty affecting both consumer and business confidence, with Prime Minister Matteo Renzi having announced he will resign if this happens.

The OECD’s TiVA database gives a clearer picture of exports in terms of domestic value added. Although between 2011 and 2015 France exported an average of €35 million in goods to Italy, only 75% of the value

added on the products was French i.e. €24 billion (1.2% GDP). A 10% drop in exports to Italy would therefore cost the French economy 0.12 points of GDP. In 2009, after the global financial crisis (extreme shock), exports to Italy fell by 21% (0.25 points of GDP). Should a new shock originate in Italy, the transport vehicles sector would cause the biggest damage to the French economy due to the proportion it represents of exports to Italy (10.6%) of which 60% of the value added is French, representing 0.13 points of GDP. Likewise, a 10% drop in exports would mean a 0.013 point loss.

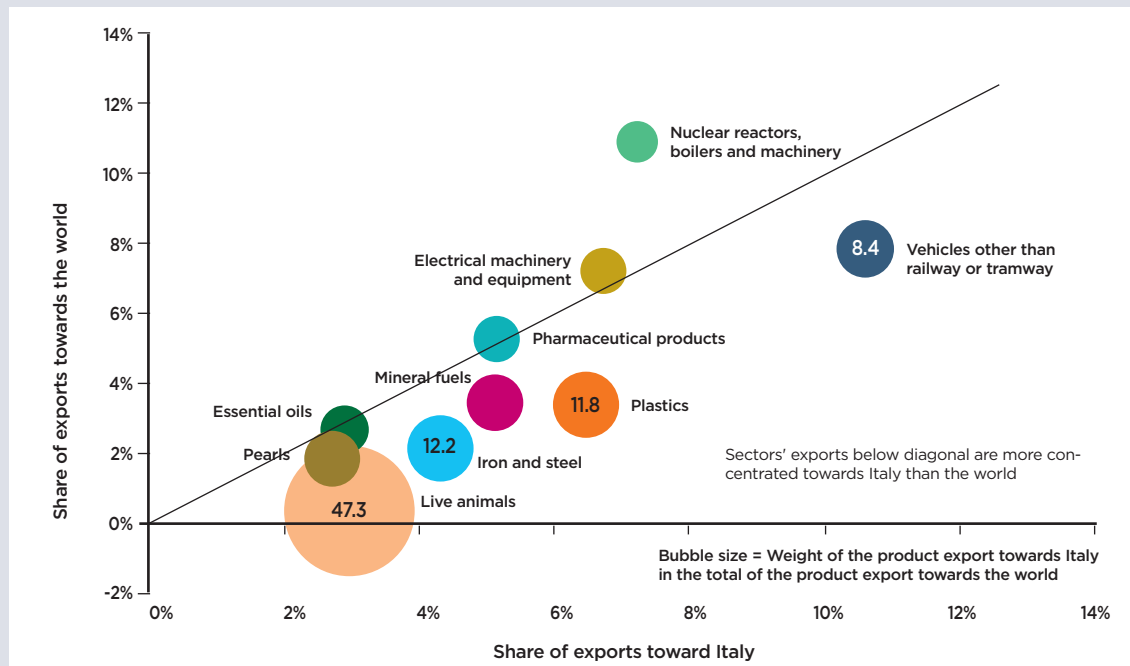
Taken in isolation, the impact on the economy of a fall in any one other product exported to Italy would be extremely marginal. Nevertheless, for some sub-sectors this partner represents a very important gateway, for example exports of live animals. In agriculture, domestic value added is 80%. Although a fall in exports in this sector would have manageable con-

sequences for the French economy because it represents only 0.04 points of GDP, it would nevertheless be highly affected. This one Italian partner absorbs 47.3% of global demand in this segment. The figures are even more extreme for cattle, which account for 96% of sales in the Italian live animals sector.

Several French segments could also be impacted. After live animals, the iron/steel and plastics sectors are the most vulnerable to changes in the Italian market. Especially since French exports from these sectors to Italy outperform those to the rest of the world. The at-risk segments are therefore medicines consisting of mixed products (89% of the pharmaceutical sector), passenger cars and other vehicles (61% of the transport vehicles sector), gas and oil (45% of the fossil fuels sector) and beauty products (43% of the essential oils sector).

Graph n°1.7

Comment regarding transport vehicles: 11% of exports to Italy are for vehicles, compared to 7% in the world. In terms of prospects for the sector, Italy represents 8.4% of global demand.



Sources: UNCTAD, Coface

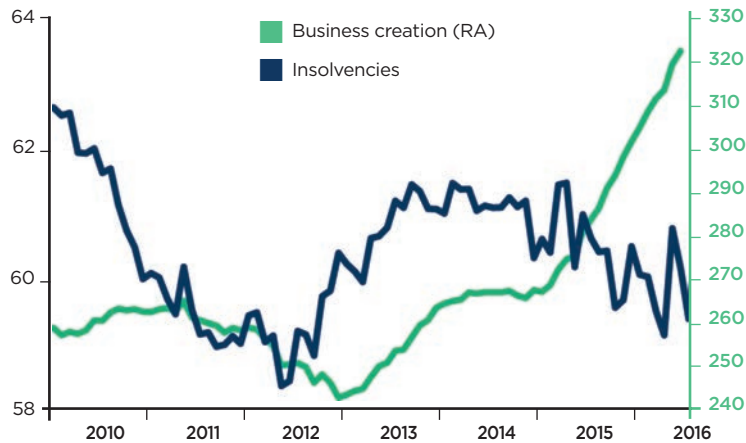
(4) Referendum on constitutional reforms to the Senate. The latest polls put the “yes” vote in the lead, but only by a narrow margin.



## 2 COMPANY INSOLVENCIES

Graph n°2.1

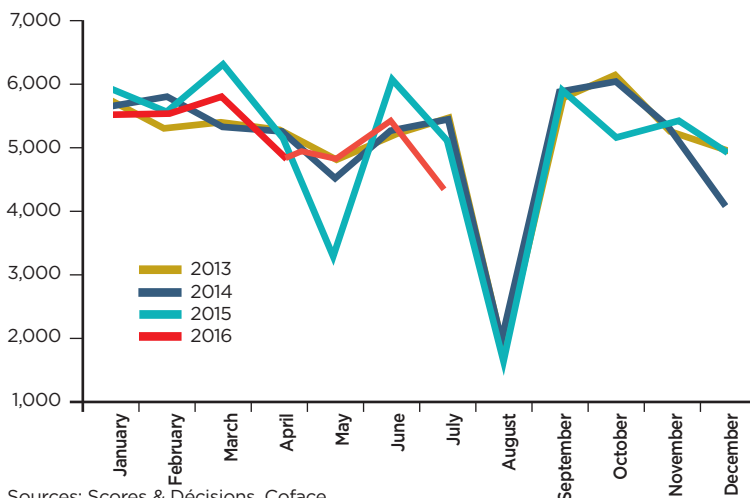
Company creations and insolvencies (in thousands, per annum)



Sources: Ellispère, Insee, Coface

Graph n°2.2

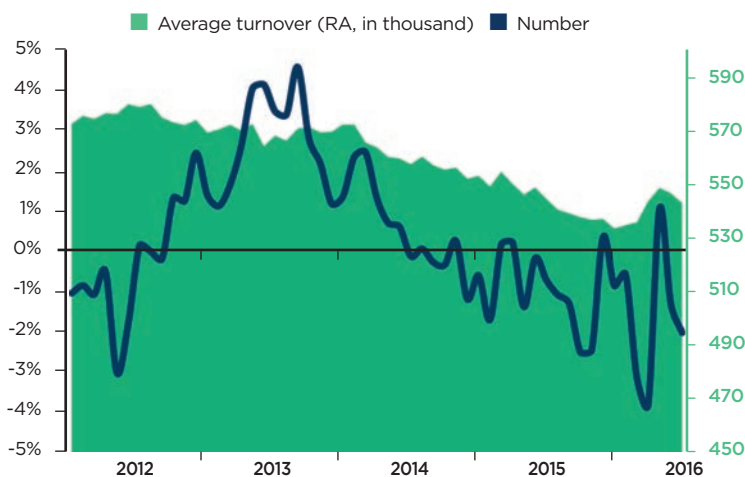
Monthly company insolvencies



Sources: Scores &amp; Décisions, Coface

Graph n°2.3

Yearly company insolvencies and average turnover (€k)



Sources: Ellispère, Coface

### The fall in insolvencies will be confirmed in Q2

In the twelve months to July 2016, 59,400 companies were declared insolvent (a fall of 2.1% over the period), almost exactly the same number as in March 2016 (59,500). The figure peaked in April 2014, after which company insolvencies in France continued to fall through to Q1 2016. The second quarter was marked by a resurgence in company insolvencies, primarily due to the resumption of activity following the effects of the strike in May 2015 during which bankruptcy data became erratic because fewer cases were being processed through the courts. The sudden jump in insolvencies during the twelve months to May was therefore only technical. 2017 will see a more gradual decline in bankruptcies despite good performance, because the strong rise in new companies (322,581 at the end of June excluding those registered as *auto-entrepreneurs*, +15 over one year) since 2015 will reflect negatively on the figures. Three in every ten companies fail in their first three years according to INSEE<sup>(5)</sup>. These figures are similar to those seen prior to the crisis (340,686 new companies in August 2008). The stock of enterprises was therefore 4.2 million in 2015 compared to 3.5 million in 2006, which will automatically push the annual rate of insolvencies to higher than the average recorded before the financial crisis.

The total cost to the economy of these insolvencies, calculated as outstanding trade debts, has reached €3.66 billion, a fall of 9% in a year. However, the number of employees affected has risen by 1% to 187,000.

In July 2016, only 4273 companies failed, a 15.7% fall on the same period in 2015. This downward trend is 3% over the year to date.

### Increase in average insolvency size

Even though it has been falling since 2012, the average size<sup>(6)</sup> of insolvencies, measured by turnover (TO), rose during the first half of the year to €542,000 at the end of July, a 1.1% increase on 2015. However, over the year the average TO has fallen by 0.3%. The metals sector appears partly to blame for this increase, with the size of its insolvencies rising by 10.9% to €1.175 million. In addition, over the year to date, two of the biggest insolvencies (not included in the reduced average) were in this sector. The two companies in question, Aveyronnaise De Metallurgie and Francaise De Roues, generated turnover of €101 million and €73 million, respectively. The biggest bankruptcy was that of the online retailer Pixmania (turnover of €295 million).

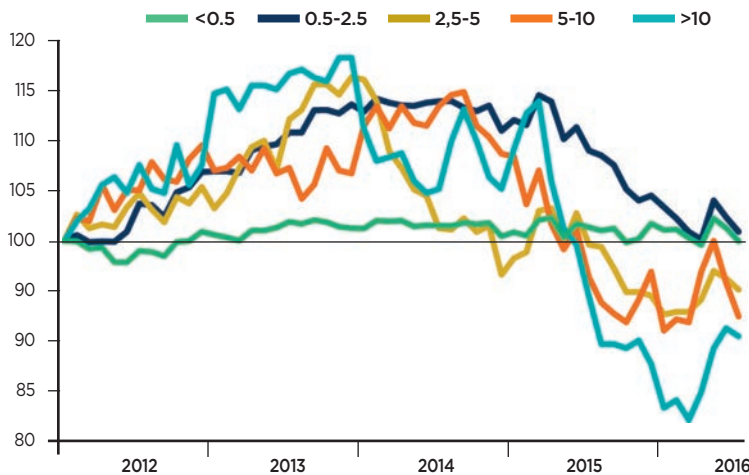
At the same time, the average age at which insolvencies are declared has levelled out at 79 months, following a record high in August 2015 of 80.4 months over one year.

(5) Insee première, n° 1543, April 2015

(6) Reduced weighted annual average; the top and bottom 1% of the distribution are excluded to give a more accurate image of average TO.

Graph n°2.4

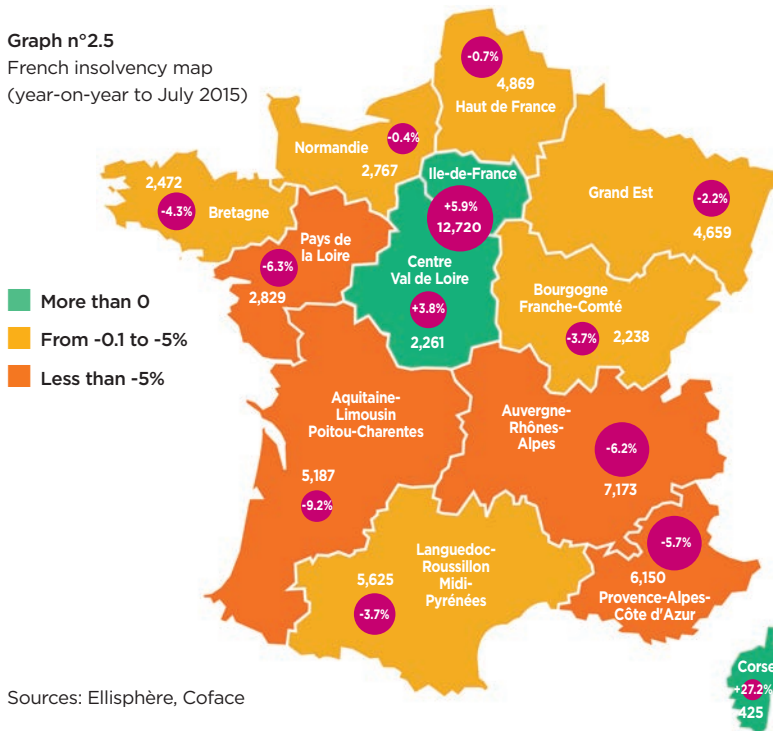
Insolvencies by turnover range (€k, 100 = January 2012)



Sources: Ellipsphère, Coface

Graph n°2.5

French insolvency map (year-on-year to July 2015)



Sources: Ellipsphère, Coface

### The smallest enterprises continued to be over-represented

Enterprises with a turnover of less than €2.5 million continue to fail at a rate higher than that recorded on 1 January 2012. They account for 97.8% of all insolvencies.

Although the number of insolvencies in each of the categories at the end of July is broadly similar to that of April, large companies are the exception and remain 7% higher than the rest (229 insolvencies).

### Still no let-up for Ile-de-France

Over the twelve months to the end of July 2016, the rate of insolvencies rose in three regions, Centre (+3.8%), Ile-de-France (+5.9%) and Corsica (+27.2%). Two regions posted a slight decrease (Normandy -0.4% and Hauts-de-France -0.7%), while four regions experienced a more marked improvement (Aquitaine-Limousin-Poitou-Charentes -9.2%, Pays de Loire -6.3%, Auvergne-Rhône-Alpes -6.2% and Provence-Alpes-Côte d'Azur -5.7%).

Ile-de-France accounted for 21.4% of insolvencies in mainland France, a figure similar to its proportion of companies in France. A rise in insolvencies across a number of sectors explains why this region is bucking the national trend. In the transport sector, bankruptcies rose by nearly 22% over the twelve months to the end of July 2016. This was the leading contributor to the 6.8% national rise. Likewise, the personal services sector posted a greater increase than the national average (11.9% vs. 3.5%). Finally, textiles (+19%) and agri-food (+13.1%), like the rest of the region, were affected. The decline in tourism in Ile-de-France following the terrorist attacks of November 2015 has only served to reinforce the trend first recorded in Autumn 2015. The sectors which have suffered the most are personal services, transport and, to a lesser extent, fashion retailers. These insolvencies are also the result of the "uberisation" of our society, a trend which is particularly strong in Ile-de-France. Coface aims to produce a cost/benefit analysis of this phenomenon in a study due for release in December 2016.

## Company insolvency forecasts for 2016

Graph n° 2.6

Yearly company insolvencies (in thousands)



According to our predictions, the rate of company insolvencies will fall by 3.4% in 2016, to a total of 58,440.

$$Def_t = b Def_{t-1} + c PIB_t + d Margins_{t-2} + \epsilon$$

This anticipated decline can be explained by a dynamic GDP as well as by healthier profit margins. With two quarters still to go, the rise in profit margins, which we believe will reach 32.7% in 2016, explains the lower rate of insolvencies.

Finally, credit to non financial companies remains on track with 4.3% growth, 3% higher than in February 2015, which leads us to hope for a positive downturn in insolvencies in the next six months.

Sources: Ellipsphère, Coface

### 3 SECTOR RISK

Table n°3.1

SECTOR RISK ASSESSMENT		
Sectors	Western Europe*	France
Agro-food	Medium risk	High risk ↓
Automotives	High risk ↗ Medium risk	Medium risk ↗ Low risk
Chemicals	Medium risk	Medium risk
Construction	High risk ↗ Medium risk	High risk
Energy	High risk	High risk
ICT**	Medium risk ↗ Low risk	Medium risk
Metals	Very high risk ↗ High risk	High risk
Paper-wood	High risk	High risk
Pharmaceuticals	Medium risk	Medium risk
Retail	Medium risk	Low risk
Textile-clothing	High risk	High risk
Transportation	Medium risk	Medium risk

Source: Coface

\* Changes in ratings Europe were made in July 2016

\*\* Information and communications technologies

▬ Low risk      ▬ Medium risk  
▬ High risk      ▬ Very high risk  
↗ The risk has improved  
↘ The risk has deteriorated

The mixed landscape of insolvency rates highlights the downturn experienced by the French economy in the second quarter of the year. Although the global outlook remains positive, the financial health of France's businesses has suffered in various ways from the terrorist attacks, strikes and bad weather. In short, for this quarter Coface has made one upgrade (agri-food) and one downgrade (automotive).

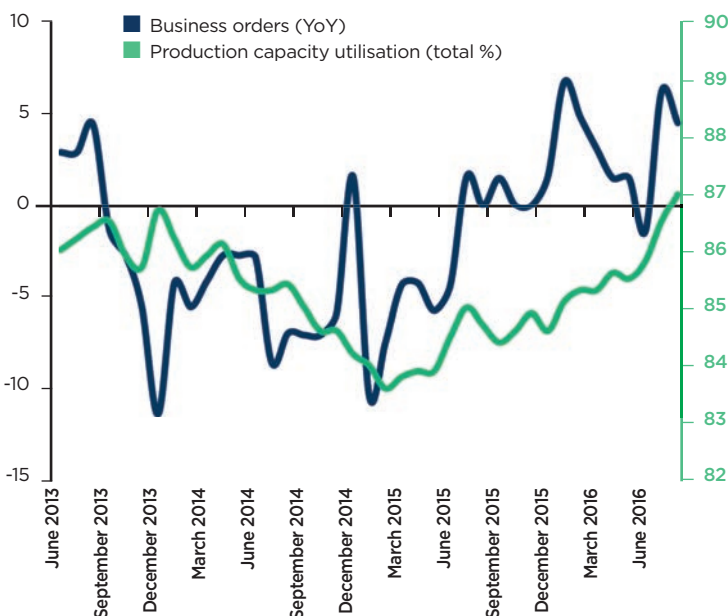
Automotive has been downgraded to low risk, in line with the rest of Europe for July (see *Automotive Analysis*, page 10). Due to poor cereal harvests and a rise in insolvencies in the meat segment the agri-food sector has been downgraded to high risk.

#### COFACE SECTOR-BASED RISK ASSESSMENT METHODOLOGY

Coface's analysis is based on financial data published by listed French companies. Its credit risk indicator simultaneously reflects changes in five financial indicators (turnover, profitability, net debt, cash flow and claim rate observed by our network).

Graph n°3.2

Production constraints in the building industry



Source: Banque de France

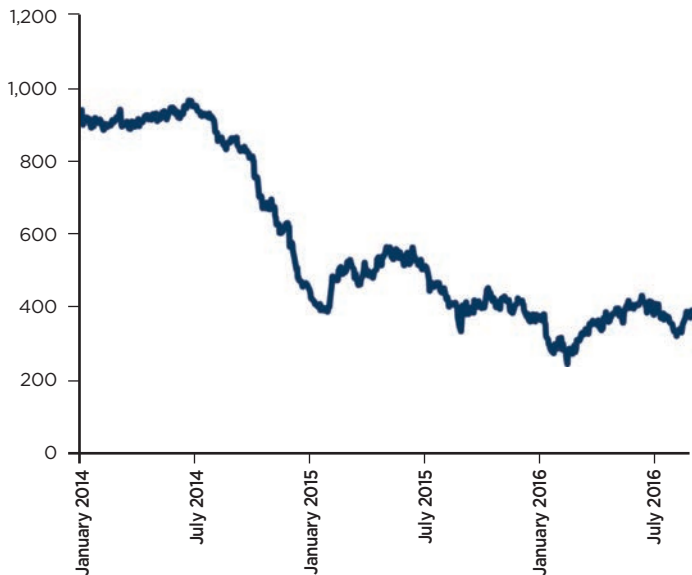
#### CONSTRUCTION : ▬ solid proof of recovery

Since the second quarter of 2015 there have been visible signs of recovery in the construction industry, with an annual fall in insolvencies of 5.7% at the end of July. Low mortgage rates are attracting consumers, whose confidence is slowly returning. The average long term fixed rate published by the Bank of France was 1.86% in June compared to 2.33% in February. Thanks to these good rates, there was a 4.1% rise in mortgages in the twelve months to June. This is the highest increase since May 2012. And the effects on prices are being felt. Nationally, there was a 0.6% increase in mortgages in the first quarter of 2016, a trend which could continue since, at the end of May, there had been a 17% rise in old home sales over one year, with a 5.2% in new home sales at the end of July. The capacity utilisation rate in the building industry rose to 87% in August, its highest level since January 2014 according to INSEE (see *graph n°3.2*). However, these healthy figures have not yet restored confidence among company directors in the industry, who still fear a downturn in the final quarter of the year.



Graph n°3.3

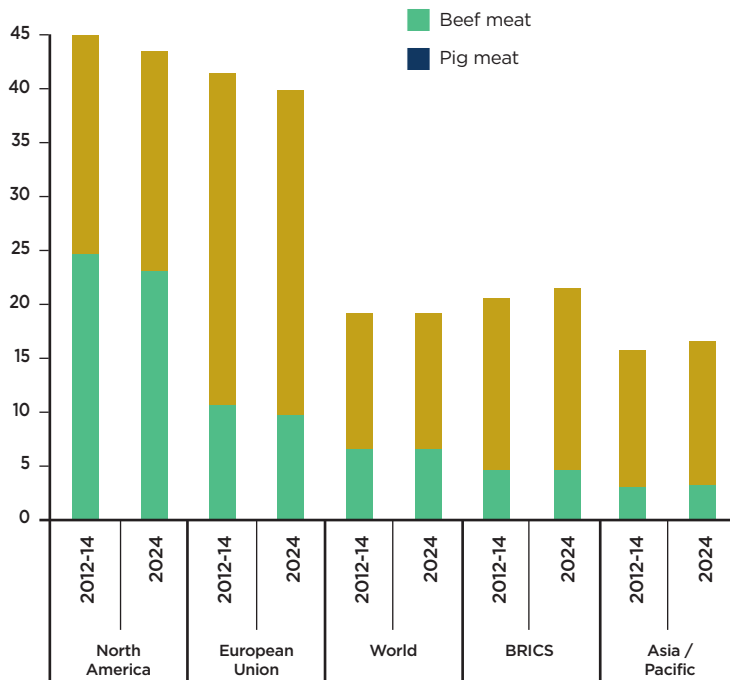
Price of naphtha in Western Europe, in USD per ton



Source: ICIS

Graph n°3.4

Worldwide annual meat consumption (kg per capita)



Source: OECD

### CHEMICALS: benefiting from a knock-on effect but no real recovery

The chemicals sector saw its insolvency rate plummet by 11.1% over the twelve months to the end of July 2016. Even though this trend has been ongoing for nearly a year, the rate of improvement appears to have picked up speed since May. Thanks to new lows in the price of naphtha (399 USD/tonne at the end of August 2016, 365 USD/tonne on average over the first eight months of the year), companies in this sector are generating healthier profits. In the short term, Coface does not predict any massive surge in the price of oil (of which naphtha is a derivative highly used in Western Europe). In addition, these companies saw their net profit margin continue to rise slightly to the end of June 2016, reaching 8.7% compared to 8.3%<sup>(7)</sup> one quarter ago. However, turnovers are waning, with just a 0.1% rise in Q2 2016 compared to the previous quarter. The UIC (Union of Chemical Industries) is reckoning on just a 1% growth in sales in 2016.

### AGRI-FOOD: an adverse global environment and national constraints

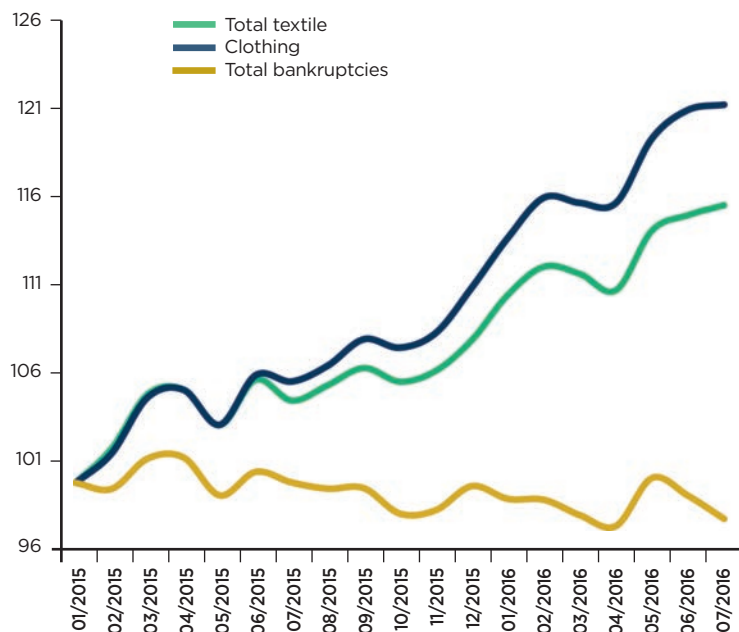
In July 2016, this sector recorded its third consecutive rise in insolvencies (+2.8%). Meat (13% of insolvencies in the sector) is the most vulnerable segment, with insolvencies up by 13%. Even though global meat prices have fallen by 9% over one year, France has bucked the trend with a 0.2% increase over the twelve months to July 2016 (INSEE). Nevertheless, although 75% of meat consumed in France is produced on the domestic market, national producers are facing strong competition from the rest of Europe (France is Europe's leading exporter of livestock and meat products). In addition, like other EU countries, French producers have not been spared the effects of a slowdown in meat consumption in developed nations.

More generally, the 3.2% rise in insolvencies in the agri-food industry (55% of sector insolvencies) is encumbering the sector as a whole. This industry is France's largest industrial sector in terms of both turnover and jobs, and comprises a majority (98%) of VSEs (76%) and SMEs (22%). For example, half of all insolvencies in the farming and fishing segments involve sole traders. Despite EU subsidies, this network of small companies remains, by its very nature, vulnerable. The current difficulties (milk crisis and poor cereal harvests in particular) should not, in the short term, do anything to improve the insolvency rate.

(7) Financial profit as a percentage of turnover

Graph n°3.5

Company insolvencies in textiles and clothing (retail)



Sources: Ellipse, Coface

## TEXTILES : ■ French clothing sector still suffer

With 2,260 companies affected (over one year), the annual insolvency rate rose by 10.6% in July. This sector is by far the most at-risk in 2016 as regards this indicator. Net margins fell by 37% from December 2015 to June 2016, as reflected in our high risk classification in April 2016.

Clothing, which accounts for 89.8% of all insolvencies in the textile/clothing sector, is mostly to blame, with a 14.8% rise in insolvencies in July 2016. Although 2015 was a symbolic year with the restructuring of Gerard Darel Pablo, the trend has continued with an annual 16.7% rise in insolvencies in the "retail sale of clothing in specialised stores" segment in July 2016. These insolvencies account for nearly two thirds (63.2%) of those in the clothing sector. The companies in this French segment have been the victim of intensified competition (Spanish group Inditex; turnover up 17% in the first half of the year) and a massive rise in online sales (36.6% market penetration predicted in 2016 vs. 31% in 2014). Finally, the unfavourable security, social and meteorological conditions caused a huge drop in tourism in the capital (and across Ile-de-France) in the first half of the year (1 million fewer tourists, a fall of 6.4%), which has also penalised sales.

## 4

### THE FRENCH CAR MARKET: FORGING AHEAD WITH INTERNATIONAL GROWTH

The French car market is on the mend. New vehicle registrations rose by 5.4% over the first seven months, and we predict a 5.6% increase for the whole of 2016. Although registrations are nearing their peak, 2017 will see yet further growth, which we estimate at between 1.5% and 2.5%. This rise is linked to the sustained momentum in household consumption (0.8 percentage points), thanks in particular to better performance on the job market and affordable credit.

The introduction of new finance options has also allowed private owners to start reconsidering the new vehicle market, as has happened in the USA and Britain.

For all these reasons, we have adjusted our risk assessment of the French car market and it is now classed as Low Risk in our quarterly sector analysis. However, we still have some reservations about tier 2 and 3 auto parts suppliers which remain vulnerable.

In addition to this economic momentum, the sector has been characterised by the rapid internationalisation of many companies. On the production side, vehicle unit costs continue to fall. As well as relocating their assembly lines, companies have also begun sending their engineering and R&D divisions to countries with more attractive labour costs. Thanks to a greater reliance on outsourcing, this strategy ought to help cut overheads.

The major parts suppliers (tier 1<sup>(8)</sup>) are becoming an increasingly important link in the value chain, and no longer have any doubts about leaving France to follow their customers and seek out new high-value prospects. They are now focusing on key technologies such as assisted driving systems and low carbon vehicles.

(8) Equipment manufacturers who supply the car manufacturers directly.

## The upturn in automotive is especially good news for the economy

### Robust vehicle registrations

Although below its long-term average (100), household confidence is on the up and is bolstering consumption. According to the aggregate indicator used by the INSEE to measure this confidence, the turning point appears to have been in June 2013 (see *graph n°4.1*). However, probably due to the terrorist attacks between June and July, the strikes and bad weather, July seems to have called a time-out. Other than this blip, certain consumers have put an end to years of austerity and bought a car thanks to finance options that are better suited to their expectations. New car on hire purchase is the most obvious example, and accounts for 64% of credit granted, according to the ASF (French Association of Specialised Financial Companies). These credit facilities accounted for 36% of consumer car credit over the first six months of 2016. This type of finance model grew by 40% in the first half of the year, whereas traditional credit was down 2.3%<sup>(9)</sup> over the same period. Britain has been experiencing an identical trend, with nearly 75% of new cars being bought by Personal Contract Purchase, a finance option identical to the French “LOA” (hire purchase) scheme.

This return of private buyers to the French car market has been accompanied by an appetite for entry-level and mid-range models. According to the CCFA<sup>(10)</sup>, over the first seven months of 2016, 53% of vehicles sold in France were in the lower economy range, whereas in Europe they represent only 42% of registrations. Some have hypothesised an impoverishment of the domestic market to explain this situation. Finally, this market is now dominated by professionals and corporate clients (55% of the market), who use their vehicles for only three years before giving them up to the second hand market. This is the market of choice for private buyers. Over five million private vehicles changed hands in 2016, most of which were in the economy range.

Graph n°4.1  
Car registrations and consumer confidence



Sources: Insee, SOeS

### Registration forecasts

We have developed a model for forecasting private car registrations in France through to the end of 2016. The chosen method uses an additive model, some of whose explanatory variables are transformed by interpolating cubic splines. These transformations take account of the non-linear effects of variables on registrations. It also incorporates the correlation structure created by the use of temporal variables.

The initial explanatory variables were consumer credit (Bank of France), unemployment rate (INSEE), consumer confidence index (INSEE), non-automotive retail sales (INSEE), the sub-indicator of propensity to purchase within 12 months (INSEE) and finally trends. Only consumer credit, consumer confidence and trends were significant to 10%.

Coface therefore predicts a 5.6% rise in registrations in 2016, less than in 2015 which saw 6.3% growth (with seasonal adjustment and working-day correction).

For 2017, we anticipate a smaller increase of 1.5-2.5%.

(9) €1,424 million.

(10) Committee of French Automobile Manufacturers.

### Manufacturers are adapting to the market

Between 2010 and 2014, French car manufacturers experienced a fall in sales on the domestic market, even though they held over 50% market share, leading to low capacity utilisation. As in Spain, they responded by reducing the unit cost of each vehicle produced in order to lower their break-even point<sup>(11)</sup>. In other words, productivity was boosted by increasing the workload per factory (producing more by assembling new models, see *graph n°4.2*) but by also cutting jobs and implementing a pay and hiring freeze. Not to mention the efforts to modernise the country's factories and improve quality, the purchase process and logistics.

Spain has gone one step further with this “internal devaluation” process, by lowering several aspects of employee pay and encouraging factories to operate 7 days a week. Spanish sites are now competing with those in France to make the same models (e.g. Trémery vs. Vigo engine plants). The State shareholding in two of France's manufacturers has enabled the country to maintain<sup>(12)</sup> its industrial tooling, even though Spanish production is now one third higher than in France<sup>(13)</sup> (whereas in 2006 it was one third lower).

In addition, the launch of new models has been a determining factor in the companies' ability to increase their factories' workload, even though this involved difficult arbitration. With the Paris Motor Show on the calendar for 2016, a number of mass-production models will be released this year, such as the new Peugeot 3008 which will be assembled in Sochaux. 37,094 units of the first version of this model were sold in the first half of 2016, a 3.7% rise on the first half of 2015, according to the CCFA. The CCFA also says this model is the fifth best selling in France.

The healthier performance of the domestic car market has also meant a significant fall in the number of company insolvencies. The rate began to fall in 2014-2015, after several years on the rise. This can be seen from *Graph n°4.3*, with the improvement being attributed to the factors stated above, in particular the upturn in the national economy.

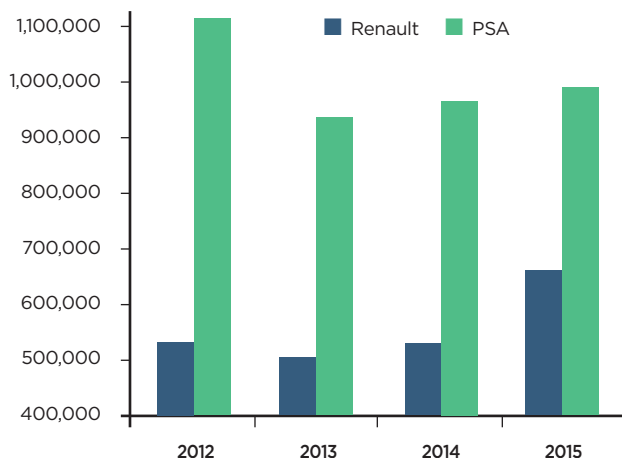
## A country with varying appeal

### Automotive: is France a host country?

A practice well understood by the car industry is that of relocation. There are several reasons why a company in this sector (manufacturer or parts supplier) may wish to relocate its production sites, such as cutting production costs, moving closer to a dynamic market or following a major client. For example, PSA, which is highly focused<sup>(14)</sup> on Western Europe and whose markets were hit badly in the crisis, is forging ahead with its international expansion by assembling entry-level models in low-cost countries<sup>(15)</sup>. Evidently it is no longer financially viable to produce vehicles with low added value<sup>(16)</sup> in France, an opinion shared by Renault<sup>(17)</sup> (and by the major equipment manufacturers). The segment is too competitive, even if volumes are significant (54% of registrations in 2015 for the “economy and below” category).

Graph n°4.2

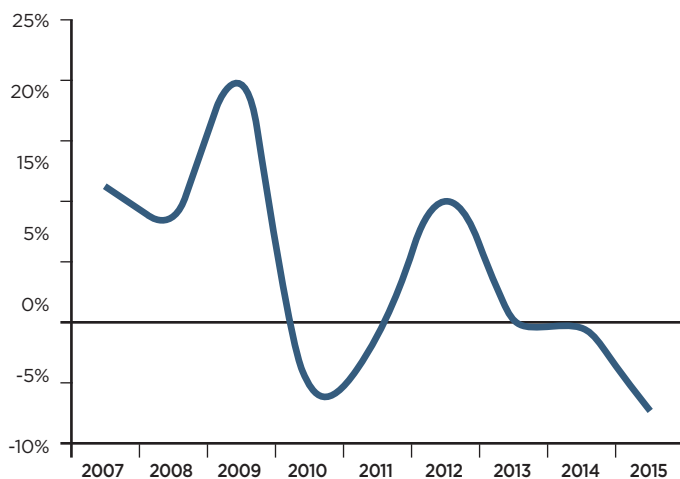
Vehicle assemblies by French car manufacturers in France



Source: CCFA

Graph n°4.3

Annual rise in insolvencies in the automotive sector



Sources: Elliphère, Coface.

(11) The output level needed for sales to equal costs.

(12) Despite the closure of the Aulnay-sous-Bois factory.

(13) In 2006, Spain produced three quarters as many cars as France.

(14) But not exclusively. PSA has for many years used assembly sites in numerous countries, but this was not enough during the crisis in 2008 or the European sovereign debt crisis.

(15) B segment, although top of the range versions may also be assembled there.

(16) Mainly small city cars whose margins are thought to be small. Several figures have been published, but without the underlying methodology.

(17) Which makes the majority of its Clio models in Turkey.

Graph n°4.4 is particularly telling on this point. Renault has developed a major site in Morocco (Tangier) where it assembles vehicles primarily for emerging markets. These entry-level models therefore benefit from cheap labour costs, but also from a prime location on the major global trade routes (the city lies where the Atlantic Ocean meets the Mediterranean Sea).

assembled around 3.5 million vehicles in 2015 according to the OICA. According to the Mexican Automobile Manufacturers Association, 70% of the vehicles it produces are for export, mainly to the USA. For many years, the country has been endeavouring to develop a sustainable production base, comprising not just equipment manufacturers but also R&D, and it is on the verge of achieving this goal. Ford of Mexico (FoM) has developed key skills in automotive engineering, not only to adapt small numbers of models to the specific requirements of the local market, but also to participate in the design of new models within the Ford Group. So far, this has concerned only engineering, and not R&D. However, thanks to a wealth of experience accumulated in this field, and the Government's desire to promote R&D, Mexico has taken a prominent role in the automotive sector. Finally, it is seeking to attract equipment manufacturers in order to create a microcosm with the right conditions for engendering R&D roles. It is therefore being monitored closely by certain Mediterranean countries, including Morocco.

Other branches of R&D could also therefore be relocated to emerging countries, as local governments develop their plans. The key driving factor behind this phenomenon is the growth of microcosms or automotive clusters in these countries, comprising manufacturers, equipment suppliers and outsourcers from the world of logistics, as well as both engineering and IT specialists. These integrated clusters will also benefit from gateways to other sectors such as aviation.

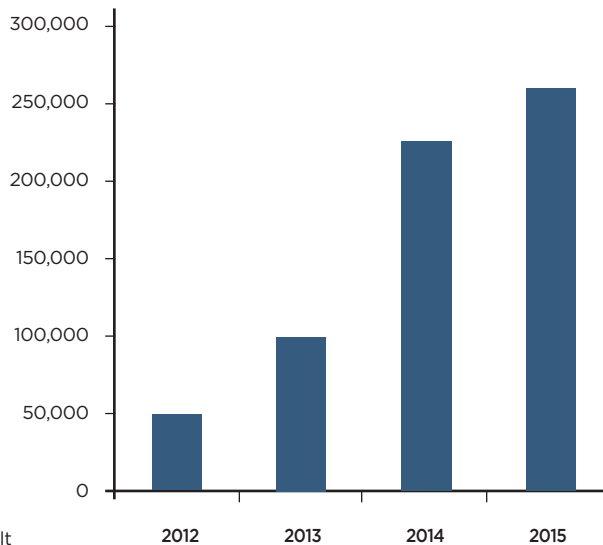
#### Equipment manufacturers also cramped for space on their home turf

After the two successive crises of 2008 and 2011-2012 (Lehman Brothers and European sovereign debt), national equipment manufacturers have been able to recover<sup>(20)</sup> by expanding not only their range (especially via R&D) but also their client portfolio. Ever since the collapse of Lehman Brothers, Valeo has re-focused its sales on more dynamic regions and clients. Sales to French clients fell from 23% of turnover in 2011 to 16% in 2015, whereas Asian car manufacturers (which are firmly rooted in the most dynamic and profitable regions and segments) increased their share of its sales from 21% to 26%.

The balance of power between equipment and car manufacturers seems to have shifted, to the benefit of the former. Graph 4,5 page 14 shows that tier 1 auto parts suppliers have an average operating margin<sup>(21)</sup> of 7.8%<sup>(22)</sup>, whereas that of vehicle manufacturers is 5.8%, a 2-point difference.

Graph n°4.4

Annual production at the Renault factory in Tangier



Source: Renault

Until now, relocations have affected mainly production and assembly. However, this month marked a turning point for the sector when PSA signed an outsourcing agreement with the engineering company Altran for an R&D facility in Morocco<sup>(18)</sup> for CAD<sup>(19)</sup> and scientific calculations. Some are insisting on the fact that this move will only benefit R&D roles that require the least grey matter, and that core research will still be carried out to a large extent by teams in France. We are inclined to agree, because France has a long tradition of automotive engineering, unlike certain other Mediterranean nations and countries in Eastern Europe. Nevertheless, on the assumption that emerging countries will be the best placed to respond to the challenges they face, there is a risk that this phenomenon could continue into the future. Let us take Mexico, for example, which

(18) Renault has built the group's largest R&D centre outside of France in Titu, Romania. This country is also home to Dacia, recently taken over by Renault.

(19) Computer-assisted design.

(20) Without Government aid, although the scrappage scheme has helped, indirectly.

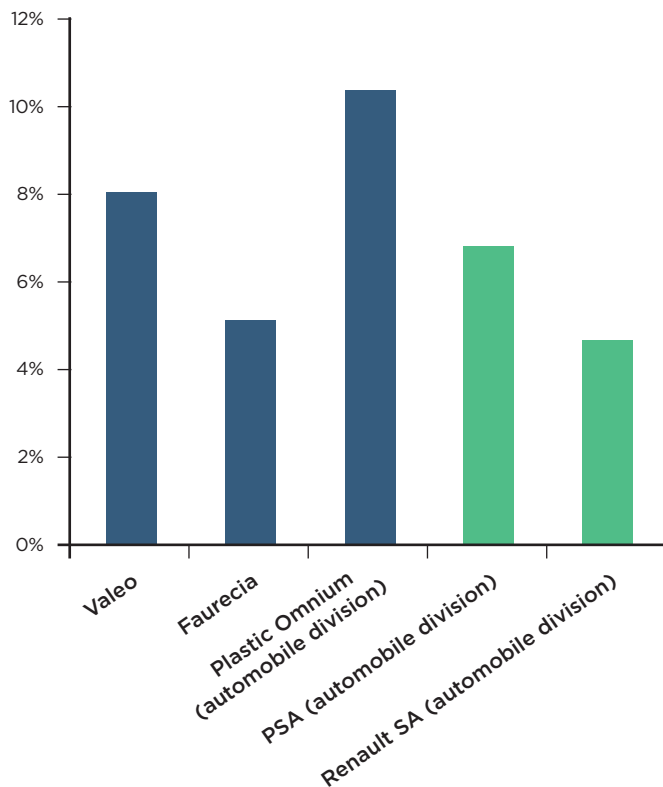
(21) Operating profit as a percentage of turnover. This ratio measures a company's profitability. Here, we are interested in the "car" divisions of vehicle and equipment manufacturers. We also note that Faurecia is a subsidiary of PSA, and the operating margin stated here does not include this parts manufacturer.

(22) First half of 2016.



Graph n°4.5

Operating margins of the main French car and parts manufacturers



Sources: Company financial reports

This balance of power can clearly be seen by the fact that tier 1 parts suppliers are the ones now developing the most attractive technologies, which will take centre stage in the future. The development of ways to combat pollution, at a particularly tricky time for diesel engines and fine particle emissions, is therefore now in the hands of parts manufacturers such as Valeo,

which also makes driving assistance systems. However, nearly 50% of its R&D expenditure is outside France, at its sites in not only Europe but also Asia and North America. Furthermore, the group has ambitions of creating a strike force of 3,000 engineers in China in the coming years.

The growth of car sales around the world, especially in emerging nations, is forcing not only the manufacturers but also and above all the parts manufacturers to find ways to expand their client portfolios. With a market composed primarily of economy vehicles, France cannot offer the necessary profitability, not to mention that the market is too crowded to allow companies to fill their order books. Even though the country has the advantage in terms of engineering, living standards and flexibility, its national car industry has reached a turning point. And after two back-to-back crises, France is becoming less competitive, as shown by the erosion of the sector's balance of trade surplus <sup>(23)</sup>. On the one hand, imports are due to foreign subsidiaries located in France wanting to peddle their wares on the Western European market (including Germany). They are due to companies specialising in electronic parts, and are slightly more dynamic (+4% per year between 2005 and 2015) than exports (+3%). Despite the economic momentum in France, the question of competitiveness of the automotive sector remains, at a time when tier 2 and 3 parts manufacturers have been decimated by years of bleakness. Finally, salaried employment in the national car industry has seen a slow decline in number. According to the Direction Générale des Entreprises <sup>(24)</sup>, the segment's workforce has plummeted by 28% since the end of 2007, and by 3% in just one year. The added value of the sector, as calculated by INSEE, has followed a similar trend, falling from €13.6 billion <sup>(25)</sup> in 2007 to €8.8 billion in 2014 <sup>(26)</sup>.

(23) Erosion of balance of trade surplus of car parts manufacturers. Direction des Douanes, Etudes et Éclairages, July 2016.

(24) Quarterly dashboard for June 2016.

(25) Figures are expressed in 2010 euros.

(26) Figures for 2015, the year in which the market recovered and the segment's added value rose, are not yet available.

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