Flash Economics

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The situation in the United Kingdom gives an idea of what France's situation would be like if it were not in the Euro

The United Kingdom has certain characteristics similar to those of France:

- Low growth ;
- High public deficit ;
- Structural current account deficit.

An important difference between the UK and France is that the UK has its own currency and an independent monetary policy. The UK's economic difficulties mentioned above mean that its monetary independence is becoming a handicap:

- The need for high short-term interest rates, partly to defend the exchange rate parity ;
- Very high long-term interest rates, with a risk of default, whereas a default by France is out of the question because of the ECB's reaction.

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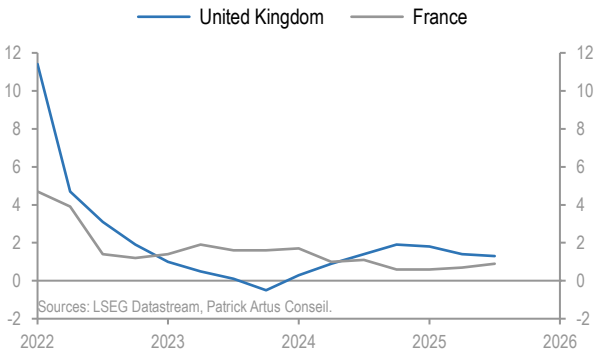
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Common characteristics between the UK and France

The economies of the UK and France share some common characteristics:

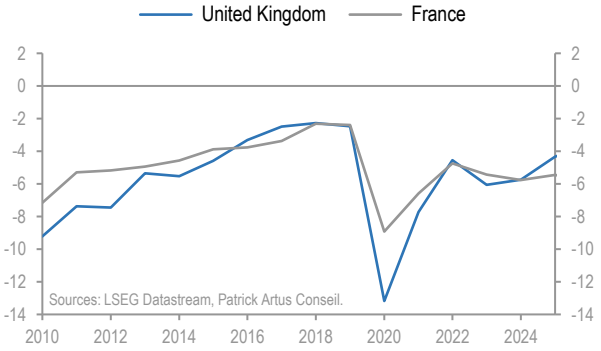
- Low growth (Chart 1) ;

Chart 1
Real GDP (Y/Y as %)



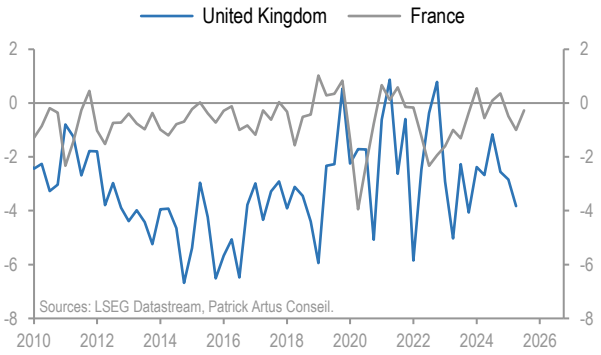
- High public deficit (Chart 2) ;

Chart 2
Fiscal deficit (as % of nominal GDP)



- Structural current account deficit (Chart 3).

Chart 3
Current account balance (as % of nominal GDP)



These common characteristics should not encourage investors to gain exposure to the UK or France

An essential difference between the UK and France: the UK has its own currency and an independent monetary policy, while France has the Euro as its currency

This difference, which could be an advantage for the UK, which has more control over economic policy than France, because it controls its short-term interest rates, **becomes a handicap in times of economic difficulty**.

We can see that **the UK**:

- Has to keep **short-term interest rates high** (**Chart 4**), to defend its exchange rate (**Chart 5**) and avoid imported inflation;

Chart 4
Central banks' key interest rate (as %)

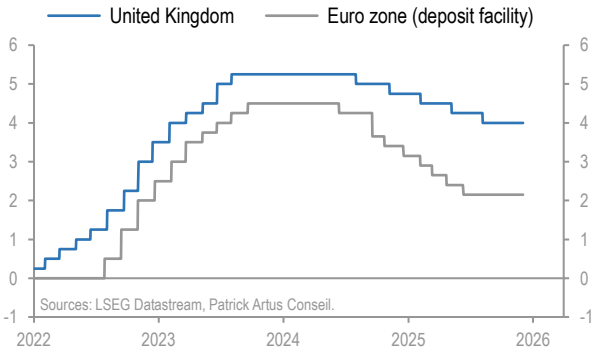
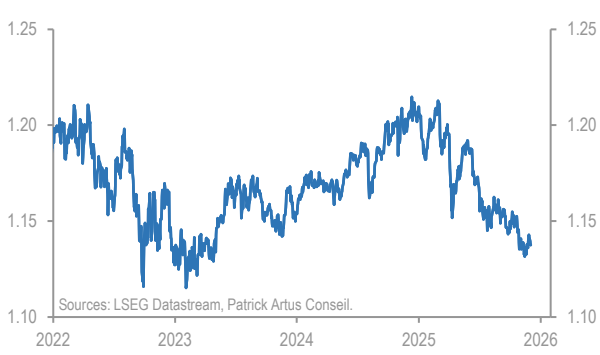


Chart 5
Pound/ euro exchange rate (GBP 1 = EUR ...)



- **Has high long-term interest rates** (**Charts 6/7**), since the UK is at risk of defaulting on its public debt, whereas a default by France is out of the question since the ECB would have to intervene (a default by France would cast doubt on the solidity of all Euro-denominated debt).

Chart 6
Interest rate on 10-year government bonds (as %)

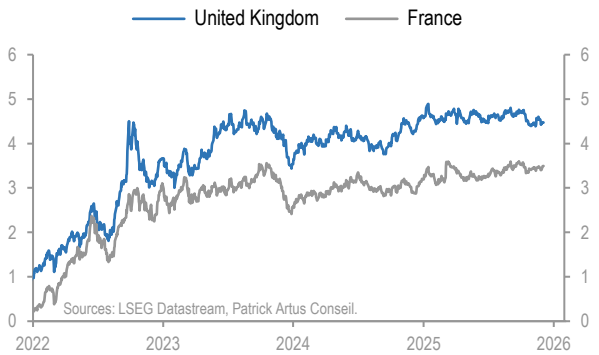
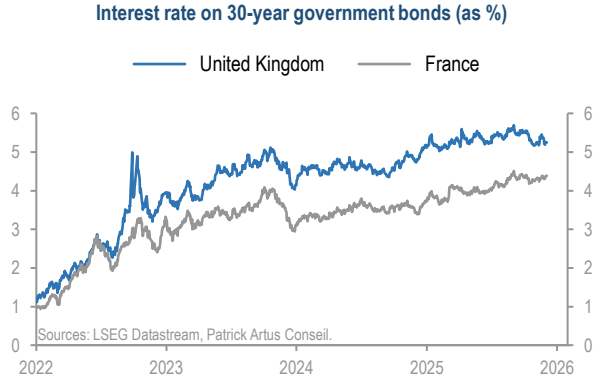


Chart 7
Interest rate on 30-year government bonds (as %)



Summary: Developments in the UK show what France's situation would be like if it were not protected by its membership of the Euro

If France were not protected by its membership of the Euro, it would experience developments similar to those seen in the UK, since its economic and budgetary situation is similar to that of the UK. France would see:

- A depreciation of the exchange rate;
- A net rise in short-term and long-term interest rates.

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