Flash Economics

N° 3
July 9th, 2024

We cannot assume that supply-side effects do not exist in France

Some politicians think with the assumption that only demand mechanisms exist, that supply mechanisms are not present.

If this were the case, demand could be strongly stimulated (higher wages, higher public deficits, etc.) without being penalised by a fall in the supply of goods and services or a weak labour supply.

But in reality, supply-side mechanisms exist and have persisted since 2017: a rise in wages reduces the profitability of companies and their ability to invest; a rise in public deficits leads to a shortfall in savings and a rise in real interest rates; a boost to demand leads to a shortfall in the supply of labour, and to a rapid rise in wages and inflation. Surveys show that, since 2017, the dominant economic regime has been one of excess demand for goods, services and labour (and insufficient supply of goods, services and labour). In this configuration, stimulating demand quickly leads to a deterioration in the economic situation, with rising inflation and falling investment.

Patrick Artus

@PatrickArtus

Marketing communication: this document is a marketing presentation. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research; and it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

It cannot be assumed that demand mechanisms are the only ones in existence in France

If only demand mechanisms exist and not supply mechanisms, **one could strongly stimulate the demand for goods and services**, with increases in real wages (**Chart 1**) with even greater public deficits (**Chart 2**), without the **effectiveness of this increase being reduced** by the fall in the supply of goods and services and by the inadequacy of the labour supply (**Chart 3**).

Chart 1
France : real wages per capita (deflated by, YoY as %)



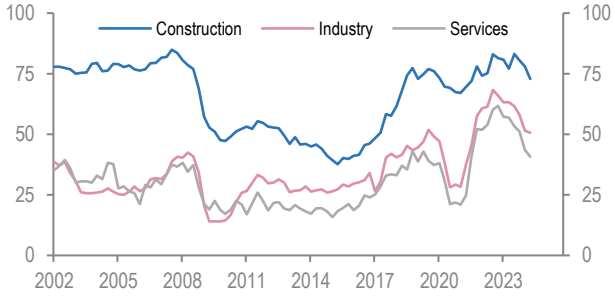
Source: LSEG Datastream, Patrick Artus Conseil

Chart 2
France: public deficit (as % of GDP value)



Source: LSEG Datastream, Patrick Artus Conseil

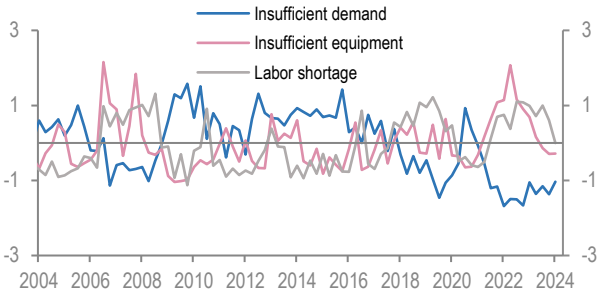
Chart 3
France: proportion of companies facing recruitment difficulties by sector (as %)



Source: LSEG Datastream, Patrick Artus Conseil

But in reality, particularly **since 2017, as shown by the survey of factors limiting production** (**Chart 4**), **supply mechanisms are playing an important role**.

Chart 4
Factors limiting production in the economy as a whole (in standard deviations from the mean)



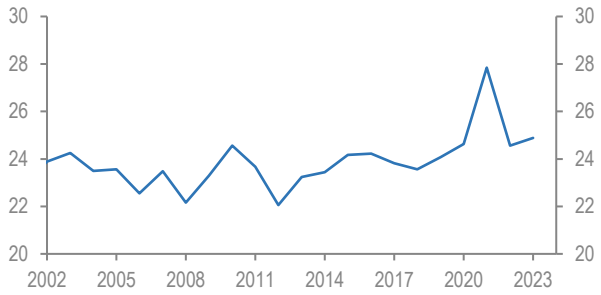
Source: LSEG Datastream, Patrick Artus Conseil

What supply mechanisms are at work?

The main supply mechanisms are as follows:

1) **Rising wages are reducing companies' profitability** (**Chart 5**), and their ability to invest;

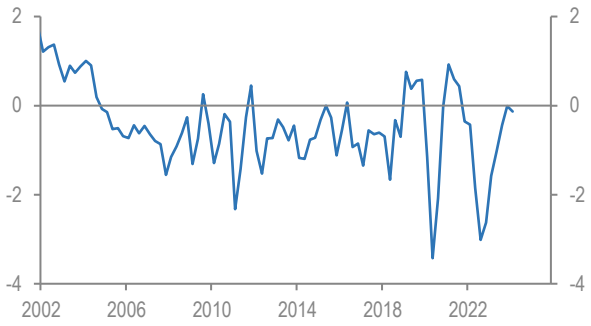
Chart 5
Profits after tax and interest, before dividends (as % of GDP)



Source: LSEG Datastream, Patrick Artus Conseil

2) **A rise in public deficits** (**Chart 2 above**) **leads to a shortfall in savings** (**Chart 6**) and a rise in real interest rates (**Chart 7**);

Chart 6
France: current account balance (as % of GDP)



Source: LSEG Datastream, Patrick Artus Conseil

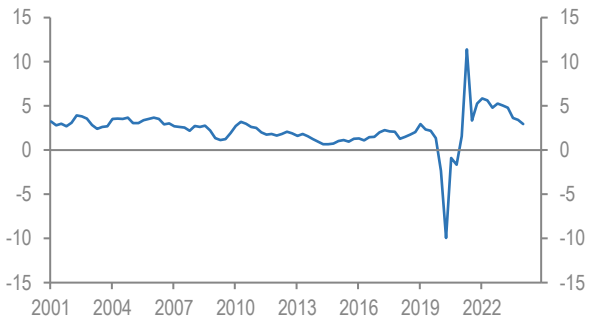
Chart 7
France: 10-year interest rate on government bonds
(deflated by 10-year inflation swap, as %)



Source: LSEG Datastream, Patrick Artus Conseil

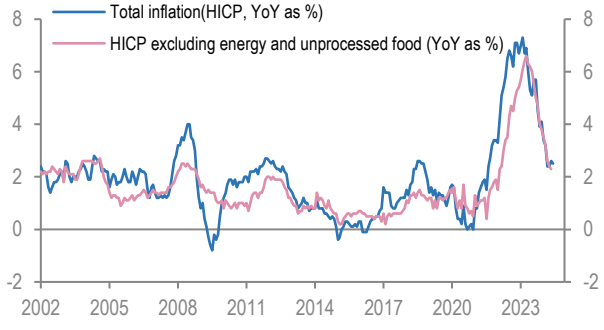
3) **A rise in demand leads to a shortage of labour supply** (**Chart 4**), a rapid rise in wages (**Chart 8**) and inflation (**Chart 9**).

Chart 8
France : nominal wages per capita (YoY as %)



Source: LSEG Datastream, Patrick Artus Conseil

Chart 9
France: inflation and core inflation

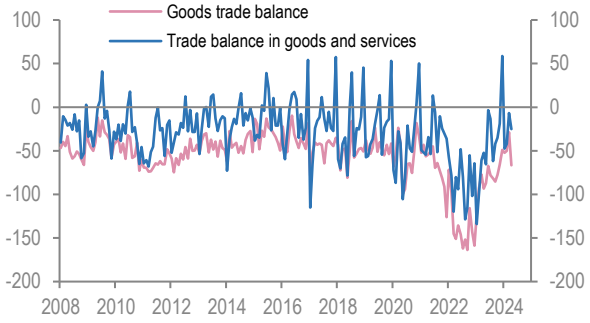


Source: LSEG Datastream, Eurostat, Patrick Artus Conseil

In this situation of excess demand for goods and labour, additional stimulation of demand (higher wages, increased public deficits, etc.) leads to:

- a weak stimulation of the demand for goods ex post and to an amplification of the situation of excess demand for goods and inflation;
- a fall in profitability and investment, if wages rise;
- high tension in the labour market;
- a sharp rise in the external deficit (**Chart 10**), and a problem in financing the economy, with insufficient savings relative to investment and rising real interest rates.

Chart 10
Annualized trade balance (€bn)



Source: LSEG Datastream, Patrick Artus Conseil

Summary: if there is initially excess demand for goods and labour, further stimulation of demand will exacerbate the supply problem.

In France today, there is already a situation of excess demand for goods and labour (**Charts 3 and 4 above**).

If one implement a policy to stimulate demand (by raising wages and further increasing public deficits), the situation of excess demand will be exacerbated, and a number of supply-side problems will emerge: a fall in investment, tension on the labour market and wage inflation, a shortfall in savings and a rise in real interest rates.

Disclaimer

This marketing communication and the information contained in this publication and any attachment thereto is exclusively intended for a client base consisting of professionals, eligible counterparties and qualified investors.

This document and any attachment thereto are strictly confidential and cannot be divulgated to a third party without the prior written consent of Patrick Artus Conseil. If you are not the intended recipient of this document and/or the attachments, please delete them and immediately notify the sender.

Reference prices are based on closing prices (if mentioned in this document).

Distribution, possession or delivery of this document in, to or from certain jurisdictions may be restricted or prohibited by law. Recipients of this document are required to inform themselves of and comply with all such restrictions or prohibitions. Neither Patrick Artus Conseil or any other person may be deemed liable to any person in relation to the distribution, possession or delivery of this document in, to or from any jurisdiction.

This document has been developed by Patrick Artus Conseil. It does not constitute a financial analysis and has not been developed in accordance with legal requirements designed to promote the independence of investment research. Accordingly, there are no prohibitions on dealing ahead of its dissemination.

This document and all attachments are communicated to each recipient for information purposes only and do not constitute a personalized investment recommendation. They are intended for general distribution and the products or services described herein do not take into account any specific investment objective, financial situation or particular need of any recipient. This document and any attachment thereto shall not be construed as an offer nor a solicitation for any purchase, sale or subscription. Under no circumstances should this document be considered as an official confirmation of a transaction to any person or entity.

Prices and margins are indicative only and are subject to change at any time without notice depending on, inter alia, market conditions. Past performances and simulations of past performances are not a reliable indicator and therefore do not anticipate any future results. The information contained in this document may include results of analyses from a quantitative model, which represent potential future events that may or may not be realized and is not a complete analysis of every material fact representing any product. Information may be changed or may be withdrawn at any time without notice.

The statements, assumptions and forecasts contained in this document reflect the judgment of its author(s), unless otherwise specified, and do not reflect the judgment of any other person. The information contained in this document should not be assumed to have been updated at any time subsequent to the date shown on the first page of this document and the delivery of this document does not constitute a representation by any person that such information will be updated at any time after the date of this document.

Patrick Artus Conseil or ay other person shall not be liable for any financial loss or any decision taken on the basis of the information disclosed in this presentation. In any event, you should request for any internal and/or external advice that you consider necessary or desirable to obtain, including from any financial, legal, tax or accounting adviser, or any other specialist, in order to verify in particular that the transaction (as the case may be) described in this document complies with your objectives and constraints and to obtain an independent valuation of the transaction, its risk factors and rewards.

All of the views expressed in this report accurately reflect the author's personal views regarding any and all of the subject securities or issuers. No part of author compensation was, is or will be, directly or indirectly related to the specific recommendations or views expressed in this report. The personal views of authors may differ from one another.