

France

Loss of momentum?

- Growth was robust in the first quarter at 0.6% q/q, but we expect it to slow to 0.2% in the second.
- Some positive factors supporting rapid rises in consumer spending and business investment are likely to fade.
- The most recent activity data and survey results are showing signs of a slowdown, but no major deterioration.
- It also remains to be seen how activity and confidence surveys will be affected on the downside by the strikes and bad weather that France has experienced in May and June, and on the upside by Euro 2016.

In the first quarter of 2016, French growth was robust, beating expectations. In addition, INSEE revised upward its second growth estimate from 0.5% to 0.6% sequentially (see chart 1). As a result, France's economy grew slightly faster than the eurozone's in Q1 (0.5% q/q), whereas their long-term average figures are the same. Most importantly, French growth has strong foundations, with consumer spending rising 1% q/q and business investment 2.4% q/q. Moreover, the second estimate of France's national accounts now shows that household investment rose slightly (by 0.3% q/q) for the first time in three years. This slight improvement is in line with other signs that the construction sector is pulling out of recession. With public-sector consumption still rising at a decent pace (0.4% q/q), domestic final demand contributed 1 point to growth in Q1, its largest contribution since 2007. Overall growth would have been even stronger without the 0.2-point negative contribution of changes in business inventories and net exports¹.

However, the economy's sudden strength is unlikely to last, at least in the near-term. Indeed, the strong pace of Q1 growth in consumer spending and business investment does not look sustainable, because it was driven by positive factors that are now likely to fade. Those factors include the boost to household purchasing power gains caused by the sharp fall in oil prices and the government's move to fiscally incentivise investment by allowing businesses to depreciate assets on a larger scale. There was also a catch-up effect in consumer spending after Q4 figures were adversely affected by the mild winter weather and November's terrorist attacks in Paris. The contribution of inventory changes is also likely to remain negative. After two quarters of strong positive contributions, the contribution from inventories was only slightly negative in Q1 and the correction should therefore continue. On the plus side, although the upturn in employment is still modest – 0.3% q/q in Q1 after a similar increase in the previous three quarters (chart 2) – it is making growth more solid and should limit the expected slowdown.

There are currently only limited signs of that expected slowdown in monthly hard data available so far. Consumer spending on goods fell

¹ The absence of export growth was the main disappointment in Q1 growth figures, whereas imports rose 0.6% q/q.

French growth breakdown

Contribution to growth of main GDP components, q/q, percentage points

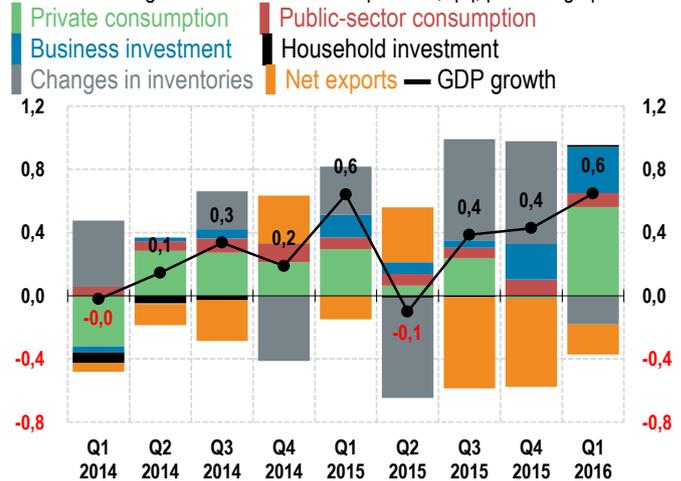


Chart 1

Source: INSEE

Upturn in the job market

Quarterly change in non-farm payrolls, thousands

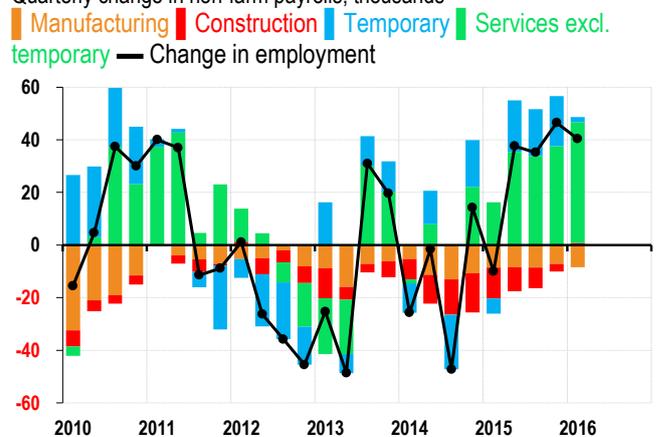


Chart 2

Source: INSEE

only 0.1% m/m in April, while the March figure was revised sharply upward, from 0.2% m/m initially to 1.1%, leaving the carry-over at +0.7% for the second quarter. Goods exports did rebound in April (1.8% m/m in nominal terms), but, year-on-year, they are down 3.4%. And the deterioration in the "new export orders" component of the manufacturing PMI signals exports are at risk to fall further. Industrial output also posted a significant rebound in April (+1.2% m/m), enough to bring back its Q2 carry-over into positive territory (+0.5% q/q). However, its *momentum* remains negative (chart 3). Based on these activity figures, our "nowcasting" model predicts Q2 growth of 0.3% q/q (chart 5).



The results of confidence surveys up to May were mixed, with both positive and negative news (chart 4). After eroding in the first few months of 2016, INSEE business-climate surveys and Markit's PMIs have slightly improved compared with the first quarter. Although the composite PMI remained low at 50.9 in May, suggesting barely-positive growth, the INSEE composite index (102 in May) is consistent with quarterly growth of around 0.5%. Only the Bank of France (BdF) survey is suggesting a slowdown in growth, leading the BdF to lower its Q2 growth forecast from 0.3% to 0.2% q/q, in line with our own and also the estimate by our survey-based "nowcasting" model (chart 5).

Detailed sector results of business climate surveys cast additional light on the situation. The INSEE survey shows an improvement across all sectors, i.e. manufacturing, services, wholesale and retail trade, and construction. However, the good news is tempered by the weaker signals given by Markit's PMIs and the Banque de France survey, which show a divergence between manufacturing, where business confidence is deteriorating, and services, where it is improving.

It also remains to be seen to what extent activity and confidence surveys have been affected by France's demonstrations, strikes and bad weather conditions in May and June. These factors are likely to cause a temporary dip in activity and confidence at the microeconomic and sector levels. At the macro level, however, we do not believe that the disruption has been large enough to have a visible negative impact on growth, at least not at this stage.

Comparable episodes in the past include October 2010 and November/December 1995, when there were protests against pension reforms proposed by François Fillon and Alain Juppé respectively. The current episode is, however, much more similar to the 2010 one than to 1995. In late 2010, refineries were blocked and there were fears of fuel shortages, similar to last month's events. Although it is hard to detect any impact on Q4-10 growth, the business climate seems to have suffered in November 2010. The limited decline in industrial production (-0.4% m/m in October 2010) masks a 60% m/m plunge in coke and refining, which was followed by a 115% m/m surge in November. Disruption in late 1995, which was very severe in the public transport sector, dragged Q4-95 growth down by 0.2-0.3 points according to INSEE. December 1995 surveys show that consumer confidence was affected more than the business climate. In addition, as it has been the case in the past, we can expect today that there will be a subsequent catch-up and rebuilding process that will boost activity. Lastly, the Euro 2016 should also have positive economic consequences.

Economic momentum

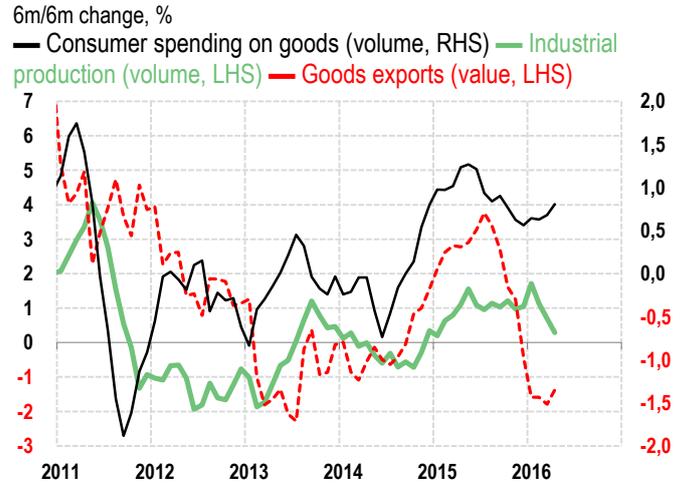


Chart 3 Sources: INSEE, customs data

Business confidence

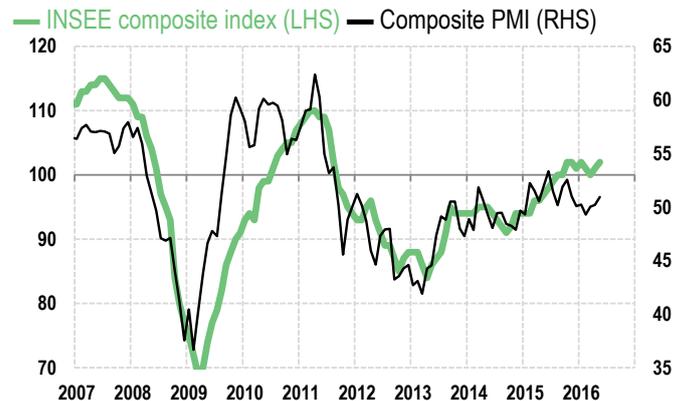


Chart 4 Sources: INSEE, Markit

French quarterly growth

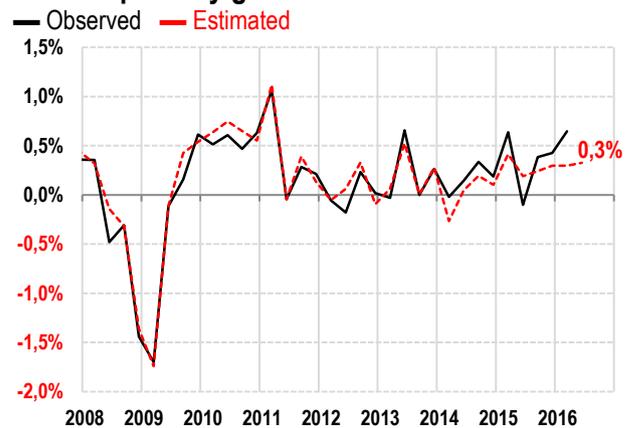


Chart 5 Sources: INSEE, BNP Paribas