France

Brexit: economic repercussions

- After the Brexit vote, we have downgraded our growth forecasts for France: very marginally for 2016 (down 0.05 points to 1.4%) and more significantly for 2017 (down 0.3 points to 1%).
- Although the pace of the recovery is only expected to slow down, the growth rate would fall back to a rather low pace. This is concerning as the negative output gap, which is still important, would stop diminishing and downward pressures on prices would therefore persist.
- Exports and business investment will be the GDP components most affected.
- The shock should be cushioned by positive cyclical factors and expected ECB action.

In edition 16-25 of Ecoweek, we reviewed the state of French growth before the Brexit result. Here, we look at the vote's impact on the French economy and the downward revision in our growth forecasts in 2016 and 2017. Brexit has changed things, but since France's recovery is starting to look more robust and self-sustained, it should only be slowed down, albeit without being called into question. However, we expect growth to become uncomfortably low, insofar as it would be only roughly in line with the economy's potential growth rate of around 1% instead of above that level. The negative output gap, which is still important, would therefore stop diminishing and downward pressures on prices would persist even though inflation is already extremely low and a cause of discomfort for the ECB.

In 2016, we do not expect annual average growth to be affected materially: we have cut our forecast by 0.05 points, which means that we are still expecting growth of 1.4%. The impact is likely to be greater in 2017, amplifying the slowdown we were already expecting before the Brexit result. We now expect the economy to grow 1% next year versus 1.3% previously. Our downgrades are slightly smaller for France than for the eurozone, where we have cut our growth forecast by 0.1 point to 1.4% in 2016 and 0.4 points to 0.9% in 2017. That is because the French economy is structurally resilient on the downside, and because positive cyclical factors are at work. Our new forecasts are much more uncertain than usual, because it is very difficult to gauge how much economic impact this unprecedented shock will cause, even on our short-term horizon.

The hit to growth will come mainly from exports, which will be affected both by much slower UK growth[1] and the euro's rise against sterling (+12% in the two weeks between 22 June and 6 July). France and the UK are indeed major trading partners. The UK accounts for 7% of France's goods exports (11% of service exports),

[1] We expect UK economy to be flat in the second half of 2016 and into early 2017. It is likely to flirt with recession before recovering in 2017 as the Bank of England loosens monetary policy and as Brexit arrangements become clearer. We have cut our growth forecasts by 0.3 points in 2016 (from 1.7% to 1.4% in annual average terms) and 1.4 points in 2017 (from 2.1% to 0.7%).

Growth on either side of the Channel

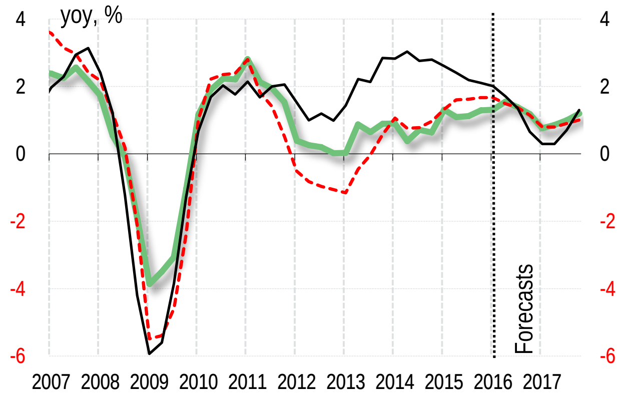

Figure 1 Sources: INSEE, Eurostat, ONS, BNP Paribas forecasts

making it France's fifth-largest trading partner, level with the USA, Spain and Italy, but well behind Germany with 16%. The UK is also the country with which France has its largest trade surplus, by a long distance (EUR 12 bn in 2015). In addition to this direct exposure, we have to take into account the Brexit effects on other EU countries, where slower growth will also reduce demand for French exports.

Business investment is also likely to be affected significantly by the general uncertainty surrounding Brexit, along with the hit to confidence, less favourable monetary and financial conditions[2], and the diminished growth prospects. Weaker business investment is then likely to weigh on the jobs recovery. This will drag down consumer spending and is likely to compromise the formerly expected slight fall in the unemployment rate. However, the negative impact on households' real disposable income would be offset by a slight reduction in inflation resulting from slower growth.

To offset these adverse developments affecting the whole eurozone, we expect the ECB to adopt, in the near future, fresh support measures[3]. In terms of fiscal policy, it is harder to see governments responding, and they may merely let automatic stabilisers take effect given the limited room of manoeuvre in many countries, including France. However, given the exceptional circumstances, temporary moves to rein in structural efforts could be tolerated.

[2] Because of lower and more volatile share prices and a general increase in risk aversion. As regards exchange rates, the euro's surge against sterling is being balanced by its decline against the US dollar and yen, against which the euro has fallen 2% and 5% respectively between 22 June and 6 July. The increase in the euro's real exchange rate has been limited to 0.7% over the two-week period. The sharp fall in risk-free rates is also limiting the tightening in monetary and financial conditions.

[3] In addition to the expected announcement, in September, of a six-month extension of its asset-purchase programme (to September 2017), the ECB could modify other parameters: front-load some of its purchases; increase the issuer limit (from 33% to 50%); deviate from the capital distribution key (which depends today on each member state's share in the ECB's capital); remove the deposit rate floor to be able to buy securities with a yield below this rate (currently -0.40%). Before that, a 10bp refi rate cut is also possible.