

France

2019, another testing year

2019 is getting off to a less strong start, with economic activity having taken a hit from the 'gilets jaunes' protest movement. The collapse in consumer confidence has been abrupt and the global environment looks less certain. Against this background, fiscal policy is being loosened: the new plan to support the purchasing power of lower income households, announced in response to December's demonstrations, should help consumer spending to catch up, at least in part. It comes alongside measures already introduced in the 2018 budget to support consumers and companies. French growth is therefore likely to show signs of resistance.

A look in the rear-view mirror at what happened in 2018 helps set the particular context as we move into 2019. Many things changed in just one year. The optimism that reigned at the beginning of 2018 proved short-lived. The strong growth that was expected as a result at that time, building on that in 2017, did not materialise. And, having looked exceptionally clear at one point, the outlook grew significantly less rosy over successive quarters.

■ Yellow card

There were many reasons for this. External headwinds (a strong euro and high oil prices, trade tensions and the slowdown in global growth) coupled with domestic factors (supply-side constraints and recruitment difficulties) contributed to depress the underlying trend to a degree that exceeded expectations. French growth also faced a series of five shocks. Two were predictable, but proved highly disruptive (tax increases in Q1; the introduction of the Worldwide Harmonised Light Vehicle Test Procedures, or WLTP, in Q3); the other three were of the unforeseeable sort (warm winter weather; transport strikes in Q2 and the 'gilets jaunes' protests in Q4).

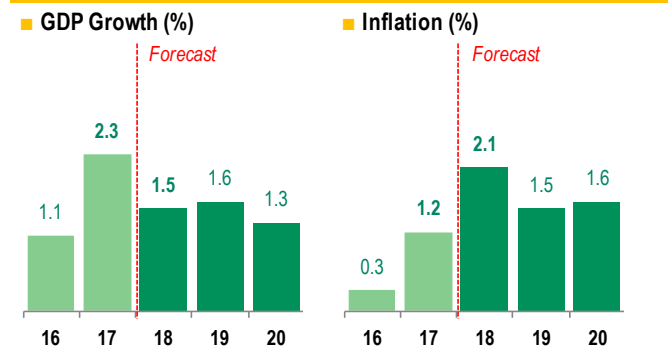
It follows that despite the dissipation of the factors that held back growth in Q2, there was scant recovery in Q3 (0.3% q/q according to the third estimate¹, after 0.2% q/q in Q2) and growth is expected to be again dragged down in Q4, with the 'gilets jaunes' protests wiping out the rebound that had been expected before the protests took place.

As far as the third quarter limited growth rebound is concerned, this was due to the limited upturns in consumer spending (0.4% q/q, from -0.1% q/q in Q2) and exports (up by just 0.3%, having been flat in Q2 and fallen by 0.4% q/q in Q1). These lacklustre figures came alongside similarly unimpressive numbers for public investment (stable after a 0.6% q/q rebound) and household investment (down just 0.1%, although this was the first quarterly decline since Q2 2015). Although the contribution from net exports was positive (0.3 of a percentage point), that was the only positive thing about it, as it was the result of a fall in imports (-0.6% q/q) and came alongside a negative contribution from inventories (-0.4 ppt). Business investment was alone in showing real vigour, and indeed growth accelerated from Q2 (1.3% q/q) to Q3 (1.5% q/q).

As far as the expected brake on growth in Q4 is concerned (we are now expecting 0.2% q/q instead of 0.6% in early October), it is

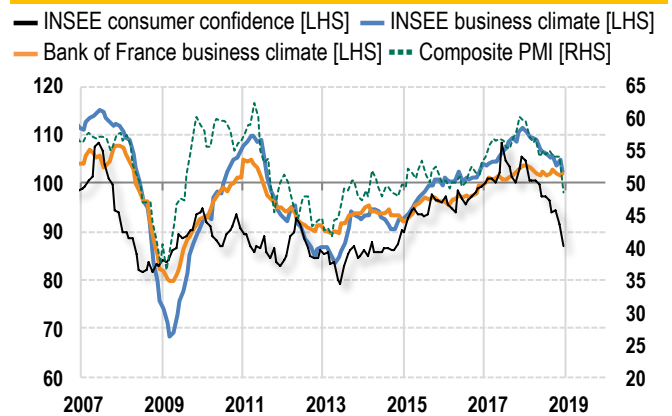
¹ The first estimate, confirmed by the second, was a little higher at 0.4% q/q.

1- Growth and inflation



Source: National accounts, BNP Paribas

2- Confidence surveys



Source: INSEE, Bank of France, Markit

largely the result of the 'gilets jaunes' movement², due mainly to its negative impact on consumer spending (which we now expect will struggle to grow, despite tax cuts which we previously expected to stimulate a rebound), but this is not the only effect. Business investment is also likely to be hit (accentuating the expected payback on investment in manufactured goods following the introduction of WLTP), as are exports (via a fall in tourist spending, which will eat into the strong expected increase as a result of late deliveries by Airbus and various other major contracts). A fall in Q4

² See also "France: A serious but temporary drag on growth", EcoFlash n° 15, 17 December 2018



GDP cannot be ruled out, but this is not the most likely scenario. For 2018 as a whole we now expect growth to reach 1.5%.

For the time being the only macroeconomic indicator of the negative effect of the 'gilets jaunes' protests has been the fall in some confidence surveys (see Chart 2). The fall in consumer confidence has been spectacular (down by 3 points in November and a further 4 points in December, taking it to 87, well below its long-term average of 100, and its lowest level since the end of 2014), with large declines also in the retail trade sector (down 7 points in December in the INSEE survey, taking it to 100, i.e. its long-term average) and services (down 6 points in December for the Markit PMI, thus falling to 49, representing the first time it has dipped below the threshold of 50 since 2016).

Other December surveys were less negative (-2 points for the INSEE survey and -1 point for the PMI in the manufacturing sector), positive (+2 points for the Bank of France industry survey) or flat (INSEE and Bank of France surveys in the services and construction sectors).

So the economic picture is not uniformly gloomy. The results of the Bank of France's surveys have allowed it to maintain its Q4 GDP growth estimate at 0.2% q/q. The good news, as we see it, lies more precisely in the absence of any further downgrading of this estimate after the 0.2 point cut in November. Between its Conjoncture in France report in October and its December report, INSEE also cut its Q4 growth estimate by 0.2 of a point from 0.4% to 0.2% q/q. Our own 'nowcast' model, based on survey data, suggests something a shade more positive, with estimated growth of between 0.3% and 0.4% q/q. The figure based on hard data is lower, however, at 0.2%, and carries a downside risk. Indeed, in the absence of figures for December, the assumption used of a continuation at November's level has the advantage of simplicity but almost certainly errs on the side of optimism.

■ **2019: new year, same growth?**

After a year of strong and steady growth in 2017, which exceeded expectations – followed by a year of weak and patchy growth, surprising on the downside, in 2018 – what will the 2019 vintage be like?

What is clear is that the year has begun with mixed prospects, worries are multiple and uncertainty considerable. There are many downside risks, whether international, financial or domestic. On the international front, the UK Parliament's rejection of the agreement with the EU on the details of Brexit (re)opens a period of uncertainty over the outcome of the process. Another significant risk is that the US economy is heading for a landing, and fears of this have been revived by tumbling equity markets at the end of last year. The scale of the slowdown in China is also causing significant concern, but this is not new. By contrast, the dramatic slowdown in the German economy³ in the second half of 2018 is a new source of worry.

³ See page 3,7,15, 23

3 – Household purchasing power gains and consumer confidence

— Consumer confidence [LHS] --- Year-on-year change in household purchasing power [RHS] --- forecast



Source: INSEE, BNP Paribas forecasts

On the domestic front, our scenario of resilient growth is based on two central factors⁴. The first relates to the underlying trend, which we still believe to be solid, albeit somewhat slower, in particular thanks to a labour market that is expected to remain on the right track. We are forecasting an increase in private payrolls in line with that in 2018 (at an average of around 1% over the year), a fall in the unemployment rate that will be only barely smaller than last year (-0.2 of a point to 8.9%) and stronger momentum in wage growth (increases of nearly 2% for the basic monthly wage indicator and 2.5% for the average earnings per worker indicator).

The second source of resilience is the positive impetus of economic and fiscal policy. This impetus is for a part channelled through support to companies via the transformation of the employment and competitiveness tax credit (CICE) into a reduction in employers' social contributions. A larger share of the impulse will come from the expected positive effect on consumer spending of the tax cuts approved in the 2018 budget, backed up by the measures to support the purchasing power of lower income households announced by President Macron on 10 December, in response to the 'gilets jaunes' protests⁵. This assumes that the link between purchasing power and consumer confidence – which was clearly broken at the end of last year – is restored (see Chart 3). We believe that this stimulus package will support growth to the tune of 0.2 of a point. This additional growth will help offset the lower growth carry-over inherited from 2018, which not only leaves our 2019 growth forecast unchanged at 1.6% (in annual average terms) but also means that growth will be relatively (and remarkably) stable compared to 2018.

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⁴ We are not overlooking the introduction of the withholding personal tax in January as the source of a possible shock to growth in Q1. But we believe that if there is to be a shock, it could just as easily be positive as negative.

⁵ See EcoFlash cited above for details of the support package