France

2020: new year, same trends

The year 2020 is expected to follow along similar lines as in 2019, a mixed performance marked by slow but resilient growth bolstered by the strength of final domestic demand. The economy is expected to keep running at about the same rate (1.1% after 1.3%). The rebound in household consumption should gather steam, fuelled by major purchasing power gains. The dynamic pace of investment, which looks hard to sustain, is expected to slow, while sluggish global demand will continue to curb exports. The intensity of several external downside risks declined in Q1 2020, including trade tensions, Brexit, and fears of a recession in the US and Germany. On the domestic front, upside risks continue to stem from supportive economic policies while the tense social climate constitutes a risk on the downside.

2019: false modesty

In Q3 2019, GDP rose 0.3% q/q, in line with expectations. This was the fourth out of the past five quarters in which growth hit 0.3% (the exception was Q4 2018, with growth of 0.4%). Nonetheless, it was a "small" 0.3% (0.27%), and marks a slight dip from the 0.4% average reported between Q3 2018 and Q2 2019.

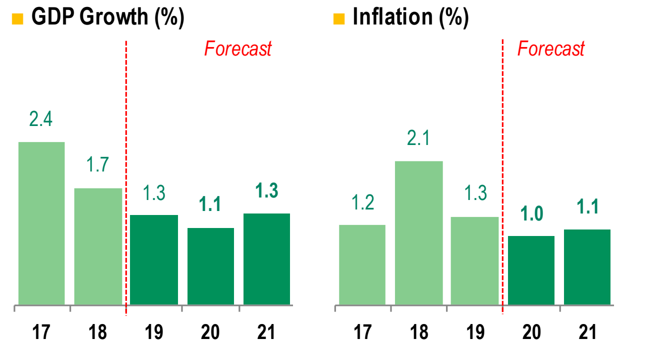
Yet even more so than in previous quarters, this performance was not as mild as it might seem. It masks the 0.6-point contribution of final domestic demand, compared to an average contribution of 0.5 points in the four previous quarters. Household consumption and business investment both rose slightly faster than in Q2, as the long-awaited rebound in the first gradually took shape, and the robust pace of the second was confirmed. Changes in inventory made a somewhat less negative contribution (-0.1 points, vs. -0.2 points). These favourable trends were offset by a marked slowdown in household investment (after an exceptional surge in Q2) and the negative contribution of net exports (-0.3 points), reflecting a rebound in imports and another small decline in exports.

Q4 growth prospects are favourable based on the business climate surveys available till December. They suggest that growth will hold at the current rate of 0.3%. The INSEE composite indicator is holding at a Q4 average of 106, the same high level as in Q3 and Q2, while the Markit composite PMI rose slightly again to 52.2, from 51.9 and 51.3, respectively.

The relatively favourable trends shown in French survey data in 2019 are noteworthy, especially compared to Germany (see chart 2). The most striking difference is in the manufacturing sector, where Germany has slid deep into recession territory while France is still in expansion territory, if only by a little bit. Trends are also different in the services sector, for partly the same reason: since the French manufacturing sector did not experience the same troubles as its German counterpart, the services sector has remained in favourable territory in France, while following a "humped" profile in Germany.

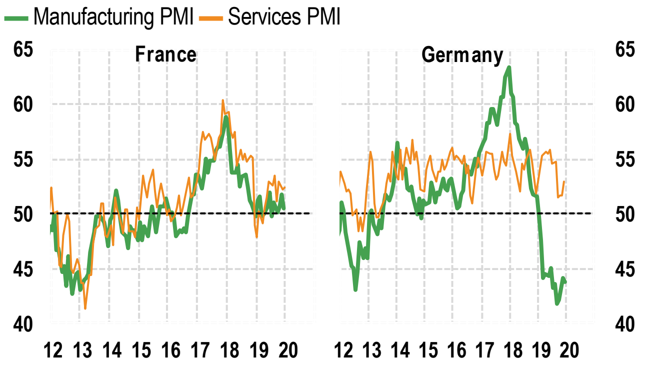
In France, the two indexes were at roughly the same level at the end of the year (50.4 for manufacturing PMI and 52.4 for services PMI), whereas in Germany there was a 9.2-point spread (43.7 and 52.9, respectively). This is only the second time the spread has been so wide since the great recession of late 2008-early 2009. The way in which this spread is absorbed will be one of the trends to watch in 2020. It is a key factor in our German scenario, with a ricochet effect on France. Our scenario calls for this differential to be absorbed on the upside, through an upturn in the business climate in the manufacturing sector. Based on the latest data, this process might be underway already. This brings us to the next question: the size of the ensuing rebound in growth, which we expect to be fairly mild.

1- Growth and inflation



Source: National accounts, BNP Paribas

2- Business sentiment in France and Germany



Source: Markit, BNP Paribas

Returning to the outlook for Q4, our nowcast soft data-based model projects growth of 0.2% q/q, which dampens somewhat our positive interpretation of the survey results. Yet our model made a similar projection for Q3. Since Q3 growth proved to be slightly stronger, it is possible that our model is underestimating Q4 growth again. This underestimation is also suggested by our forecast using hard data, which is higher (0.5%). Yet this projection is fragile because it is based only on October and November data.

Like the INSEE, we are forecasting Q4 growth at 0.3%, while the Bank of France is a little less optimistic with an estimate of 0.2%. As to the breakdown of growth, we forecast net exports to make a very positive contribution (0.3 points), buoyed by the strong rebound in exports that has been observed in every fourth quarter since 2016[1]. It would be offset by an equally negative contribution of the change in inventory, as signalled in survey data. Final domestic demand would make a slightly less positive contribution than in Q3 (0.4 points) due to a somewhat smaller increase in household consumption, a much lower increase in business investment, household investment and public consumption, and a comparable rise in public investment.

The strikes and demonstrations against pension reform, which have been ongoing since 5 December, risk eroding growth in late 2019 and early 2020. Although the business climate in December was not affected, it is likely only a matter of time. Household confidence proved more sensitive and declined sharply for the first time in a year (-3 points). The negative impact of such strikes on the economy is channelled through an immediate fall in the consumption of transport services, which carried over to activity in retailing, hotel and food services, leisure activities and tourism. At refineries and ports, blockades have also caused disruption. Yet although the impact might be substantial at the sector, microeconomic or regional level, it is small at the macroeconomic level. Certain expenditures definitively fall by the wayside, but others are stimulated, substituted or postponed. To give an idea of the order of magnitude, the INSEE estimates that previous major strikes had a negative impact on growth of between 0.1 and 0.2 points. And whenever there is a negative impact, it is followed by a catching-up phase and extra growth.

In 2019, the average annual growth rate adjusted for the number of working days is estimated at 1.3%, compared to 1.7% in 2018. While definitely a sharp slowdown, it is nonetheless misleading because, on the one hand, it masks the major contribution of final domestic demand, which rose to 1.8 points, from 1.3 points the previous year. The lower growth in 2019 can be attributed to the more negative contribution of the change in inventory (-0.4 points vs -0.3) and net exports' more normal contribution (-0.1 points instead of +0.7). On the other hand, French economy is not slowing down as sharply as the Eurozone average (1.1% vs. 1.9%) or Germany (0.6% vs. 1.5%).

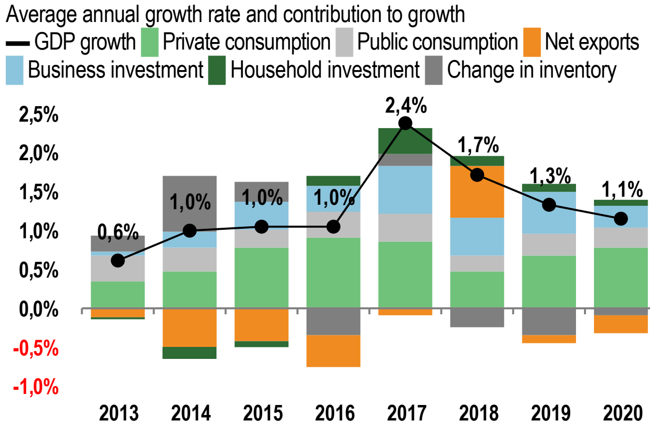
2020: basically the same refrain

Broadly speaking, 2020 is likely to repeat the same refrain as in 2019: feeble but resilient growth. The growth engines will not be the same, however. Under our base case scenario, the contribution of household consumption (0.7 point vs 0.6 in 2019) will surpass that of total investment (0.5 points vs 0.8), which is a more customary configuration for the French economy.

All of the conditions seem to have come together for a bigger increase in household consumption: rising confidence, major purchasing power gains (lifted by job and wage growth, tax cuts and mild inflation) and dynamic lending at attractive terms. Yet the real question is just how much bigger. In 2019, all of these conditions had already come together, yet the rebound was still mild, partly because there is a certain lag before households react to bigger

[1] INSEE, *French quarterly exports depend heavily on the aeronautics and naval sector*, box pp 58-60, Note de Conjoncture, December 2019

3- Breakdown of growth



Source: INSEE, BNP Paribas

purchasing power gains. In 2020, this lag will no longer come into play, or less so in any case. Even so, we still expect French households to remain cautious. Consumer spending is only expected to pick up a little (1.4% vs 1.2%). Yet the rebound could be much stronger given the size of purchasing power gains (about 2% in 2019 and 2020, according to our estimates).

As to investment, in contrast, the conditions seem to have come together for a slowdown. The expected decrease in business investment will be partly automatic, after reaching a robust pace that looks hard to sustain. The mixed outlook for demand would also play a key role, and to a lesser extent, fewer pressures on production capacities. Favourable financing conditions should help buffer the slowdown. Public investment would suffer a payback as the municipal election cycle comes to an end[2]. Household investment would get a small boost from the strong momentum of the existing home sales market, although it would continue to be limited by sluggish activity in the new home sales market.

Export growth would remain mild in keeping with sluggish global demand. France is expected to maintain its (feeble) market share, as it has since 2013. It can count on its strengths (aeronautics, pharmaceutical products, luxury goods, cosmetics, agro-food and automobile equipment) and a favourable exchange rate.

All in all, we forecast growth at 1.1% in 2020 (1.3% using data unadjusted for the number of working days). This small slowdown compared to 2019 is not significant in our eyes. It masks a slight acceleration in the quarterly growth profile. Growth will continue to outpace the forecast for the eurozone (0.8%) and Germany (0.4%). We see 2020 as a year of consolidation: consolidation of the positive impact of purchasing power gains on household consumption, and in general, consolidation of the positive expected effects of recent reforms.

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[2] INSEE, *Municipal election cycle: what impact on public investment, employment and production?*, article pp 33-45, Note de Conjoncture, December 2019