

FRANCE

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FEEBLE GROWTH BUT NO RECESSION

Inflation continued to rise in early 2022 to the point that it began to erode household confidence in March. These purchasing power problems foreshadow a decline in consumer spending. With fiscal support measures limiting the increase in inflation (by nearly 2 percentage points in April), growth is expected to remain slightly positive (0.3% in Q1 and 0.1% in Q2 according to our estimates).

Since early 2021, the French economy has been buffeted by a series of headwinds and tailwinds, which have made economic trends more uncertain. The resurgence of the Covid-19 pandemic hit the services sector first as health restrictions were tightened in December and January. The lifting of these measures in February triggered a rebound in the services sector confidence index, suggesting a return to the dynamic growth rates of fall 2021. Yet the shock caused by the Russian war in Ukraine undercut this momentum and fuelled the acceleration of inflation with much higher pump prices in March. This trend is bound to continue in Q2 due to second round effects on the prices of manufactured goods, services and most food items.

HOUSEHOLDS ANTICIPATE MORE INFLATION

According to the INSEE, household confidence fell by 6 points in March 2022 compared to February, the biggest decline since the recession of 1993 and the lockdown of April 2020. Household assessments of past inflation deteriorated in March, but did not change much compared to February. To the contrary, many more households are now anticipating further price increases over the next 12 months, with the balance of opinions deteriorating by 50 points in March to unprecedented levels. Initially hoping the shock would be only temporary, households now see it as a more lasting trend that will probably have an impact on consumer spending. According to our estimates, the share of energy-related spending (housing and transport) could reach 10.3% of household consumption in 2022 (assuming oil prices hold above USD 100 per barrel throughout 2022), the highest proportion since 1986.

Fiscal support helps buffer the shock. Without this support, the share of energy-related spending would temporarily approach the absolute record of 11.6% reported during the cold wave of early 1985. Purchasing power gains amounted to 0.8% q/q in Q4 2021, three quarters of which corresponds to the EUR 100 inflation premium distributed to nearly 23 million French citizens in late 2021 (as well as to another 15 million eligible citizens, who will receive the inflation premium in early 2022).

Other household support measures include a freeze on regulated prices for gas (since October 2021, recently extended to year-end 2022) and electricity (through year-end 2022, after an increase limited to 4% in February), as well as a EUR 0.18 per litre reduction on pump prices applicable between 1 April and 31 July (with an additional pricing effort at the discretion of service stations). Without these measures, April's inflation rate would have been nearly 2 percentage points higher than our forecast of 4.7% (1.5 points for gas and electricity prices based on the INSEE's calculations in February, and 0.5 points based on our estimates for the fuel price subsidy starting in April).

These measures also reduce by as much the negative impact on household purchasing power, albeit for a net overall cost for public finances that we estimate at EUR 21.5 bn (EUR 26 bn for additional measures offset by additional revenue of EUR 4.5 bn). In addition to measures dedicated to protect households, this also includes support

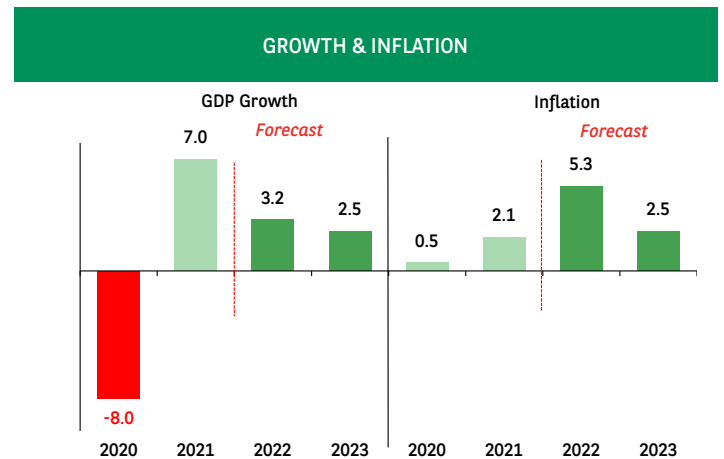


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

measures for companies (coverage of half of higher energy costs for companies whose energy expenditures exceed 3% of turnover; a higher ceiling on state-backed loans, which was raised from 25% to 35% of turnover; and targeted sector measures).

COMPANIES OPT FOR CAUTION

The AFTE/Rexecode survey on corporate cash flows shows that companies are also feeling the strain of inflationary pressures, with a 12-point deterioration in the balance of opinions concerning operating cash flow in March. According to the INSEE business climate surveys, companies are also increasingly constrained to pass through higher costs to sales prices, especially for household goods (including food products).

We must add the expected impact of the inflationary shock on household consumption to the difficulties companies are encountering, which is leading them to scale back production, especially in the automobile, chemical and IT & electronics sectors. Another reason to be cautious is the uncertainty over foreign demand and the security of industrial supply chains for energy and metals.

Consequently, we expect growth to slow to an estimated 0.3% q/q in Q1 (from 0.7% q/q in Q4 2021) and to 0.1% q/q in Q2, as economic policy buffers the price shock, helping to avoid recession in the short term. We have revised downwards our full-year 2022 growth forecast by 1 percentage point to an average annual rate of 3.2%.

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