FRANCE

GROWTH ERODED BY UNCERTAINTY

France's economic growth is set to slow over the next two years, and the unemployment rate is set to rise, at a time when the gains in purchasing power associated with disinflation are behind us and political uncertainty is likely to weigh heavily. A difficult period that could be cushioned by a rebound in aeronautical production, but which could also see the materialistion of downside risks weighing on trade opportunities in Germany and the United States. One of the challenges for France will be to achieve fiscal consolidation without affecting its attractiveness, and in particular the ability of its labour market to create jobs when the recovery takes hold.

GDP GROWTH WEAKENS

While growth in 2023 and 2024 (according to our estimates for the latter) was just over 1%, it is expected to fall below this threshold in 2025 and 2026. Business sentiment has been below its long-term average (100) since October 2023, but its decline accelerated from July 2024, reaching 96 in November. This deterioration was offset, until September 2024, by the rebound in household confidence from 81 in March 2023 (when inflation peaked) to 95, due to disinflation. This augured resilient growth and a change in determinants (less business investment vs. more household consumption). However, the sharp downturn in household confidence, from 95 to 90 between September and November, highlights the likelihood that household spending will not pick up the slack from business spending and that growth will suffer as a result.

UNEMPLOYMENT ON THE RISE

The deterioration in household sentiment is linked to the fear of a rise in unemployment (the balance of opinion on the outlook for unemployment rose from +28 to +42 between September and November 2024).

The noticeable deterioration in the manufacturing industry, linked to the absence of a rebound in demand in France and in the eurozone (including Germany), led to the first job losses in the sector in Q3 (1,700) since Q3 2017 (excluding the Covid-19 period). Market services, whose momentum has clearly run out of steam (an average of 4,500 net new jobs created over the last four quarters, compared with 36,000 over the previous four quarters), are set to follow suit. We expect private sector employment to fall by almost 100,000 jobs in 2025. This should accentuate the rebound in the unemployment rate, which remains moderate for the time being (from 7.1% in Q1 2023 to 7.4% in Q3 2024), to 8.5% in Q4 2025.

DISAPPOINTING DISINFLATION

Inflation slowed sharply in 2024 (1.7% y/y in November compared with 3.9% y/y a year earlier) and is now lagging behind wage growth (+2.3% for inflation compared with +3% for gross monthly wages on average in 2024), and even more so behind that of gross disposable income (GDI). The latter has also benefited from the rise in social benefits (+5.9% according to our estimate) due to their indexation to (high) inflation in 2023 – hence an increase in real GDI that we estimate at +2% in 2024.

However, this disinflation is not widespread. Inflation in services (half of the household consumption basket) remained at 3.1% y/y (harmonised index) in November 2024. This divergence is likely to remain significant in 2025. While average inflation should be closer to 1%, inflation in services is expected to remain above 2%, mainly due to the foreseeable rise in healthcare costs (consultations and supplementary health insurance) and insurance costs (home and car insurance). Wages should continue to rise slightly faster than inflation (+1.5% in 2025). However, real GDI is expected to stabilise, as it is not benefiting from the same dynamics as in 2024. As a result, growth in household consumption in 2025 is set to remain the same as in 2024 (+0.8%).

GROWTH AND INFLATION

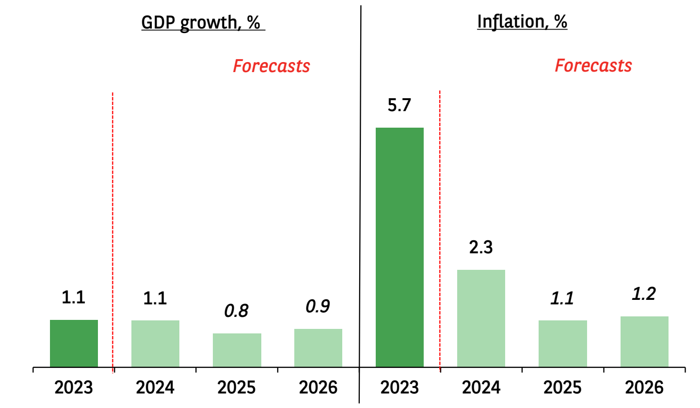

CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

BUDGET: UNPLEASANT ARITHMETIC

In 2023 and 2024, the budget deficit was clearly out of sync between the initial Budget Acts and budget implementation (4.4% compared with 6.1% of GDP in 2024), a phenomenon linked to government choices (indexation of benefits to the high inflation of 2023) and unpleasant surprises on the revenue side (including the impact on VAT receipts of the weak growth in household consumption). In addition, from 2025 onwards, as nominal GDP growth falls due to the end of the inflationary period, the level of the public deficit stabilising the debt ratio should fall to 3% of GDP (from 7% in 2023). However, as the motion of no-confidence passed on 4 December should result in the 2024 budget being extended, at least for the first few months of 2025, the prospects for consolidation are at the very least postponed. However, at the level of the public deficit seen in 2024 (6.1% of GDP), the debt-to-GDP ratio would increase by three points per year and debt servicing would reach 3% of GDP in 2027 (compared with 1.8% in 2023), a dynamic that must be halted as soon as possible. If no new budget is adopted in 2025, we estimate that the extension of the 2024 budget could result in a deficit of 6.7% of GDP.

THE SWORD OF DAMOCLES HANGING OVER FRANCE'S ATTRACTIVENESS AS A BUSINESS LOCATION

Budgetary uncertainty must not be allowed to undermine the three-pronged strategy that has underpinned French growth over the past ten years: the labour market (reducing labour costs, reforms, increasing the employment rate), the business climate (reducing taxes on businesses and making it easier to set them up) and the development of services (also supported by the other two pillars). These three elements have fuelled the country's attractiveness to investors as well as an unprecedented wave of business creations.

However, while fiscal consolidation is necessary, it must not be to the detriment of these three elements. Budgetary support for employment (particularly apprenticeships) and tax stability for businesses were questioned during the preparation of the 2025 budget. While the rejection of this budget maintains a favourable budgetary framework in the short term, it does not remove doubts about the paths that further budgetary consolidation could take. This uncertainty is likely to penalise investment decisions in France over the coming quarters: investment by non-financial companies is likely to fall by 2% in 2025, after already falling by 1.7% in 2024.

EXPORTS: A GROWTH DRIVER IN 2025?

Foreign trade made a paradoxical contribution to French growth in 2024, with a positive net contribution that we estimate at 0.9 points, but which was largely due to the fall in imports (-1.3% y/y). The aeronautical industry was absent from the picture, owing to serious production difficulties that prevented it from ramping up to meet a full order book. As a result, this sector contributed just 0.2 points to export growth over the first three quarters of 2024 (+1.6% y/y), compared with 2.1 points in 2023. A rebound in aeronautical production in 2025 would therefore help to offset the more negative factors (*see box*).

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FRANCE: MAIN EXPORTS TO THE US VS. IMPORTS (EUR BN)

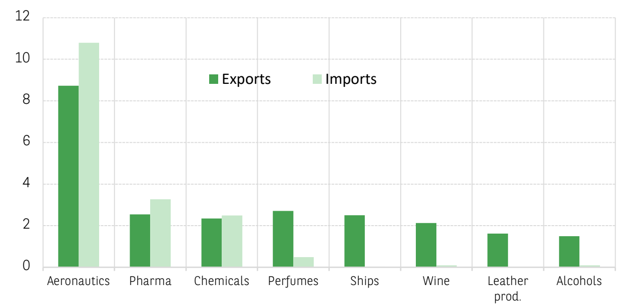

CHART 2

SOURCE: FRENCH CUSTOMS, BNP PARIBAS

FRANCE'S EXPORTS TO GERMANY (EUR BN)

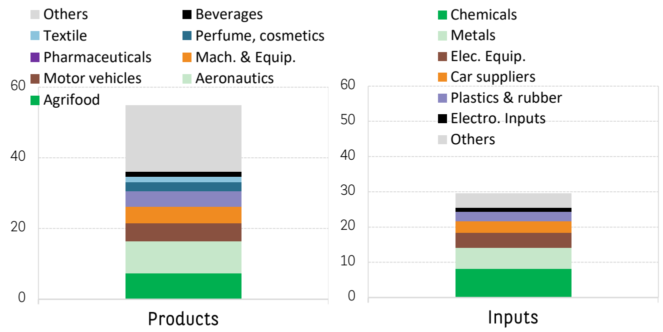

CHART 3

SOURCE: FRENCH CUSTOMS, BNP PARIBAS

PROTECTIONIST RISK: DIRECT OR INDIRECT EXPOSURE?

Bilateral trade between France and the United States is relatively balanced, with France even recording a slight deficit (EUR 5 billion over the last twelve months to the end of August).

This is also the case for aeronautics (France's leading export sector to the United States, but with a deficit of EUR 2 billion), where there is also a high degree of interconnections (joint venture in engines, use by Airbus and Boeing of numerous subcontractors on both sides of the Atlantic). Protectionist measures that would limit trade in this sector would therefore be detrimental to both partners, especially as it is already struggling with supply constraints linked to the difficulties encountered by its subcontractors in increasing their production, and the relative absence of competitors in a high-tech sector.

Otherwise, France's bilateral surpluses are in sectors where the US is less present (beverages, luxury goods). These sectors could be exposed to a risk of retaliation if, following initial US measures, a European response were to precipitate a new round of tariff increases by the United States.

On the other hand, France would probably be more immediately exposed to the impact of tariffs imposed on sectors on which the German economy depends (13.3% of French exports, compared with 7.8% for the United States). Germany accounts for half of Europe's trade surplus with the United States (*see the box in our text on Germany*). What's more, industrial inputs account for 40% of French exports to Germany. This is a key issue in explaining the decline in French exports to Germany since mid-2023 (-4.5 bn y/y cumulative over twelve months). This trend shows that, in the short term, France is more exposed to the risk, which is already present, of a partial de-industrialisation of Germany (which could be exacerbated by the rise in US tariffs).