FRANCE

MULTIPLE CONSTRAINTS ON GROWTH

French growth is set to bottom out in 2025, due to political and trade uncertainties. It should pick up again in 2026, buoyed by a rise in public consumption driven in particular by defence spending and the expected acceleration in German growth. This more promising European environment would therefore outweigh the shock of the rise in US tariffs by 2026. Inflation is expected to remain moderate and the deterioration in the labour market contained. The level of the public deficit will remain a brake in a higher interest rate environment.

GROWTH MAY NOT IMPROVE UNTIL 2026

The late implementation of the 2025 budget (only voted for in February) complicated the start of the year. Business sentiment hit a low point in December 2024, at 94 (97 in March 2025), as did consumer confidence, at 88 (92 in March 2025). Consumers are pessimistic about the future economic situation and the outlook for living standards. Uncertainty indicators remain at high levels, with trade uncertainty now prevailing. This should primarily affect sectors where the United States is a direct market (aerospace, wine and spirits) or an indirect market through Germany (such as French subcontractors to German industry).

French growth is expected to recover in the long run. The implementation of the budget is accompanied by an increase in collective public spending (defence, police, justice), while individual public consumption (education, health) is not affected by the budgetary consolidation effort. From the second half of the year, and even more so in 2026, the implementation of Germany's «whatever it takes» policy is set to benefit French growth, which is expected to hit 1.1% in 2026 (0.6% in 2025).

GROWTH AND INFLATION

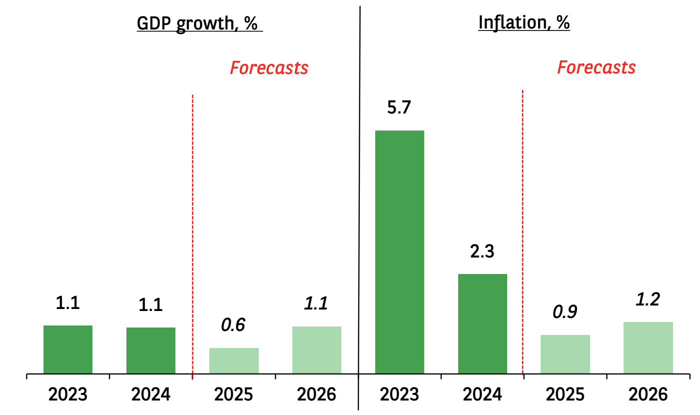

CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

RISING UNEMPLOYMENT: EXCESSIVE FEARS?

The labour market has deteriorated, with 90,000 net job losses in the fourth quarter of 2024. 2025 began on a negative note, with a decline in the employment climate to 93 in February (96 in March), according to INSEE. The balance of opinion on the fear of unemployment rose sharply (+46 in March compared with +30 on average in Q3 2024) in the household survey.

However, the unemployment rate fell in the fourth quarter to 7.3% from 7.4% in Q3, due to a drop in the youth participation rate. At the same time, the proportion of 15-29 year-olds not in employment or training hit its highest level, outside the COVID period, since Q3 2019, at 12.8%.

Weak demand and the deterioration in the capacity utilisation rate are leading to a rise in unemployment. However, this is expected to be modest and limited in time. The unemployment rate is set to reach 8% by the end of 2025, before falling again in 2026 as a result of the foreseeable improvement in activity.

INFLATION SET TO REMAIN MODERATE

Disinflation is significant. Inflation has returned to pre-Covid levels in most items of the consumer price index. However, INSEE's business climate survey shows limited prospects for price rises, including in services (where inflation remains slightly higher).

A European retaliatory response to the Trump administration's increase in tariffs could lead to rising inflation. However, the euro's appreciation against the dollar since the start of the year (and its continuation towards 1.12 at the end of 2025 and 1.2 at the end of 2026, according to our forecasts), and the recent fall in energy prices should limit imported inflation. In addition, the wage moderation seen over the last few quarters is also consistent with contained inflation and gains in real wages.

As a result, household purchasing power is expected to increase by 0.7% in 2025 and by 0.4% in 2026. However, these increases will be lower than in 2024 (+2.5%), when they were underpinned by exceptional growth in social benefits (+6.1% in 2024, offsetting inflation in 2023).

PUBLIC DEBT RATIO UP DESPITE CONSOLIDATION

The budget deficit deteriorated in 2024 (5.8% of GDP after 5.4% in 2023) and the public debt to GDP ratio returned to 113% of GDP, its 2021 level (wiping out the gains made in 2022-23 during the inflationary period). The adoption of the budget for 2025 paves the way for the implementation of budgetary priorities (defence, security, justice) and should therefore support the increase in public consumption. The budget target finally set for 2025 brings the deficit back to its 2023 level (5.4% of GDP). It may not seem very ambitious. However, the budgetary effort, excluding the rise in the interest burden (+0.4 points of GDP in 2025) and new expenditure (+0.2 points of GDP), is close to 1 point of GDP. However, with this level of deficit and nominal growth expected to fall to 2.5%, public debt is set to hit 115.5% of GDP in 2025, exceeding its previous record in 2020. Counteracting this increase will be difficult in the years ahead (*see our box*).

FRANCE REMAINS ATTRACTIVE

Budgetary uncertainty and the measures considered during the to-and-fro between the houses of parliament (capital gains tax, in particular) sparked fears that France's attractiveness for foreign investment (the leading European country, according to the EY barometer) would deteriorate. Ultimately, this has not been the case. While the increase in corporate taxation can be penalising, the exceptional nature of the corporation tax surcharge is a lesser evil. The increase in social security contributions is ultimately more limited (EUR 1.6 billion) than in the initial plan, and is therefore impacting labour costs less than expected. Another positive sign is the continuing momentum in business creations, which since November have been approaching the level maintained until August 2024.

EXPORTS: ON THE BRINK OF A MAJOR UPHEAVAL

Growth in exports of goods and services slowed markedly in 2024 (+1.1% in volume terms). In terms of goods, France suffered a drop in exports to Europe (EUR -15 billion in value, of which almost -5 billion each to Germany and Italy), while aeronautics exports stagnated. In addition, exports to the United States rose the most (EUR +3.5 billion).

The next few quarters should be marked by a profoundly negative change - because France is exposed to the customs tariffs that the US administration could decide on (pharmaceuticals, luxury goods, wines and spirits), followed by a more positive one - a rebound in growth in Germany and the eurozone that could be generated by the European defence investment plan. What's more, aeronautics production is set to increase as the sector manages to overcome its supply constraints. As a result, exports should regain momentum, underpinning French growth in 2026.

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FRANCE: DECOMPOSITION OF FISCAL DEFICIT (% OF GDP)

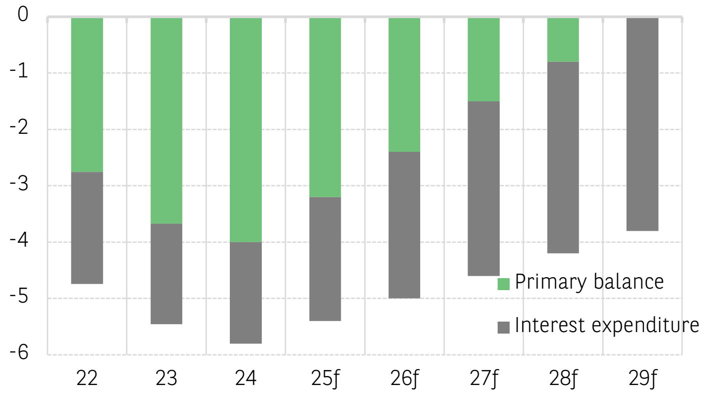

CHART 2

SOURCE: INSEE, BNP PARIBAS FORECASTS (F)

Rearmament constrained by budget constraints

France, the world's second largest arms exporter (9.6% in 2024, according to SIPRI), should benefit from the massive investment plan announced by Germany and from the European rearmement effort, which will eventually bring military spending in European Union countries to 3.5% of GDP.

However, France is not expected to make the biggest effort because of its tight budget. For the time being, the government has declined the budgetary leeway of 1 point of GDP that the European Commission will grant in terms of public deficit to countries that increase their military spending.

Interest rates are the primary constraint . While the effect of their rise on the interest burden is delayed due to the relatively high average maturity of French debt (8.5 years), the weight of the interest burden is set to double between 2024 and 2029 (increasing by almost 2 points of GDP to hit 3.8% of GDP).

The second constraint, which is also long-term, is the increase in military spending. Even if the low range were to be adopted (a target of 3% of GDP in 2030), the additional effort would be almost 1 point of GDP compared with 2024. However, this effort will be smoother than elsewhere in Europe, as, in France, we anticipate an increase in military spending of 0.2 points of GDP per year from 2026 onwards, while Germany's is set to rise from 2% of GDP in 2024 to 3.5% in 2027.

Third constraint: with Parliament divided, it will be difficult to consolidate the budget by de-indexing social spending (which was mooted for a while) or by making more direct savings on local authority spending. In 2025, the budget savings mainly concern central government spending. This will result in budgetary consolidation spread over a long period. In order to reduce the deficit, tax increases seem inevitable.

Our assumptions include an increase of 0.5 points of GDP in military spending compared with the French military programming law (LPM), which would result in a deficit of more than 3% of GDP in 2029 (still possible in the future, even if France rules it out for the time being, see Chart 2). Assuming that 10-year interest rates structurally above 3%, the apparent interest rate should go above nominal growth (about 2.5% of GDP), public debt would continue to rise inexorably between now and the end of the decade.