EDITORIAL

FRENCH ECONOMY: FOUR STRENGTHS AND ONE WEAKNESS

The French economy is entering a new budgetary cycle that is likely to be as complicated as the previous one. However, the economy appears to be more robust than in 2024. Firstly, the productive sector is in better shape today in several key areas (notably aeronautics and agriculture), which is reflected in the growth figures. Secondly, the shadow of political uncertainty has not undermined the strengths of the French economy: business creation, the labour market, a balanced current account, the transmission of ECB rate cuts to the private sector and the improvement in private investment. However, a budgetary process that is completed quickly, without too much uncertainty, and that leads to consistent consolidation, with a return to a deficit of 3% of GDP by the end of the decade, remains a necessary condition for France to reap the maximum benefits.

The French economy enjoyed spring buds, with a good wheat harvest in May, a spectacular rise in aeronautical production from June onwards, a rebound in hiring and therefore net job creation in Q2, and a sharp increase in business creations. All this good news comes at a time when sentiment indicators, such as the business climate and, even more so, household confidence, still point to a lack of confidence. It is as if we are talking about two different countries.

FRENCH GROWTH: A REBOUND ALREADY UNDERWAY

French growth, which is usually close to the eurozone average, is expected to fall below it in 2025 (0.7% versus 1.3% according to our forecasts). However, it would be premature to talk of sustained underperformance. We estimate that nearly half of this gap is due to a lack of production momentum, which is already beginning to ease, supporting a rebound in growth to 0.3% q/q in Q2.

This rebound comes from key sectors that had previously dragged growth down:

- The aeronautics industry, whose order books are as healthy as they were before Covid, while production had until recently been struggling to keep up. The post-Covid rebound was effectively halted for nearly 18 months (from December 2023 to May 2025) due to supply constraints (problems with suppliers, production capacity and labour). However, since June 2025, there has been a major rebound (*Chart 1*), a sign that new production capacity is coming online and that France will finally be able to catch up.
- Agriculture was particularly affected by excessive rainfall in 2024. In 2025, rainfall levels in the spring were normal, which has already contributed nearly 0.1 percentage points to growth in H1 (compared with -0.2 percentage points in 2024).

The problem with French electricity, or more specifically the slump in domestic production, was observed in 2022 and resolved in 2023 (with record production and exports since then). Producer prices fell by nearly 40% from their peak in Q1 2023, a decline even greater than the European average (-30%). In a world which is becoming increasingly electrified and is seeking to do so in a carbon-free manner, having clean and cheap electricity is an asset for sustainable growth.

Growth should therefore catch up some of its lag compared to the eurozone average in 2026 (1.1% in France, 1.4% in the eurozone according to our forecasts).

FRANCE CREATES MORE THAN IT DESTROYS

For the past decade, France has been engaged in a major transition towards services (partly replacing the production and consumption of goods). This has supported a sharp increase in business creation and employment.

AERONAUTICS OUTPUT (VOLUME, SA, MOVING AVERAGE 3-MONTHS)

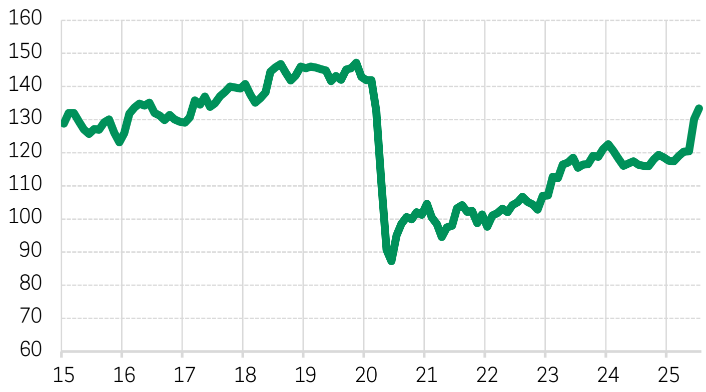

CHART 1 SOURCE: INSEE, BNP PARIBAS

RELATIVE UNIT LABOR COSTS: FRANCE VS. GERMANY

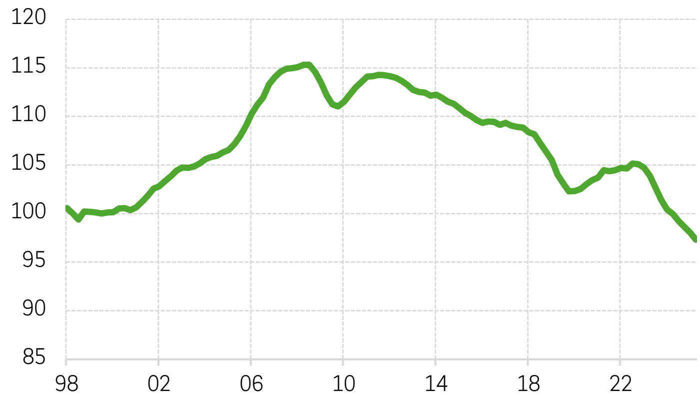

CHART 2 SOURCE: INSEE, DESTATIS, BNP PARIBAS

There is currently no sign that this development is stalling. The slowdown in growth since early 2022 has not affected it, nor has the increase in political uncertainty since mid-2024:

EDITORIAL

Business creations are on the rise: +8% between December 2024 and August 2025. This contrasts sharply with the early 2010s because, unlike during that period, weak growth is not accompanied by a decline in creations today.

The labour market is proving resilient: after numerous job creations post-Covid, employment remains high, as evidenced by an employment rate of 69.6% in Q2 2025 (+5 points in 10 years, more than half of which were post-Covid). Since the start of the period of weaker growth recorded from 2022, the unemployment rate has risen only marginally (7.5% in Q2 2025, compared with a low of 7.1% in Q1 2023). In addition, wage growth has been fairly «moderate» since the mid-2010s, as evidenced by a decreasing unit labor cost gap between France and Germany (*Chart 2*).

FRANCE IS NOT DECLINING

The current account balance remains relatively balanced, even if its composition has changed:

- The trade balance in goods deficit (manufactured) has structurally widened beyond the more specific changes linked to the energy bill (as in 2022-2023). However, production delays have weighed heavily, and growth in aeronautical and cereal exports should help to reduce this deficit from H2 2025 onwards.
- The services surplus: the modern economy is also, and increasingly, based on services. These are increasingly traded, and France's surplus remains strong.
- Income also remains in surplus. Admittedly, France receives a lot of foreign direct investment, and non-residents hold more than half of France's public debt, but this is a sign of attractiveness. In addition, French investors hold significant claims on the rest of the world, which generate even greater income.

A striking byproduct of the relative balance of France's current account is the fact that the economy's financing capacities and needs broadly offset each other. France finances the rest of the world to the same extent that the rest of the world finances France. At the domestic level, public financing needs are reflected in the financing capacity (savings) of households. At the same time, the financing needs of non-financial companies are (in aggregate) very limited.

THE PRIVATE SECTOR IS INVESTING, ESPECIALLY SINCE THE ECB LOWERED ITS RATES

France is a leader in investment in intellectual property products, which account for nearly 5.5% of GDP. This is more than its European neighbours, including Germany, and more than the United States. Overall investment is quite significant among non-financial companies, which maintain a relatively high investment rate (21.5% of their added value, 1 point above the historical average and 2 points above Germany) despite a decline linked to the period of rising interest rates.

A favourable factor in the recent period has been the decline in interest rates for the non-financial private sector (see chart), which has not been affected by the tensions that have arisen on sovereign rates. This advantage can be explained by the fact that banks finance themselves at the swap rate (which is more closely correlated to the ECB rate than to the OAT), which remains lower than the OAT as it does not reflect any counterparty risk (the risk associated with the creditworthiness of French banks is residual, as these banks are solid[1]).

1 As mentioned by the IMF in its latest Financial Sector Assessment Programme.

FRANCE: CURRENT ACCOUT BALANCE (EUR BN)

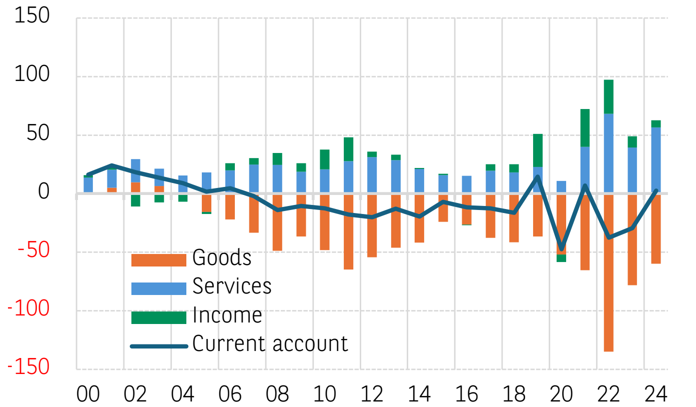

CHART 3 SOURCE: BANQUE DE FRANCE, BNP PARIBAS

FRANCE: NET LENDING(+)/NET BORROWING(-) IN % OF GDP

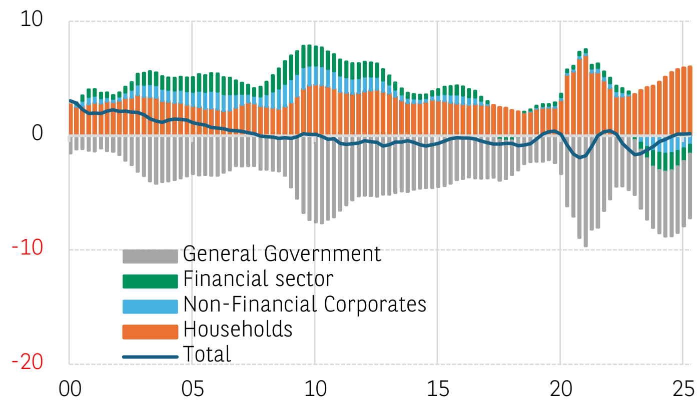

CHART 4 SOURCE: INSEE, BNP PARIBAS

10-YEAR SOVEREIGN YIELD VS. INTEREST RATE ON LOANS TO CORPORATES

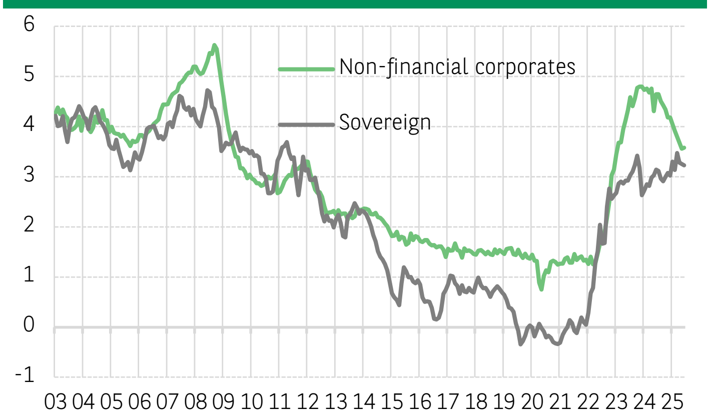

CHART 5 SOURCE: BANQUE DE FRANCE, BNP PARIBAS

The fall in lending rates to the non-financial private sector has contributed to an upturn in credit and investment (and even a stabilisation in business insolvencies).

At the same time, the rebound in housing is not spectacular, either in new construction (household investment up 1.4% between Q3 2024 and Q2 2025) or in existing housing (moderate increase in transactions), but it comes after several quarters of contraction. In addition, purchase intentions continue to rise (according to INSEE's August household survey, 9% of households wanted to buy in the next two years), in a context where households can take on more debt (thanks to moderate debt levels and lower interest rates).

THE SWORD OF DAMOCLES HANGING OVER PUBLIC FINANCES

French public finances were marked by a deterioration in the public deficit in 2023 and 2024. However, it was when the National Assembly was dissolved in June 2024 that tensions over (public) interest rates emerged, with the spread between French and German rates widening from 50 basis points before to 65-80 basis points after.

All in all, this was a limited deterioration. However, it should be noted that the European "risk-free rate" (the German rate) has begun to rise and is likely to continue to do so under the weight of increasing debt in Germany.

In the recent (more pronounced) rise in French rates, we note the growing role of the German 10-year sovereign rate, while the spread between French and German rates is still fluctuating within the range it entered in H2 2024.

Furthermore, as the ECB is not expected to lower its key rates any further, according to our scenario, the support provided by monetary policy seems to be behind us.

Such an interest rate environment complicates the fiscal situation while calling for the deficit reduction path to be maintained. The medium-term target is a return to a deficit of 3% of GDP in 2029 (a target validated by the European Commission in autumn 2024). According to our calculations, this would bring public debt to 120% of GDP, nearly 7 points higher than in 2024.

This scenario assumes an "all-inclusive" budget adjustment, taking into account the increase in interest charges and military spending of nearly 0.5 percentage points of GDP per year; the net effort announced by the Bayrou government was higher (0.8 percentage points of GDP[2]).

This effort could therefore be reduced by nearly EUR 9 billion (0.1 percentage point of GDP corresponds to EUR 3 billion, assuming growth close to our forecast for 2026, 1.1%) without being contrary with European commitments. An adjustment that is ultimately too low would imply a more pronounced increase in the debt ratio, with a greater likelihood of upward pressure on interest rates. Against this background, the international interest rate environment has changed: the ECB has stopped easing its monetary policy and German rates are rising.

CHANGE IN THE FRANCE-GERMANY SPREAD AND THE GERMAN 10-YEAR RATE FROM JUNE 9, 2024

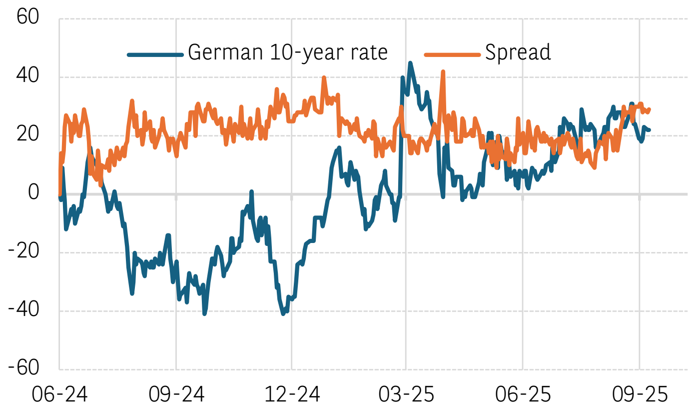

CHART 6

SOURCE: BANQUE DE FRANCE, BUNDESBANK, BNP PARIBAS

In conclusion, the fundamentals of the French economy are resilient. However, confidence levels in the private sector remain low, even more so for households than for businesses. In this environment, the French growth underperformance relative to that of the eurozone is expected to narrow in 2026, but not to disappear, precisely because of this burden. Household consumption growth is therefore expected to remain below GDP growth for the fourth consecutive year. This situation will effectively limit the capacity of French growth to rebound.

Stéphane Colliac

2 These 0.8 percentage points of GDP corresponds to the EUR 44 billion in announced effort minus the increases in interest expenditure, military spending and the contribution to the EU budget in 2026.