EDITORIAL

FRENCH GROWTH: IS THE WORST OVER?

While French growth reached 1.1% in 2023 and 2024, uncertainties, particularly of a political nature, are expected to drive growth slightly down in 2025 (0.7% according to our forecasts). The difference can be explained primarily by the weak growth carry-over after Q4 2024 and Q1 2025. However, we are probably over the worst and growth is expected to strengthen from Q2 onwards. In fact, implementation of the 2025 budget should restore confidence and allow an increase in public consumption compared to Q1 (when it was penalised by renewal of the 2024 budget). Basically, we think that the momentum of the transition to services - accompanied by strong business creations - has not been interrupted. Accordingly, the fundamentals of French growth are preserved.

PAST EVENTS LEAVE THEIR MARK

France has a real budget and this is not just a renewal of the 2024 budget. So, the economy is expected to emerge from a period of three quarters during which adverse effects prevented France from reaching what Insee considers to be its trend pace (0.2% q/q per quarter, excluding exceptional effects).

No salvation in Q3 2024, apart from the Olympic Games. According to Insee estimates, while the Olympic Games (OG) contributed nearly 0.3 points to French growth, the effects of crowding-out (reduction in public works activity, rather disappointing commercial and tourism activities outside the OG, etc.) deducted nearly 0.1 points: 0.2% + 0.3% - 0.1% = 0.4%.

In Q4 2024, the effect of the no-confidence vote. A repeat of Q3, but for a different reason: the uncertainty that peaked following discussions on the budget that led to the no-confidence vote against the Barnier government. While the exceptional effects associated with the OG were the opposite in terms of Q4 GDP (direct effect and crowding-out effect), and starting from trend growth still at 0.2%, resulting in GDP growth of -0.1% (according to preliminary estimates), the suggestion is a cost associated with this uncertainty of around 0.1 points: 0.2% - 0.3% + 0.1% - 0.1% = -0.1%.

In Q1 2025, the renewal of the 2024 budget very probably impacted growth. The shock should be 0.1 points once again (according to our estimates), maintaining weak growth (+0.1% q/q according to our forecasts, once again below trending growth): 0.2% - 0.1% = 0.1%. France began the year without being able to implement part of its public policies. This has delayed the increase in spending in sovereign areas (defence, security, justice) and disbursements of aid programmes (as no budget had officially specified the scope of the new envelope for 2025), such as MaPrimeRénov'.

Conclusion: GDP growth weakening in 2025. Our forecast for 2025 is +0.7% as an annual average. Growth is therefore expected to be lower than in 2023 and 2024, at 1.1% in both years, primarily due to a lower growth carry-over (0.4% at the end of Q1 2025, compared to 0.7% a year earlier). The difference can be explained by the impact of the 2025 budget, through negative carry-over effects (uncertainty, late implementation), for 0.2 points, and its consequences for growth once adopted, for 0.2 points, due to higher taxation and lower spending (effects on public spending, and therefore on investment and public consumption; on private investment, due to a reduction in public support).

NEGATIVE CYCLICAL ELEMENTS BUT MORE POSITIVE STRUCTURAL ELEMENTS

In our view, the budget proposed by the Bayrou government seems more credible than the budget of the Barnier government, particularly in terms of growth forecasts (0.9%, down 0.2 points compared to that of the Barnier government) and the budget deficit (5.4% of GDP, versus 5% for the Barnier government). The reduction in this deficit is no longer based on a reduction in the social security deficit, and less on the decrease in local authority spending than before (EUR 2.2 billion compared to 5 billion initially), leaving the government budget to make most of the cuts to be made in spending (EUR 8.8 billion). This effort is more narrowly distributed but more likely to succeed, as the government has more control over its own spending than local authorities or social security.

What the budget is expected to impact. In order to reach a more credible budget deficit target, choices have been made in terms of reducing spending:

• Reduction in support for employment (nearly 4 billion in budget cuts), even though momentum in the labour market has weakened significantly (50,000 net job losses in the private sector in Q4 2024). We forecast 100,000 net job losses in 2025 (the first excluding the Covid period) and an increase in unemployment of around 8.5%. However, fear of unemployment weakens the likelihood of a drop in the level of household savings.

• Reduction in support for investment and decarbonisation in 2025: spending on France 2030 and MaPrimeRénov' will shrink. In addition, the drain of EUR 1.6 billion in additional employer contributions is expected to contribute to the deterioration of corporate margins (around 30% on average in 2025 compared to a level we estimate at 31% in Q4 2024), which should also lead companies to revise their investment outlook downwards again this year (-1.3%, after already reaching -1.6% in 2024).

Uncertainty is different, but still there. In view of these elements, other barriers could have an impact, notably on the international context. Uncertainty is high, as everything depends on US political decisions, directly (trade policy) and indirectly (impact on US inflation and therefore on global interest rates). These assumptions could affect investment prospects (in addition to the causes already discussed).

Structurally, the basis for growth is preserved. To cope with the headwinds and uncertainties (past, present and future), France does have some strengths. These are based on several areas of momentum and are not specific to France (service innovations, decarbonisation), but, in this context, France is doing well:

• France is able to create companies, with an increase in creations that continued unabated in 2024 (+5.4%).

• France has significantly improved the functioning of its labour market: proof of this is the strength of job creation after Covid, along with the development of apprenticeships and self-employment, which have brought more flexibility to companies.

• France has a comparative advantage in services, particularly in those linked to intellectual property and technology (investment in this area represented nearly 5.5% of GDP in 2024, significantly more than in the other major Eurozone countries).

• Aeronautics and agriculture, in which production was affected in 2024 (due to supply constraints for the former and climate constraints for the latter), are expected to regain their usual weight in French growth in 2025.

• Public spending in sovereign areas is expected to increase (including EUR +3 billion in military spending in 2025), which should boost public consumption. An effort that needs to be intensified, as Ursula von der Leyen discussed at the Munich Security Conference the prospect of a surge in Europe's defence spending to ultimately reach 3% of GDP.

Recent data show that, despite a less favourable economic climate that is likely to weigh on the labour market's capacity to create jobs in 2025, these balances are not affected.

While this base should generate less growth in 2025 (in activity, investment and employment), the balance of risk is perhaps a little more even than one might think at first glance (good news of the adoption of the budget, impacts of lower interest rates and disinflation in France and Europe), hopefully with less disruption by the next fiscal process. However, this is not expected to translate into a sharp rebound in 2026 (growth forecast at 0.9%).

AND WHAT IF A MORE POSITIVE SCENARIO EMERGES?

There is a trajectory to materialise the government's growth forecast. Compared to the assumptions we apply in our forecast, this presumes that adoption of the budget favours a positive confidence shock (cancelling out the cost of its non-adoption in Q4 2024 and in Q1 2025). In other words, the negative impact, linked to cuts in spending and higher taxation (including + EUR 12 billion for companies), may be offset by a drop in the level of household savings and a favourable impact of the fall in risk premiums.

The adoption of the 2025 budget reduced the spread between Germany and France by nearly 10 bps, but the latter, at nearly 70 bps, remains 20 bps above its pre-dissolution level. The German 10-year rate is 20 bps lower than its level on 7 June 2024, while the French rate is close to its own level (3.1%). However, lower rates can boost investment (households and companies) and, while not making a rebound possible, at least limit its contraction. When we look at the German economy, which saw rates fall more than in France, the rebound in new factory orders (+4% between August and December 2024, measured as a 6-month moving average), which can be explained by new orders for capital goods, could be one of the first signs of improvement on the investment front.

In France, this could be translated by more favourable exports than in 2024 for machinery and equipment, as well as for industrial inputs. We can also expect a rebound in second-hand transactions on properties: interest rates are slightly lower than at their peak and the decline in prices seems to be a thing of the past. So it is less relevant than before to wait to buy.

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