ECO FLASH

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France: households' purchasing power, the big gain

Hélène Baudchon

- **In 2019, French households are expected to benefit from major purchasing power gains, which we forecast at roughly 2.5%, the biggest increase since 2007.**
- **Several factors will contribute to this big gain. Tax cuts will be the most visible source, but measures to support earned income and social benefits will also play a key role.**
- **Milder expected inflation will also help, but this factor could be reversed, especially if the current upturn in oil prices continues.**

Households' purchasing power is regularly a key issue in France. Today it is drawing even more attention, largely because of the paltry gains of the past decade. The sluggishness of purchasing power gains is one of the explanations for the current social malaise, as expressed by the "yellow vest" (*gilets jaunes*) movement. Part of the response to these difficulties consequently lies in a boost to purchasing power, in particular through tax cuts.

Three rounds of measures were launched: those introduced in the 2018 and 2019 finance bills, the emergency economic and social measures (MUES) approved in late December 2018 and additional measures following the conclusion of the Great National Debate, which were announced by Emmanuel Macron during a press conference on 25 April 2019. According to our estimates, the first two sets of measures will boost purchasing power by nearly 2.5% in 2019 (after a 1% gain in 2018). Some of these measures, along with the new ones presented following the Great National Debate, will continue to boost purchasing power in 2020. Based on a preliminary calculation, these new measures lift our forecast of purchasing power gains by 0.5 points, from 1% to 1.5%.

Before going any further, we must first define what we mean by "purchasing power". This term is widely used but does not always mean the same thing. It can be used to cover very different individual situations that deviate from the macroeconomic benchmark defined by the national accounts.

■ Purchasing power gains: a long-term view (1)

Breakdown of annual purchasing power gains

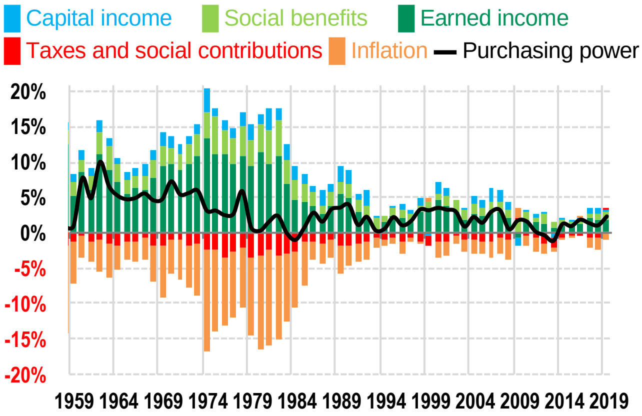

Chart 1 Source: INSEE, BNP Paribas estimates

This is one reason for the sometimes big gap between people's feeling and experience and the aggregated figures.

Using the national accounts definition, purchasing power is a measure of real gross disposable income (GDI). *Disposable* income refers to the portion of household income that is available after paying taxes and social contributions (whose weighting is slightly above 20% of pre-tax income). Pre-tax income is comprised essentially of earned income (which accounts for about 60%), as well as social benefits (about 30%) and capital income (15%). *Gross* income refers to the fact that it is not adjusted for fixed capital consumption pertaining to self-employed businesses and home ownership. It is *real* once it has been adjusted for prices. Purchasing power gains are thus the difference between the nominal GDI growth rate and inflation[1].

[1] Measured by the change in the personal consumption expenditure deflator, which is fairly close to that of the consumer price index.

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2008-2018: purchasing power's lost decade

According to this definition, declines in purchasing power at the macroeconomic level are extremely rare and small in scope (see chart 1). Yet the most recent decline lasted over a 2-year period (-0.4% in 2012 and -1.2% in 2013). Since 2014, purchasing power has increased at an average annual rate of slightly more than 1%, compared to 2% since the mid-1980s and 3% if we look back as far as the 1960s.

The sluggish pace of recent gains is one of the reasons why purchasing power is a recurrent focal point of debate. It is even easier to understand why it is such a big issue today if we look at purchasing power in terms of consumption units, i.e. after taking into account demographic trends via the number and composition of households, which gives us a better picture of the individual perceptions of purchasing power gains[2]. Measured in consumption units, purchasing power tends to decline more frequently. In the recent period, it rose only 0.6% a year on average. What is even more striking is that, based on consumption units, purchasing power was barely higher in 2018 than in 2008 (see chart 2). Clearly we can speak of a lost decade.

Among the reasons for this long stagnation were the sharp increase in fiscal pressure over the past decade and the deterioration of the labour market situation. Yet these two factors did not hit the same households. According to research by the French Economic Observatory (OFCE)[3], for households in the lower half of the earnings distribution scale, increases in taxes and other social contributions between 2008 and 2016 were more than offset by higher social benefits. The opposite was true for the upper half of the scale, especially for the 35% making up the wealthiest households. Although low-income households benefited from tax and social benefit reforms, they were hard hit by labour market trends (rising unemployment, job insecurity and involuntary part-time work), which was not the case for the wealthiest households.

New social and fiscal measures introduced in 2017 also had different effects on living standards depending on the household's position on the income scale, although the impact was neutral on the population as a whole[4]. For the 20% of low-income households at the bottom of the scale, the net impact was positive thanks to measures to increase social benefits. For households in the 5th to 7th decile (the 30% of households making up the middle class), the net impact was positive thanks to income tax cuts. For the 20% of households at the top of the scale (last two deciles), the net impact was negative, mainly due to the increase in old-age pension contributions.

Purchasing power gains: a long-term view (2)

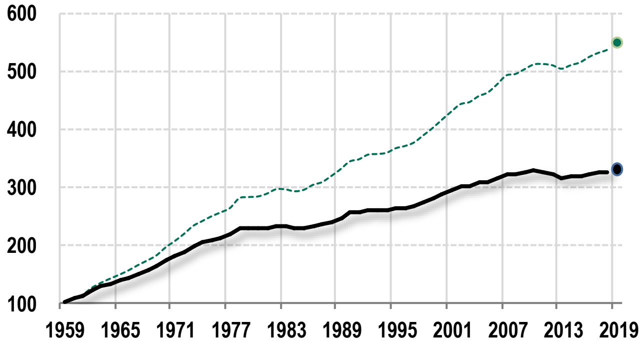

Chart 2 Source: INSEE, BNP Paribas estimates

In 2018, between January and October to be more precise, the purchasing power gains from social and tax reform measures were more than offset by higher prices for oil products (a third due to higher energy taxes and the remaining two thirds to higher oil prices)[5]. The overall impact encompasses a significant decrease in the standard of living of pension holders and a very slight improvement in that of households in which the head of house is employed. Within this category, the combined impact differs depending on the household's position on the income scale. The impact was negative for households in the 1st decile due to the high share of spending on petrol. The impact was nil for the 2nd decile and positive for the 3rd through 9th deciles, thanks to the favourable impact of the social contributions / CSG switch (the cut in the former being financed by a hike in the latter). The impact on the highest decile was also nil since the social contributions / CSG switch was less favourable: the higher CSG rate on capital income offset the decline in social contributions on wages.

2019: purchasing power is expected to markedly rebound

These different factors, combined with the relatively heavy weight of pre-committed expenditure (30% of household budgets on average[6], see chart 3), explain the negative feelings about the standard of living in France. Part of the response therefore lies in a boost to purchasing power, notably through tax cuts, which ranked highest, above jobs and wages, in French people claims. From a more general perspective, boosting households' purchasing power is also a way to stimulate growth: the more immediate effects of stimulating demand round out supply-side stimulus measures, the impact of which tends to be more spread out over time.

In terms of amounts, major tax cuts were embedded into the 2018 and 2019 finance bills (including MUES emergency

[2] Household needs do not rise in tandem with its size. The size of each household in terms of consumption units is measured the following way: the first adult accounts for 1 unit, every additional person older than 14 years account for 0.5 unit and every child younger than 14 years-old for 0.3 unit. Since 1960, consumption units increase by 0.9% a year on average.

[3] P. Madec, P. Malliet. M. Plane, R. Sampognaro and X. Timbeau, *"Between 2008 and 2016, social welfare and fiscal reforms strained household revenues but strengthened the buffering role of the social redistribution system"*, INSEE France, Social portrait 2018.

[4] A-L. Biotteau, S. Fredon, F. Paquier, and K. Schmitt, "*Social benefit and contribution reforms implemented in 2017 had virtually no impact on standard of living inequalities"*, INSEE France, Social portrait 2018.

[5] A-L. Biotteau and L. Rioux, *"In October 2018, the gains from social contribution reforms were offset by higher prices for oil products"*, *INSEE Focus* n°149, 12 March 2019.

[6] This fraction reaches 60% for poor households, 40% for low-income households, 30% for middle-class households, and 20% for high-income households. *Source*: DREES, March 2018.

social and economic measures[7]). Net tax cuts (i.e. after adjusting for tax hikes) amount to EUR 15 bn over the period 2018-2020, and is broken down as follows: a little more than EUR 1 bn in 2018, nearly EUR 11 bn in 2019 and EUR 3 bn in 2020 (see table).

In 2019, tax cuts will provide the most visible support for purchasing power. Yet the other components of GDI will also benefit from support measures: earned income will get a boost from the so-called "Macron" bonus[8], overtime work will be tax exempt and the flat tax on SME incentives and profit-sharing was eliminated[9]. Social benefits will also get a lift with the increase in the in-work bonus and various minimum welfare benefits[10]. After increasing 2.7% in 2018, the same pace as in 2017, nominal GDI will get a significant boost in 2019: we estimate it will increase by 3.3%.

Regarding inflation, we expect it to ease sharply this year, to 1% from an average annual rate of 1.7% in 2018, thanks primarily to an oil effect (oil prices are not expected to rise as sharply). The cancellation of the energy tax hike will also help reduce inflation by 0.2 points according to our estimates. Yet this does not take into account the strong upturn in oil prices since the start of the year, which could spoil the party. The risk is that inflation surpasses expectations, which would erode the expected purchasing power gains in 2019 by a similar amount.

Based on our current forecasts, we estimate purchasing power gains at 2.3%, the biggest increase since 2007 (+1.7% in consumption units). Moreover, these gains are expected to benefit a broad segment of the population. More specifically, the MUES emergency economic and social measures have significantly improved the distribution of these gains in favour of middle income households[11].

In 2020, the expected purchasing power gains are likely to be smaller, but still relatively strong, thanks to previously approved tax cuts, as well as the new measures announced following the Great National Debate, including an income tax cut (EUR 5 bn), the re-indexation of the lowest pensions to inflation (EUR 1.4 bn), and the renewal of the "Macron" tax-

Weight of pre-committed expenses

% of GDI

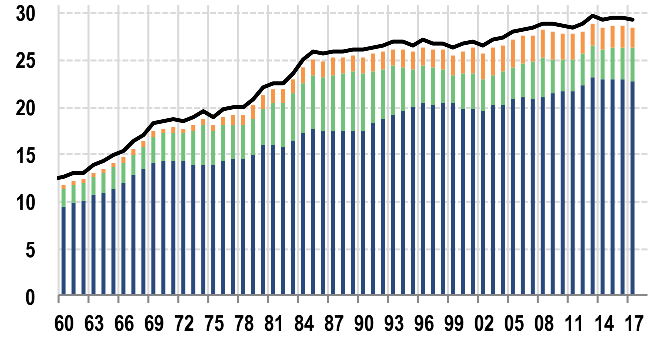

Chart 3 Source: INSEE

Main social and tax measures affecting households in 2018-2020

EUR bn	2018	2019	2020
Total	**-1.4**	**-10.6**	**-3.1**
Housing tax relief	-3.2	-3.8	-3.1
Creation of the real estate wealth tax	-3.2		
Introduction of a flat tax on capital income	-1.4	-0.8	+0.4
Increase in the Agirc-Arrco supplementary pension fund rates		+1.1	-0.1
Social contributions / CSG switch*	+4.4	-4.0	-0.3
Reduction of CSG tax rate on low-income pensions		-1.6	+0.1
Tobacco tax	+0.9	+0.5	+0.6
Energy tax	+2.4	0.0	0.0
Expansion of household employee tax credit	-1.0		
Extension of energy transition tax credit	-0.3	+1.1	+0.1
Tax exemption for overtime work		-3.0	-0.8

**The General Social Contribution (CSG) was increased by 1.7 points in January 2018, while the elimination of the 3.15% in employee contributions for unemployment and health insurance (2.4% and 0.75%, respectively) was conducted in 2 phases: -2.25 points in January 2018 and the remaining 0.9 points in October. Calendar effects explain why the measure appears as a tax increase in full-year 2018 and a tax cut in 2019. By construction, the measure is budget-neutral.*

Table Source: April 2019 Stability Programme

free bonus. Other measures were announced that are also likely to boost purchasing power, including the increase in the minimum old-age pension, guaranteed child support payments and the introduction of a single minimum welfare benefit. Based on preliminary calculations, these new measures add 0.5 points to our forecast of purchasing power gains, which rises from 1% to 1.5% in 2020 (a 2.8% increase in nominal GDI minus inflation of 1.3%).

Purchasing power gains are expected to be significant in 2019, as well as in 2020, albeit to a lesser extent. However, for a truly sustainable increase in purchasing power gains, what really counts is job and wage momentum.

Hélène Baudchon
helene.baudchon@bnpparibas.com

[7] These measures amount to EUR 10.8 bn: cancellation of the energy tax increase (EUR 3.9 bn); exemption of overtime work from income taxes and the advancement to 1 January (from 1 September) of the exemption of social contributions (EUR 2.4 bn); cancellation of the CSG tax increase for some pension holders (EUR 1.3 bn); increase in the in-work bonus (EUR 2.8 bn) and expanded eligibility for the energy voucher and conversion bonus (EUR 0.4 bn). *Source*: Court of Auditors.
[8] An exceptional tax-free bonus, capped at EUR 1,000, which companies can voluntarily offer employees whose 2018 wages do not exceed three times the annual minimum wage.
[9] Supply-side measures are also expected to have positive effects on employment: transformation of the CICE tax credit into lower employer contributions, additional relief at the minimum wage level, and labour market reforms (a three-pronged reform of the Labour Code, professional training and unemployment insurance).
[10] These increases are nonetheless offset by the partial de-indexation of pensions, family allowances and housing benefits and by the APL housing benefit reform.
[11] P. Madec, M. Plane, and R. Sampognaro, *"2019 budget: purchasing power gains, but a higher deficit"*, OFCE policy brief n°46, 29 January 2019; M. Ben Jelloul, A. Bozio, T. Douenne, B. Fabre, and C. Leroy, "*2019 budget: what impact on households?*" *IPP* notes, n°37, January 2019.

GROUP ECONOMIC RESEARCH

William De Vijlder Chief Economist	+33 1 55 77 47 31	william.devijlder@bnpparibas.com
ADVANCED ECONOMIES AND STATISTICS		
Jean-Luc Proutat Head – United States, United Kingdom	+33 1 58 16 73 32	jeanluc.proutat@bnpparibas.com
Hélène Baudchon France – Labour markets	+33 1 58 16 03 63	helene.baudchon@bnpparibas.com
Louis Boisset European Central Bank watch, Euro area global view, Japan	+33 1 57 43 02 91	louis.boisset@bnpparibas.com
Frédérique Cerisier Euro area (European gouvernance and public finances), Spain, Portugal	+33 1 43 16 95 52	frederique.cerisier@bnpparibas.com
Catherine Stephan Nordic countries – World trade – Education, health, social conditions	+33 1 55 77 71 89	catherine.stephan@bnpparibas.com
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Tarik Rharrab Statistics	+33 1 43 16 95 56	tarik.rharrab@bnpparibas.com
BANKING ECONOMICS		
Laurent Quignon Head	+33 1 42 98 56 54	laurent.quignon@bnpparibas.com
Laure Baquero	+ 33 1 43 16 95 50	laure.baquero@bnpparibas.com
Céline Choulet	+33 1 43 16 95 54	celine.choulet@bnpparibas.com
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EMERGING ECONOMIES AND COUNTRY RISK		
François Faure Head	+33 1 42 98 79 82	francois.faure@bnpparibas.com
Christine Peltier Deputy Head – Greater China, Vietnam, other North Asian countries, South Africa	+33 1 42 98 56 27	christine.peltier@bnpparibas.com
Stéphane Alby Africa (French-speaking countries)	+33 1 42 98 02 04	stephane.alby@bnpparibas.com
Sylvain Bellefontaine Turkey, Ukraine, Central European countries	+33 1 42 98 26 77	sylvain.bellefontaine@bnpparibas.com
Sara Confalonieri Africa (Portuguese & English-speaking countries)	+33 1 42 98 43 86	sara.confalonieri@bnpparibas.com
Pascal Devaux Middle East, Balkan countries	+33 1 43 16 95 51	pascal.devaux@bnpparibas.com
Hélène Drouot Korea, Thailand, Philippines, Mexico, Andean countries	+33 1 42 98 33 00	helene.drouot@bnpparibas.com
Salim Hammad Latin America	+33 1 42 98 74 26	salim.hammad@bnpparibas.com
Johanna Melka India, South Asia, Russia, Kazakhstan, CIS	+33 1 58 16 05 84	johanna.melka@bnpparibas.com
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