

FRANCE

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ROBUST REBOUND

Based on May and June business confidence surveys, the French economy has been rebounding more vigorously than expected from the third lockdown. We have raised our Q2 growth forecast, from near zero to near 1% QoQ. In Q3, the mechanistic rebound would bring growth to about 3% QoQ. Growth is expected to ebb thereafter as the catching-up effects dissipate, although it should remain high, bolstered by the fiscal impulse. The downside of the vigorous upsurge in demand is that it is squeezing the supply side, which is less responsive. The ensuing supply chain constraints, higher input prices and hiring difficulties are all sources of friction that must be monitored since they could hamper the recovery. GDP growth could average 6% in 2021 (an optimistic forecast that is a half point higher than the June 2021 consensus), and will remain strong at an estimated 4.6% in 2022. In our eyes, the economic risks are balanced: the unlocking of forced savings that have accumulated over the past year is an upside risk, while supply-side tensions and pricing pressures are downside risks. Although the Covid-19 pandemic has diminished significantly, the health risk has not completely disappeared given the rapid spread of variants.

SIGNS OF A VIGOROUS RECOVERY

Judging by the business climate surveys for May and June, the French economy has been rebounding more vigorously than expected following the end of the third lockdown. Despite the lockdown, April survey results were already a positive surprise (by rising, in the case of the composite PMI from Markit, and barely dipping for the INSEE composite index, thanks in particular to a strong showing from industry). Buoyed by expectations of brighter prospects, the improvement in the May surveys was impressive, notably in services, even though lockdown measures had been lifted only partially. The INSEE survey results for June maintained this positive momentum, in keeping with the ongoing easing of health restrictions. Buoyed by all economic sectors, the composite index gained another 5 points (after 12 in May) to reach 113, the highest level since summer 2007. This is well above the pre-crisis level of 105, which was already higher than the benchmark of 100. It is also worth noting that since the beginning of the year, the business climate has picked up more rapidly than employment: the gap, which is unusually big, signals strengthening productivity gains (see chart 2).

The upturn in household confidence was less impressive (up 3 points in May and 4 points in June). Granted, the INSEE indicator rose 2 points above the benchmark level of 100 in June, but the index was still 2-3 points below the pre-crisis level of early 2020. However, a few very positive points are worth highlighting. In June, there was a big improvement in household assessments of their future standard of living in France and in the balance of opinions on the opportunity to make big-ticket purchases. Fears about unemployment trends have also dropped off sharply since the beginning of the year.

There are also some encouraging news from hard labour market data. Employment continues to surprise positively. Private sector payroll job gains were revised upwards in Q1 2021 (from +0.3 to +0.5 % QoQ). The unemployment rate remained virtually flat at 8.1% in Q1 2021. Hiring reports for jobs lasting more than 1 month (excluding temporary work) rebounded very strongly in May (+37% m/m), reaching the highest level since 2006 (the year the series began). The number of category A jobseekers registered with Pôle Emploi, the French employment agency, declined sharply in May (-3.7% m/m). Yet the indicator is still 8% higher than the pre-crisis level of February 2020. Based on the gauge of hiring reports (a 4-month moving average of more than 2.7 million contracts), the French labour market could return to good health rather quickly¹, but it will be much harder to reach the second gauge based on the number of jobseekers (the number of category A jobseekers must decline by 130,000 in 6 months).

¹ See EcoFlash n°21-09, *The French labour market: outlook for 2021*, 6 May 2021

GROWTH AND INFLATION (%)

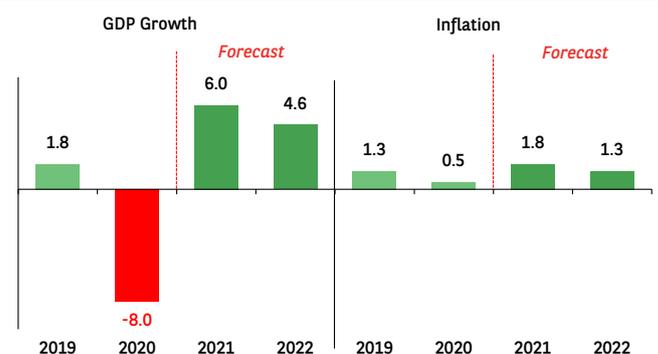


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

THE FRENCH BUSINESS AND EMPLOYMENT CLIMATE

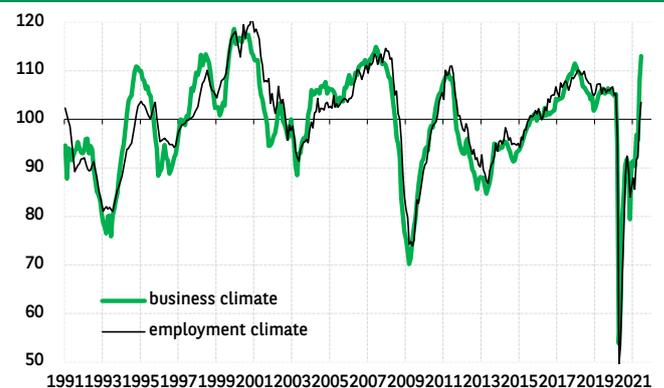


CHART 2

SOURCE: INSEE, BNP PARIBAS

Thanks to these various signs of improvement, there has been a reduction in the shortfall of GDP relative to the pre-crisis level. In its economic update of early June, the Bank of France estimated this shortfall at 6% in April, 4% in May and 3% in June, which points to



a Q2 growth forecast of about 0.5% QoQ. Our own hypothesis is a bit more optimistic (shortfall of 3.5% in May and 2% in June), resulting in a Q2 growth forecast of nearly 1% QoQ. In Q3, the mechanistic rebound would then bring growth to about 3% QoQ. Growth should ease thereafter as the catching-up effects dissipate, although it should still remain high, bolstered by the fiscal impulse. By the horizon of year-end 2021, the economy could return to pre-crisis levels. But the recovery will probably continue to mask sector disparities: certain sectors will have surpassed their pre-crisis levels (real estate, financial services, information and communications, non-market services) while others will continue to fall short (transport equipment, hotel and restaurant services, leisure activities).

In 2021, average annual growth is expected at 6%, and it should remain strong in 2022 at 4.6%. Note that these forecasts incorporate an extra fiscal stimulus of EUR 10 bn in 2021 and 2022, which adds about 0.4 percentage points to growth each year. The stimulus aims to steer GDP back towards its pre-crisis trajectory.

THE DOWNSIDE TO VIGOROUS DEMAND AND OTHER POINTS TO MONITOR

The downside to the vigorous upturn in demand is that it is creating tensions in the supply side, which is less responsive. The ensuing supply chain constraints, higher input prices and hiring difficulties are all sources of friction that must be monitored closely as they could hamper the recovery². Our scenario's underlying assumption is that these tensions will gradually diminish as economic activity returns to normal and supply and demand reach a new equilibrium. The recovery is unlikely to be hampered significantly. Yet these sources of friction represent a definite downside risk, an unwelcome negative shock that could lead to production shutdowns and smaller corporate margins.

The evolution of business failures is another point of fragility to watch. Business failures plunged in 2020 and in early 2021, but this counter-intuitive movement can be attributed to the effectiveness of emergency support measures. Corporate bankruptcies are now poised to rebound. The big question is by how much. We should expect to see bankruptcies return at least to pre-crisis levels (an increase of about 25,000). They have probably already begun to pick up, because April 2021 has marked the first increase since early 2019. What would be truly alarming is if the number of bankruptcies were to rise above this normalisation trend. Yet several factors should help contain the increase, including the ongoing economic recovery, the gradual withdrawal of emergency measures, the roll out of participation loans and other support measures under the France Relance plan, and new anti-bankruptcy measures.

Despite the big improvement in the health situation, it is still a downside risk: we cannot rule out the possibility of a new post-lockdown wave of Covid-19 with the rapid spread of variants in the background. Thanks to the increase in vaccination coverage, hopefully it will be possible to avoid another lockdown.

On the other hand, growth could also surprise on the upside if the unlocking of forced savings accumulated over the past year is bigger than expected and/or the labour market situation is better than anticipated. In our eyes, these upside risks balance out the downside risks.

PRICE COMPONENTS OF MANUFACTURING PMI AND INFLATION

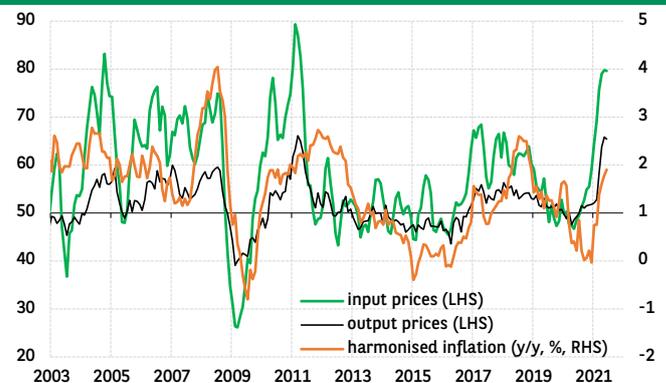


CHART 3

SOURCE: INSEE, MARKIT, BNP PARIBAS

ONE LAST FISCAL BOOST BEFORE SUPPORT IS GRADUALLY WITHDRAWN

As part of the supplementary finance bill for 2021 (PLFR 2021) presented in early June, the government raised its forecast for the fiscal deficit to 9.4% of GDP, which is 0.4 points higher than anticipated in April's Stability Programme, and 0.2 points higher than in 2020. This deterioration might seem paradoxical, because an upturn in growth as strong as the one expected in 2021 is supposed to reduce the deficit, and because the contours of the crisis exit strategy, i.e. the withdrawal of the safety net of emergency measures, have begun to be sketched out³.

The reason behind this paradox lies in spending, whose expected increase is larger than the revenues' rise (EUR 64 bn and EUR 47 bn, respectively, compared to 2020). About 60% of the increase in spending can be attributed to "ordinary" expenditures, and to a lesser extent, support and stimulus measures (about EUR 25 bn). Another interesting figure is the sharp increase in credits under the Emergency Plan, which rose from EUR 6 bn in the initial finance bill to nearly EUR 45 bn in the PLFR 2021. Nearly EUR 30 bn corresponds to 2020 credits carried over to 2021, and about EUR 10 bn is for additional resources allocated to the Solidarity Fund and the short-term working scheme. This last increase in the budget of the emergency measures aims to prepare the ground for their future withdrawal. It should help ensure that their gradual withdrawal will be as painless as possible for the companies concerned.

During two extraordinary years marked by the crisis (2020) and the exit from the crisis (2021), the prevailing logic was "whatever it takes". The year 2022, in contrast, should mark the beginning of the return to a more ordinary constrained fiscal policy. Although the time is not yet ripe for greater austerity, the fiscal trade-offs promise to be difficult in the 2022 budget.

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² See Chart of the Week, *Recovery in France: slowed before it started?*, 12 May 2021
³ See EcoTV Week, *France: start of the recovery and crisis exit strategy*, 21 May 2021

