France

A glimpse of stability in an ocean of uncertainty

Business confidence surveys are showing signs of levelling off. Hard data for January and February are rather positive. These factors are consistent with the economy keeping up growing at about 1.2%, which is our growth forecast for 2019. Although this is not very high, it is synonymous with the resilience the French economy is expected to show in an environment marked by uncertainties and downside risks. The main factor behind this resilience is the positive impetus of economic and fiscal policy, notably stimulus measures to boost household purchasing power, and the expected ensuing rebound in household consumption.

Q4 2018 growth eventually held up a bit better than expected, with an 0.3% quarterly GDP gain vs expectations of 0.2%. Admittedly, this is a lacklustre growth rate, disappointing in absolute terms but, at least, it remained on the same pace as in Q3 and a little higher than the eurozone average (0.2% q/q in Q4 2018 after 0.1% in Q3). However, activity slowed significantly in year-on-year terms: growth dropped to only 1% y/y in Q4 2018, from 2.8% y/y in Q4 2017. The average annual growth rate slid to 1.6% from 2.3% in 2017.

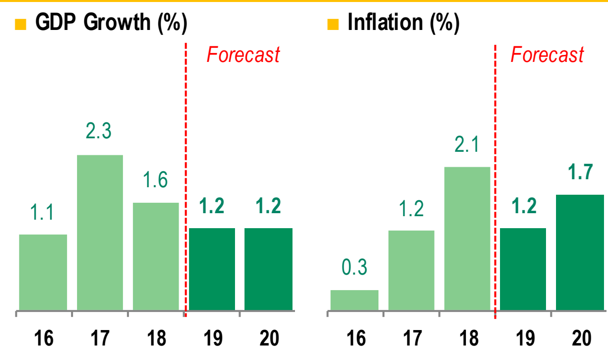
Mixed growth

Although quarterly growth rates were similar, the GDP breakdown was not the same. Both quarters paint a mixed picture with growth hampered by a series of bumps and shocks[1]. Q3 growth was supported by a rebound in household consumption, an acceleration in corporate investment and a positive contribution of net exports, but it was pulled down by a decline in household investment, a stagnation of public investment and a negative contribution of changes in inventory. In Q4, changes in inventory made a smaller negative contribution to growth (-0.1 points, vs -0.5 points) but the positive contribution of final domestic demand also eroded (0.2 points, vs. 0.5 points). Household consumption was flat and corporate investment slowed down markedly while household investment continued to decline. Net exports made another positive contribution of 0.3 points, the same as in Q3, but it was based on a much stronger combination of exports and imports (up 2.2% q/q and 1.3% q/q, respectively, vs. +0.6% q/q and -0.2% q/q in Q3[2]).

Growth prospects are still mixed in Q1 2019. The sense of a deteriorated cyclical environment is mainly derived from the PMIs for the manufacturing and services sectors. Last December, both abruptly dropped below the 50 threshold, which separates expansion from contraction, and have fluctuated around 49 ever since. Yet this negative signal is offset by a more positive signal from the Insee surveys (see chart 2). The Insee composite business climate index is holding above its benchmark average of 100[3], *i.e.* in expansion territory (104 in March). Moreover, the index has increased since the beginning of the year, by one point a month. This improvement is fuelled by the construction and retail and wholesale trade sectors. In manufacturing and services, the business climate remained more or less flat, which is good news for industry but a source of concern for services. In each sector, the business confidence index was above the benchmark average of 100[4].

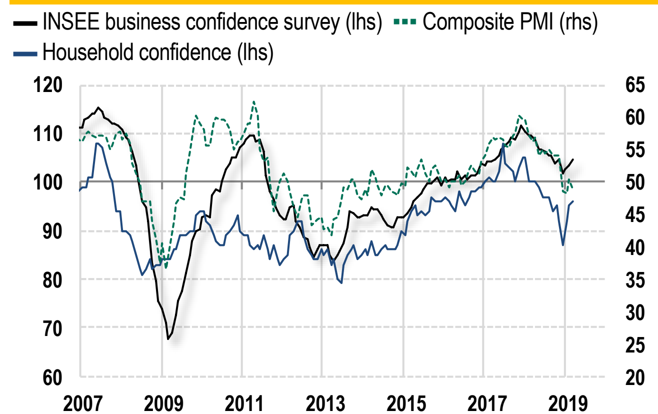
Household confidence rebounded more strongly (+9 points between January and March), regaining the ground lost in November and December (-8 points). At 96, the composite index is nonetheless well below its benchmark average of 100.

1- Growth and inflation



Source: National accounts, BNP Paribas

2- Confidence surveys



Source: INSEE, Markit

---

[1] *France: 2019, another testing year*, EcoPerspectives Q1 2019
[2] Exports contributed +0.7 points to growth in Q4 (vs +0.2 points in Q3) and imports contributed a negative 0.4 points (vs. +0.1 points in Q3).
[3] Since 2000, 100 corresponds to average growth of 0.3% q/q.
[4] Specifically, the March index was 102 in industry, 103 in services, 112 in construction, 102 in retail trade and 107 in wholesale trade.

Between the mixed signals of surveys and the rather positive hard data (production, consumption and exports) in January and February, the most likely scenario seems to us to be that Q1 growth will stabilise at 0.3% q/q. This is the same as the Bank of France's estimate, while the Insee is expecting growth of 0.4%. Our Nowcast model based on hard data also shows growth of 0.4%, while the estimate based on survey data points to 0.2%.

Thereafter, we expect growth to hold to a quarterly pace of 0.3%. Though not very high, it is nonetheless synonymous with the resilience the French economy is expected to show in the face of the world economic slowdown. To be more precise, the French economy will not be sheltered from the global slowdown and from the European one in particular, but it will not be hit as hard either. According to our estimates, French growth will lose 0.4 percentage points to 1.2% in 2019, from 1.6% in 2018, while eurozone growth will decline by 0.9 points, to 0.9% from 1.8%. If this proves to be the case, then French growth will surpass that of the eurozone for the first time since 2013.

This resilience can be attributed to three factors. Two are specific to France and definite, although the extent of their buffering effect is open to debate: 1) the positive impetus of economic and fiscal policy and 2) the relatively low degree of openness[5]. The third factor is shared with the eurozone and cannot be taken for granted because it pertains to a forecast, although we do not see the degree of uncertainty as very high: the strength of the labour market which brings in its wake job creations, declining unemployment and wages acceleration. Additionally, monetary and financial conditions remain growth-supportive.

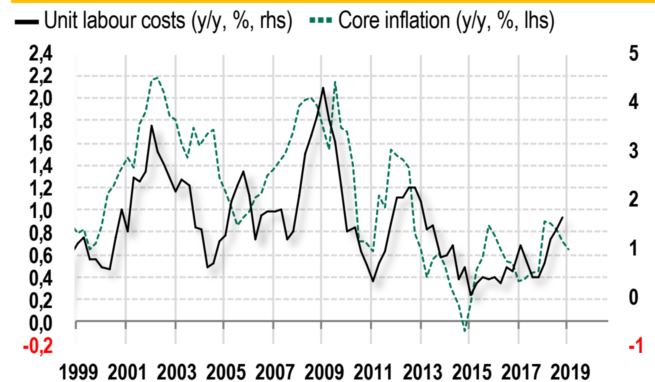
Looking at the components of growth, and considering the factors mentioned above, this resilience will depend on the household consumption rebound, which should get a boost from major purchasing power gains expected in 2019. In 2020, we do not foresee a further acceleration in consumption,[6] and unless other growth engines pick up the slack, growth is expected to remain stable at 1.2%. This forecast is slightly below that of the consensus and of the official institutions (ranging between 1.3% and 1.4%), a sign of the significant downside risks surrounding the economic outlook (recession fears, commercial tensions, Brexit).

Core inflation: the great missing

When we lose something, we know more or less where to look to find it, and the same can be said about core inflation: we should be able to find it in upstream prices, the closing of the output gap and wages acceleration. So far, however, it is nowhere to be seen.

To be more precise, core inflation has increased (from an average annual rate of 0.4% in 2017 to 0.8% in 2018) but its feeble scope raises doubts. This increase even seems to have nothing to do with the improvement in the economy and looks to be due solely to a statistical base effect: after jumping from 0.5% year-on-year in December 2017 to 0.9% in January 2018, core inflation has returned to a slightly downward trend. In March 2019, it even fell back to 0.5%.

3- Core inflation and unit labour costs



Source: INSEE, OECD, BNP Paribas

The disinflationary impact of the euro's appreciation between mid-2017 and mid-2018 might be one explanation for the limited upturn in core inflation. Sector-based factors have also weighed in, such as the repercussions of the reduction in housing benefits for low-income rental rates and another sharp decline in the prices of telecommunications services. The second-round effects of the sharp rise in oil prices through October 2018 have not kicked in yet either (especially in terms of airline prices).

From a more fundamental perspective, low core inflation can also be blamed on corporate efforts on margins, which have been sustainable so far because unit labour costs have only begun to rise very recently and mildly so (see chart 3). Yet if unit labour costs accelerate over the forecast horizon as we expect, they would increase pressure on margins, resulting in a stronger upturn in core inflation.

Hélène BAUDCHON
helene.baudchon@bnpparibas.com

[5] Nonetheless, France is indirectly exposed via Germany, its main trading partner.
[6] Although the measures to be taken in response to the Great National Debate are not known yet, the additional fiscal surplus that the government is prepared to inject would increase the chances of such an acceleration.