

## FRANCE

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## IS A RECESSION COMING?

French growth was surprisingly up in the second quarter (+0.5% q/q), supported by the positive impact of the lifting of Covid-19-related restrictions on tourism and leisure. The rest of the economy was almost flat according to our estimates (+0.1% q/q) due to accelerating inflation. After a negative first quarter (-0.2% q/q, including "after adjustment"), this indicates a narrowly avoided recession. Looking ahead, however, the deterioration in business surveys, the impact of energy prices on businesses, the drought and the decline in electricity production increase the recessionary risk.

The lifting of Covid-19-related health restrictions from March onwards contributed significantly to the surprise rise in French growth in the second quarter (+0.5% q/q). The accommodation and catering sector and spending by non-residents in France (mainly tourism and business travel) alone explain the growth in household consumption and exports, showing the otherwise rather weak dynamics of the other growth drivers. The employment figures bear out this sense of both the positive and the negative, with 187,000 net new jobs created in the first half of the year, but, at the same time, 36,000 job cuts in temporary employment.

## WHERE DO WE START?

This positive growth performance in the second quarter may come as a surprise given the ongoing inflationary shock. Indeed, one might expect it to have had a greater impact on activity, particularly as it severely affected household confidence from March onwards (-7 points over 1 month). Household confidence was the first to deteriorate as a result of the sharp rise in oil prices following the outbreak of war in Ukraine (+23% in March). The figures can be reconciled with this reality by adjusting the change in GDP for the impact of changes in Covid-19 restrictions<sup>1</sup>. In the first quarter, growth remains at -0.2% q/q, but in the second quarter, this adjustment implies a limited growth in GDP of 0.1% q/q. The succession of these two figures points to a narrowly avoided recession.

The impact of the inflationary shock can be seen in the dynamics of household purchasing power, which fell in both the second quarter (-1.1% q/q) and in the first quarter (-1.6% q/q). Other items of household expenditure are more affected by purchasing power constraints (with fairly sharp declines in agri-food, transport equipment and capital goods). On the other hand, construction activity statistics remain dynamic. They seem to be more related to an order book that was largely filled in the past and delays on construction sites (cost constraints and scarcity of labour), while new orders are down.

## WHERE ARE WE HEADED?

Leading indicators have all deteriorated, including the business climate calculated by INSEE (-10 points for the index in the manufacturing sector between February and August) or households (-17 points on the composite index between December 2021 and August 2022, the balance of opinion at -37 on the desirability of making major purchases in August, the lowest since the crisis of 2008) or the PMI indexes (which are now flirting with the threshold of 50, synonymous with contraction). It therefore appears that growth momentum is waning. After an already sluggish first half of the year, and considering that the exceptional effects linked to tourism and leisure are unlikely to boost growth beyond the third quarter, the risk of a recession is significant.

<sup>1</sup> Household consumption is adjusted by freezing the transport services, accommodation and catering items at their fourth quarter level and by cancelling half of the decline observed in Q2 on agri-food products (based on the assumption that the decline in the consumption of agri-food products corresponds in part to the increase in catering spending). Exports are restated by freezing tourism at its fourth quarter level.

## GROWTH &amp; INFLATION

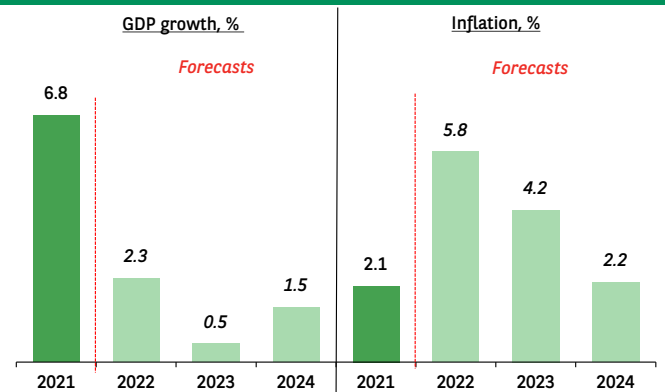


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

Furthermore, the manufacturing sector has characteristics that, combined, are typical of a pre-recession situation: a sharp drop in demand (order books fell from 7.3 to 5.9 months between February and August 2022 according to our estimates), and inventories now above normal.

That said, the rise in energy prices is taking place in a context of drought. This reinforced the decline in electricity production (accelerating since it began in March, -23% y/y in July) and weighed on agricultural production, causing the food component of the INSEE price index to rise in August by 1.7% m/m (the highest since January 2002). Overall, we expect inflation to stabilise around the August level (5.9% y/y) by the end of the year, with the fall in oil prices (reinforced by the fuel rebate) offsetting inflationary pressures elsewhere. In a move similar to the rest of the euro zone, business producer prices are expected to increase further, reflecting the rise in wholesale electricity prices (+7.9% m/m in Germany in August). This points to constraints on business, linked to a risk of shortages this autumn/winter, and increases the likelihood of a recession.

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