

THE SHOCK TO PURCHASING POWER IS SMOOTHED BUT NOT FULLY ELIMINATED

The French economy is stuck between three developments with different effects: an inflation shock that is denting consumer spending, a negative supply shock (supply constraints in industry) and the lifting of public health restrictions (benefiting growth as of the second quarter, having held it back in the first quarter). Government measures that have limited inflation were unable to prevent negative growth in the first quarter. However, the positive impact of the lifting of public health restrictions and a rebound in purchasing power should allow for a recovery towards positive growth in the third quarter (+0.3% q/q).

France suffered a fall in GDP in the first quarter (-0.2% q/q), largely as a result of the 1.5% q/q slide in household consumption. According to our calculations, around two thirds of this decline in consumer spending is due to acceleration in inflation (5.2% y/y in May according to the INSEE index, 5.8% y/y according to the harmonised index), with one third corresponding to "lost opportunities" (impact of public health restrictions relating to the Omicron wave at the start of the year on accommodation/catering and transportation, supply restrictions limiting car and textile sales).

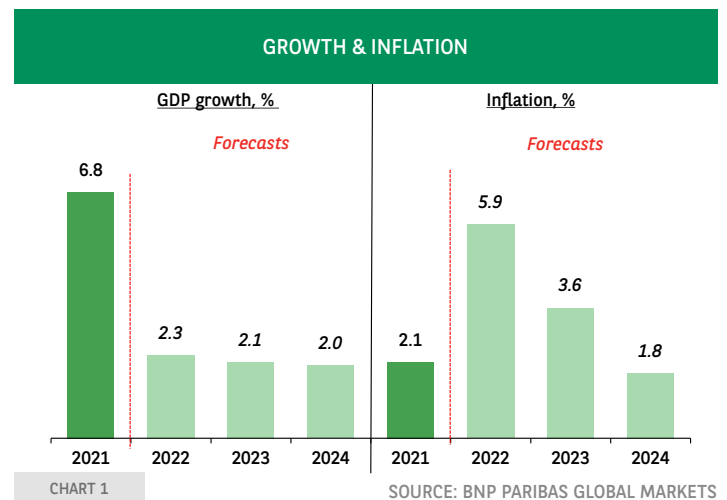
INFLATION SPREADING MORE AND MORE

The inflation shock that rattled France during the last year stems from energy prices (+28% y/y at the end of May). We expect energy prices to stabilise at their current high level between now and the end of this year. Meanwhile, all other prices should continue to rise. According to our calculations, future increases in food prices (+4.2%) and services (+2.2%) are similar to those already seen over the first five months of 2022 and higher in terms of manufactured goods (+2.9% vs. 1.9%). This means that inflation has not yet reached its peak and is expected to near 6.5% y/y in September.

This brisk inflation is denting household purchasing power (-1.8% q/q in the first quarter according to INSEE) and consumer spending (-1.5% q/q). The reduction in purchasing power has been limited by the measures adopted by the French government but not avoided. The freeze on regulated gas prices at the October 2021 level, the 4% cap on electricity price rises in February 2022 and the rebate of EURO.18 per litre on fuel (until July 2022, and likely to be extended) have avoided 2 points of inflation (according to our estimates and those of INSEE). However, a rebound in purchasing power is not likely until the third quarter (+0.9% according to our forecasts). A new package of measures is expected in the coming weeks, including an increase in civil servant wages and pensions (costing EUR4bn and EUR5bn respectively in 2022, assuming an increase of 4%) and a possible one-off "food cheque" planned in September (which we estimate at EUR1.2bn). Ultimately, loss of purchasing power should reach 0.8% in 2022 on our estimates, slightly lower than in 2013 (-1.1%), the worst level in history, but with a different cause, having previously been due to higher taxation. In 2022, according to our calculations, the government's policies will be favourable, as the loss of purchasing power could have reached 3.1% without anti-inflation measures. As a result of this more severe than previously anticipated inflation shock, we have cut our 2022 growth forecast by 0.9 percentage points to an average of 2.3% for the year.

THE EXISTENCE OF OTHER GROWTH DRIVERS

To achieve this level, growth in France will have to improve gradually. We expect zero growth in the second quarter and a slight rebound of 0.3% q/q in the third quarter. This is not by any means because of the inflation shock no longer having an impact, or even having less of



an impact, but because of other growth drivers becoming apparent. The economy is only partly back to normal post-Covid and the lifting of health restrictions as of February 2022 should have a favourable impact. It is therefore likely that the accommodation and catering sector and transportation services will return to their pre-Covid level between now and the third quarter.

At the same time, aeronautics made a significant contribution to growth in exports in the first quarter. As of the second quarter, tourism should add to this. For example, the Greater Paris region welcomed around 12.1 million tourists between January and May, 80% of whom were foreign (compared with 3.7 million and 15.1 million over the same period in 2021 and 2019). These two factors will mask momentum in other types of exports, for which the picture is more mixed (in keeping with the slowdown in growth in other countries, particularly in the eurozone), but they should allow for further growth in exports.

These growth drivers should enable the French economy to return to growth as of the third quarter and provide more moderate support thereafter. Household spending and investment – the decisive factors behind growth – will therefore have to firm up for this to continue.

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