

DESPITE GREATER HEADWINDS, GROWTH IS LIKELY TO REMAIN STRONG

Factors hampering growth in the short term are gaining strength (supply chain disruptions, surging inflation, and the resurgence in the Covid-19 pandemic), but the resilience of business sentiment through November as well as numerous targeted measures to support household purchasing power help allay fears. In Q4 2021, we are forecasting growth of 0.6%, although the risk is on the downside. In full-year 2021, growth is expected to average 6.7%. In 2022, it will remain a robust 4.2%, bolstered by the accommodative policy mix, the unblocking of excess savings, the catching-up of the services sector as well as strong investment and restocking needs.

In mid-November, the services sector seemed to be able to return to its usual role as a support factor for French growth. Among the favourable factors, the services sector is not impacted as much by current supply chain disruptions and upward pricing pressures on a number of inputs, at least compared to industry and construction. Since the end of the third lockdown in May-June, there has also been a powerful catching-up movement in the services hit hardest by the crisis (hotel and restaurant services, transportation services and leisure activities). Positive signals can also be seen in terms of investment in market services, production¹ and the business climate. This picture of a recovery in services was reinforced by the optimistic tone of the Bank of France's November economic update and of November business sentiment surveys (INSEE and PMI).

In the span of a few weeks, the situation has changed a lot with a major deterioration in the health situation, the emergence of the Omicron variant, and greater risk that activity restrictions will have to be introduced again. The services sector is not without troubles of its own: it faces strong hiring problems and is not sheltered from the negative impact of surging inflation (through the erosion of purchasing power which undermines household consumption). But above all, business momentum in the services sector, at least those implying a close contact with the general public, is at the mercy of the health situation. We should expect business sentiment to fall significantly in December and business leaders to express greater economic uncertainty, as newly measured by the INSEE.

Our Q4 growth forecast of 0.6% q/q now comes with a downside risk. Our forecast is deliberately lower than the Bank of France's outlook dated early November (0.75% q/q), to take into account a less positive cyclical situation in Germany and its spillover on France, as well as the expected normalisation of growth and the negative impact of supply chain disruptions and inflationary pressures. The resilience of the business climate through November as well as various measures to support household purchasing power (energy cheque, gas and electricity tariff shield, advanced minimum wage hike, and inflation compensation) should nonetheless help allay these fears. Another positive factor is the stability of purchasing power in Q3 (nominal gross disposable income rose about the same as the consumption deflator). Activity would have to deteriorate sharply in December to significantly reduce Q4 growth. As long as no new restrictive measures are introduced², however, activity should continue to show proof of resilience.

Meanwhile, inflation continues to surge. According to the November flash estimate, it amounted to 2.8% y/y, the highest since 2008. Inflation is expected to climb even higher, at least in December, before levelling off at about 3% according to our forecasts, then easing towards 2% over the course of H2 2022. In the manufacturing sector, inflationary pressures are sharply up as evidenced by the uptrend in the balance of

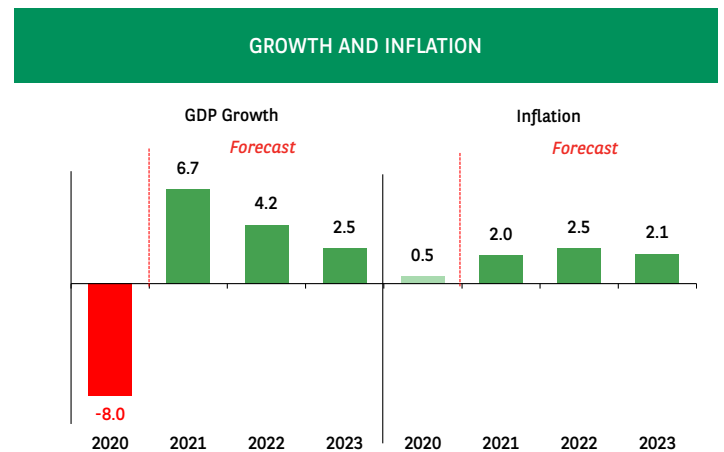


CHART 1

SOURCE: BNP PARIBAS GLOBAL MARKETS

opinions on price expectations. The input price components of the PMIs are also trending upwards in both industry and services. The balance of household opinions concerning past inflation has also risen very sharply, while inflation expectations are still largely above the long-term average, despite November's surprising decline.

Despite greater headwinds (more inflation and supply chain disruptions), and thanks to stronger growth carry-over after a better-than-expected Q3, our 2021 growth forecast has been revised upwards relative to our September outlook. Our 2022 forecast, in contrast, is virtually unchanged. We have nonetheless adjusted the infra-annual profile by lowering H1 growth to take into account more negative factors, and raising H2 growth, as we expect these headwinds to dissipate. A number of support factors are still at play too. They are the same as for the Eurozone as a whole: the accommodative policy mix, the unblocking of at least part of accumulated forced savings, the catching-up of the services sector, and strong investment and restocking needs.

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¹ In September, production in the services sector was nearly 3% above the pre-pandemic level of February 2020, while industrial production was nearly 5% lower.

² Any measures introduced are unlikely to be as strict as during April's lockdown, thanks to the advancement of the vaccination campaign. Assuming that December's lockdown will be similar to the one in April in terms of its negative impact on activity, it would remove about 0.3 points from Q4 growth.

