

16 May 2017

FRANCE SCENARIO 2017-2018

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“

*A modest recovery,
but with signs of
improvement ”*

FRANCE

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OVERVIEW: A MODEST RECOVERY BUT WITH SIGNS OF IMPROVEMENT

In 2016, over the full year, French growth came out at 1.1%, a pace very similar to that of 2015 (1.2%), and was therefore disappointing despite that much vaunted “alignment of the planets” (ie, the combination of a weak euro, record low interest rates, and cheap energy). We foresee an improvement in growth, to 1.3% in 2017 and to 1.4% in 2018.

This scenario sits against a backdrop of a very busy electoral timetable for France in 2017, with a general election in June, hard on the heels of the presidential election. Our forecast has been drawn up with a generally unchanged economic policy. The scenario is largely determined by the global economic and financial environment, and by the unfolding of the economic cycle. **It will be tweaked in light of the economic policy measures implemented by the new government.**

External support factors (euro, oil and interest rates) continue to play a relatively favourable role, even if oil prices and long-term interest rates are edging higher. In addition, the favourable effects of certain economic policy measures, and those supporting businesses in particular (CICE, Responsibility Pact), justify our growth forecast, whose momentum is nevertheless limited by persistent structural constraints

(high unemployment, a competitiveness deficit, and fiscal consolidation, etc.). France's recovery is thus likely to rely on a slightly larger cyclical component as the economic climate gradually improves towards a self-sustaining recovery (investment-employment-incomes-consumption).

Principal components of our scenario

1. Household consumption is still the main driver of the recovery. The consumption trend is likely to ease back a little, however, to 1.4% in 2017 and 2018, compared with 1.8% in 2016, as rising inflation will restrict the increase in purchasing power. After coming in at an annualised 0.2% in 2016, inflation is forecast to reach 1.2% in 2017 and 1.3% in 2018 (Insee figure, total inflation).

2. The upturn in investment is helped by support measures for businesses. Firms' improved margins and profits, combined with an increase in the industrial capacity utilisation rate, suggest that the recovery in investment will continue. We are forecasting a 3.7% increase in business investment in 2017, then of 4.7% in 2018, compared with 3.9% in 2016.

3. After its strong negative impact on growth in 2016, the contribution from

foreign trade is forecast to again be negative in 2017 and 2018, but to a lesser degree. The foreign exchange environment, a modest improvement in demand addressed to France, and a more favourable outlook for certain sectors such as aerospace and tourism, should bolster French exports. Their recovery should nevertheless be fairly sluggish given that France suffers from a persistent competitiveness deficit (cost and non-cost). Imports are likely to continue rising, moreover, although at a modest rate, fuelled by domestic demand.

4. Labour market: We are forecasting a slight drop in the unemployment rate, to 9.5% in 2017 and 9.3% in 2018, compared with 9.7% in 2016 (Insee figure for continental France), on the strength of the favourable effect of economic recovery.

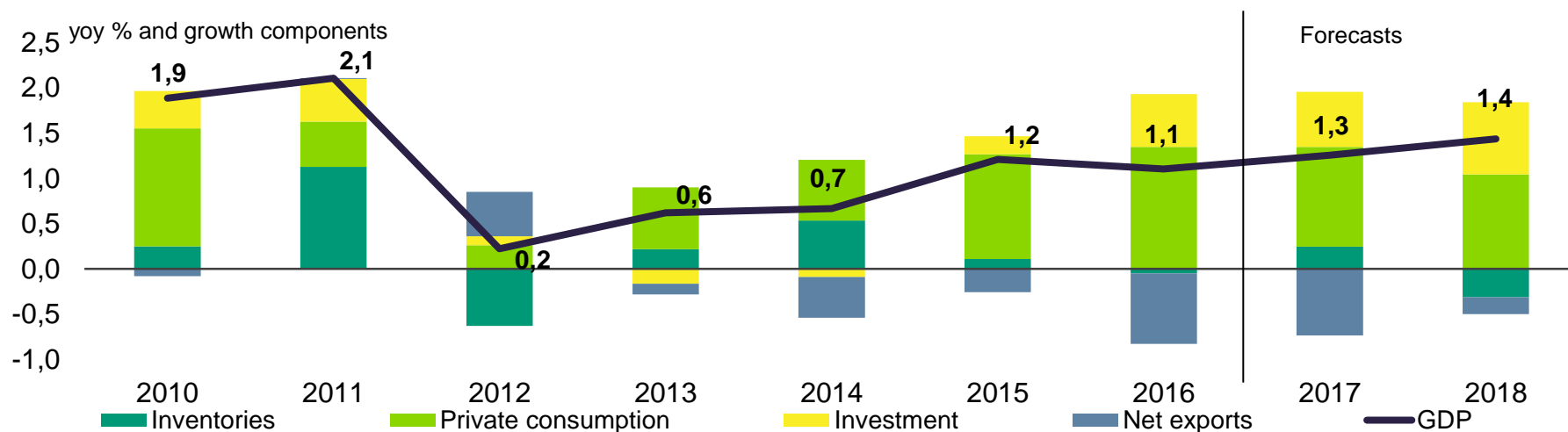
Persistent obstacles and risks, however: insufficient competitiveness, public deficit, high unemployment, and electoral uncertainty in Europe. **Hence, a recovery that will be no more than modest.**

OVERVIEW: A MODEST RECOVERY BUT WITH SIGNS OF IMPROVEMENT

France	Yearly average (YoY, %)				Quarterly growth (QoQ, %)											
	2015	2016	2017	2018	2016				2017				2018			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	1,2	1,1	1,3	1,4	0,6	-0,1	0,2	0,5	0,3	0,4	0,4	0,4	0,4	0,4	0,4	0,4
Households consumption	1,5	1,8	1,4	1,4	1,2	0,2	0,1	0,6	0,1	0,5	0,4	0,4	0,3	0,3	0,3	0,3
Total Investment	0,9	2,7	2,8	3,6	1,1	0,1	0,2	0,6	0,9	0,9	0,9	0,9	0,9	0,9	0,9	0,9
Change in inventories*	0,1	-0,0	0,2	-0,3	-0,2	-0,8	0,7	-0,2	0,6	-0,3	-0,2	-0,2	0,0	0,0	0,0	0,0
Net exports*	-0,3	-0,8	-0,7	-0,2	-0,2	0,5	-0,6	0,2	-0,7	0,0	0,0	0,0	-0,1	-0,1	-0,1	-0,1
Unemployment (Eurostat)	10,4	10,0	9,8	9,7	10,1	10,0	10,0	10,0	9,9	9,8	9,9	9,8	9,8	9,7	9,8	9,7
CPI (quarterly : YoY)	0,1	0,2	1,2	1,3	0,0	0,1	0,4	0,5	1,2	1,1	1,2	1,2	1,4	1,3	1,2	1,2
Government net lending (% GDP)	-3,6	-3,4	-3,2	-3,3												

* Contributions to GDP growth

Growth and its components



Source : Insee, Crédit Agricole S.A., 2017 Q2 to 2018 Q4 : forecasts

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Main lines of Emmanuel Macron's programme

1. **Supply-led policy**, with a continuation of the efforts to improve the competitiveness and quality competitiveness of the French economy :
 - Income tax and payroll tax reductions for firms amounting to 15 billion euros over five years; company income tax cut to 25%; transformation of the CICE tax credit into a lasting six-point reduction in payroll taxes.
 - Labour law reform: greater labour market flexibility and strengthening of collective bargaining at branch and company level.
 - Support for innovation and fast-growing sectors; 10 billion-euro increase in public investment in environmental and energy transition; digitalisation, transport, and healthcare.
2. **European integration and strengthening of the eurozone:**
 - Create a European defence fund and set a common eurozone budget.
 - Comply with 3% of GDP deficit threshold and gradually reduce the public deficit to 1% of GDP in 2022. Large-scale spending cuts are planned, estimated at 60 billion euros over five years (savings on health insurance; better incentives for getting people back into work with unemployment benefits strictly tied to efforts to find a job; public sector staff reductions).
3. **Social measures** for households, especially the most disadvantaged.
 - Higher spending (15 billion euros): state aid for education; vocational training, especially for job-seekers; hiring premiums for people coming from priority areas; unemployment benefits for people resigning their jobs and for the self-employed.
 - Tax cuts (10 billion euros): exemption from council tax for 80% of households; lower payroll taxes for employees, paid for via an increase in the CSG solidarity contribution.

Mr Macron's programme should result in a further improvement in firms' margins and cost competitiveness and hence in a recovery in investment and, in the medium-term, in employment. In addition, the planned measures in respect of labour law and unemployment benefits should lead to job creations in the medium term. The increase in public investment should help both to support innovation and improve the qualifications of young people and job seekers.

There is no certainty, however, that, due to their fairly modest scale, the support plans for firms and households will significantly reduce France's structural weaknesses. Mr Macron's programme should therefore, in all, lead to a gradual recovery in growth and jobs in 2018-2022.

In the short term, we note that the priority seems to be

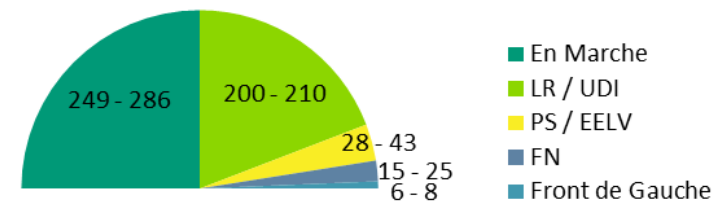
given to the speedy adoption of labour market reforms by recourse to Presidential decree. The outcome of the general election (two rounds on 11 and 18 June) places limitations on this procedure, which requires National Assembly assent.

In all likelihood, the reform will aim to: 1) generalise the inversion of the hierarchy of norms in order to bolster negotiations at company level, especially as regards wage bargaining, 2) merge the various employee representative bodies, 3) cap the amount of damages paid by employment tribunals in the event of dismissal without just cause.

On 3 May 2017, the Opinionway institute published a projection of the outcome of the forthcoming general election. This was not an opinion poll, but a projection carried out on the basis of previous election outcomes.

The study gave "La République en marche" as the biggest parliamentary group in the National Assembly, with 249-286 seats, followed by the LR/UDI group with 200-210 seats. The Front National would win 15-25 seats.

National Assembly composition forecast



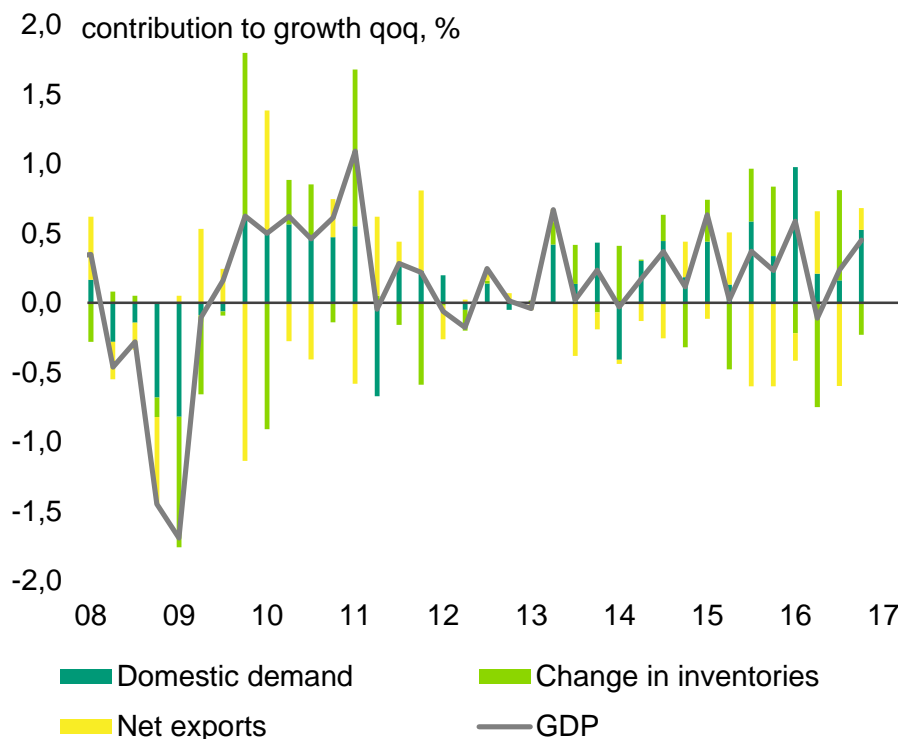
Source: Institut Opinionway (03/05/2017), Crédit Agricole S.A.

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Growth not allaying doubts

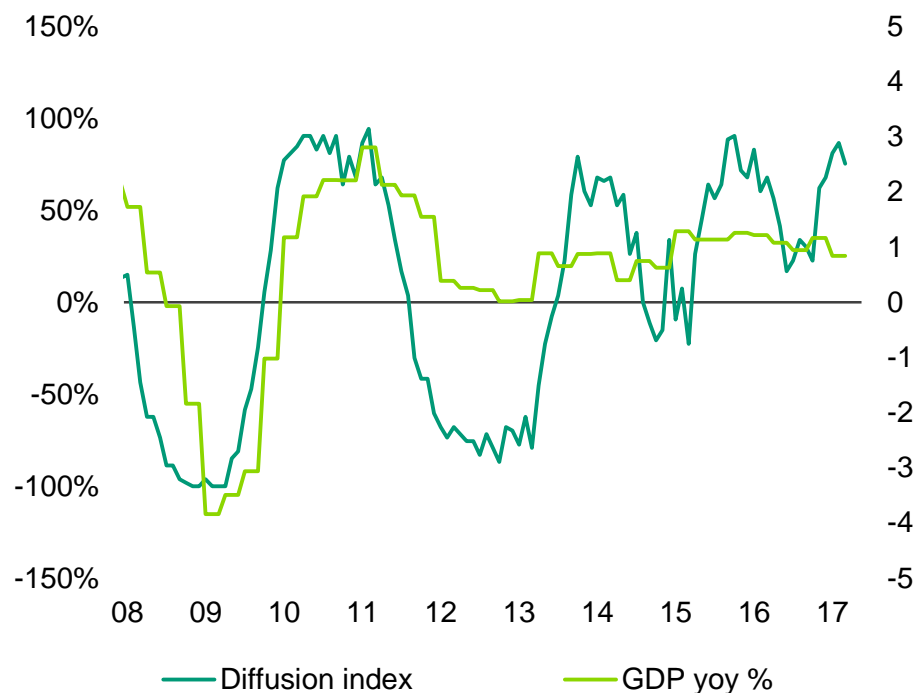


Source : Crédit Agricole S.A.

GDP saw a modest increase in Q1 2017, with growth in line with expectations (+0.3% over the quarter).

The growth figure is driven by an acceleration in business and household investment, as well as by inventories, while household consumption is virtually lifeless and foreign trade is

Growth diffusion index

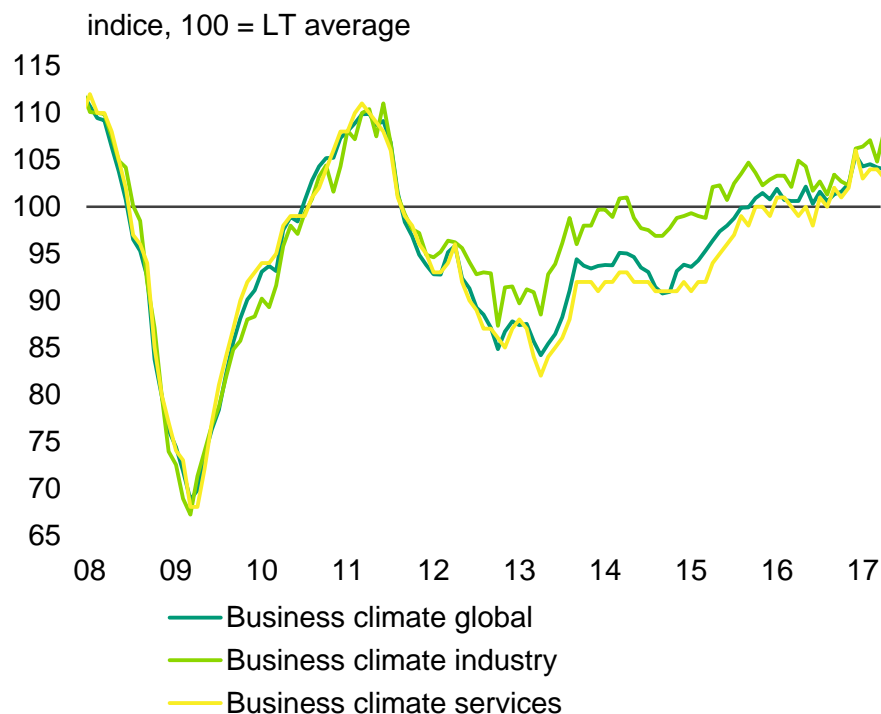


Source : Crédit Agricole S.A.

making a negative contribution.

The diffusion index shows a marked recovery at a positive 75%: this means that 75% of its variables have improved over 12 months.

Insee Business Climate survey



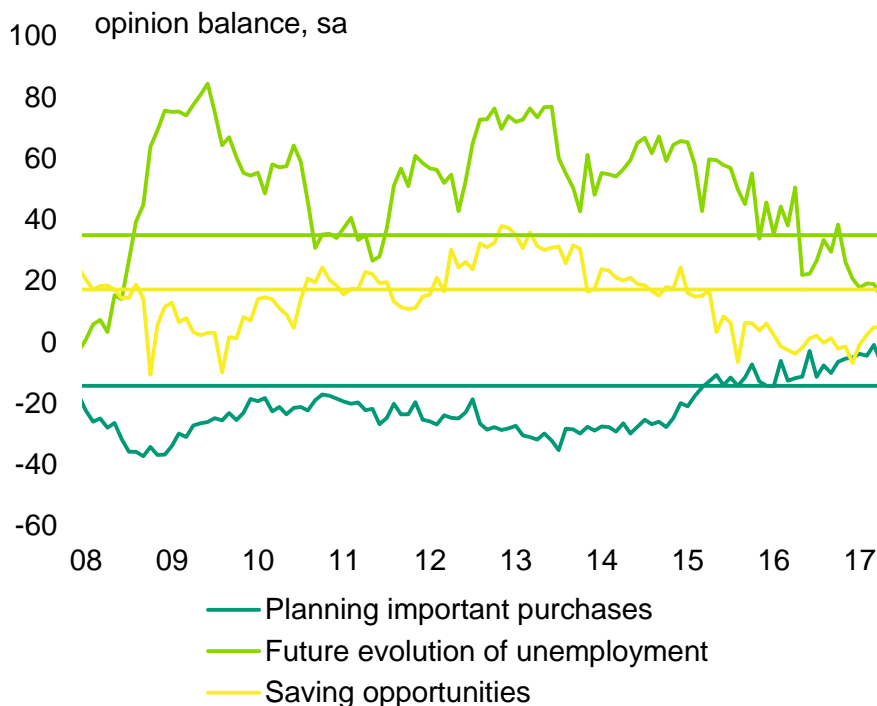
Source : Insee, Crédit Agricole S.A.

The business climate has been upbeat since the start of the year.

It shows a pick-up in growth in both services and industry.

Household confidence levels are still upbeat after rebounding

Household Confidence

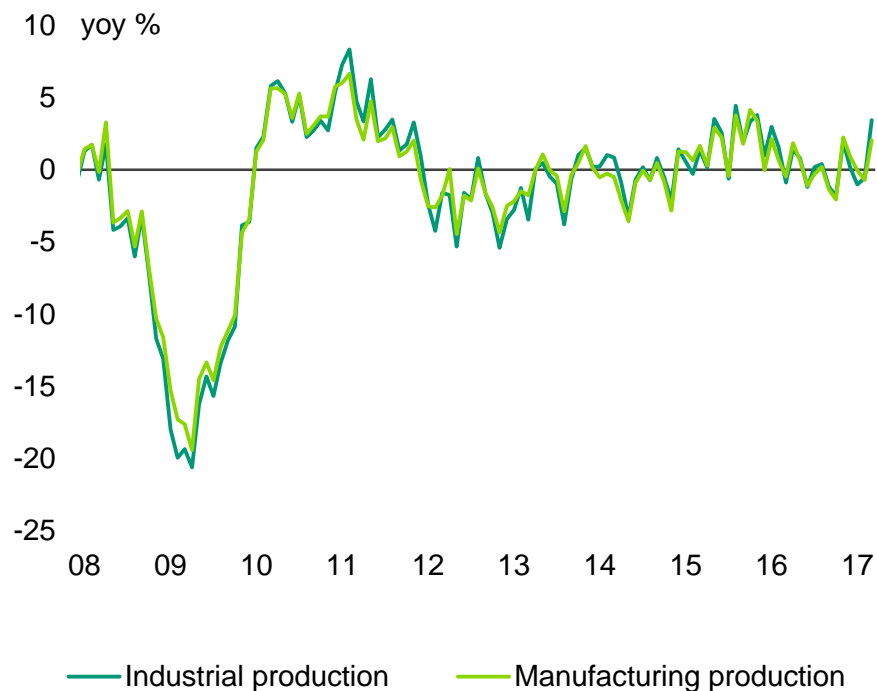


Source : Insee, Crédit Agricole S.A.

in late 2016-early 2017.

Fears about the trend in unemployment are receding, and intentions to purchase big-ticket items are on the rise.

Industrial Production



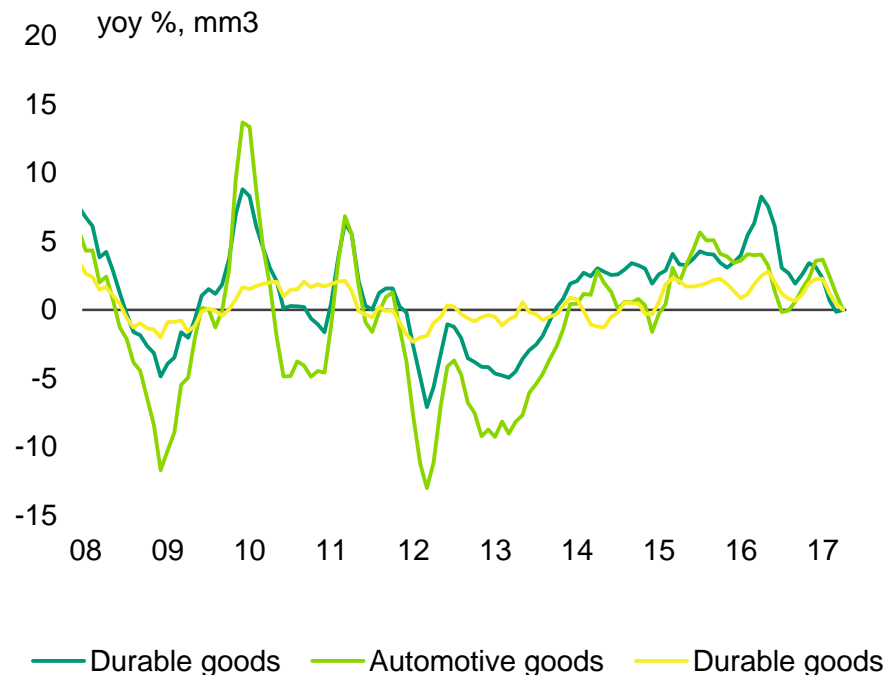
Source : Insee, Crédit Agricole S.A.

After falling for three months, manufacturing output bounced back in March.

The improvement in survey data is starting to appear in the hard data.

The growth carry-over for Q2 was 1.4% over the quarter.

Household consumption of goods



Source : Insee, Crédit Agricole S.A.

Household consumption marked time in Q1 2017, with a fairly sharp drop in goods (-0.4% over the quarter, compared with +1.0% in Q4 2016), mainly driven by the fall in energy spending.

Purchases of manufactured goods are slowing (+0.4% compared with +1.0%), mainly due to a fall-off in vehicle purchases.

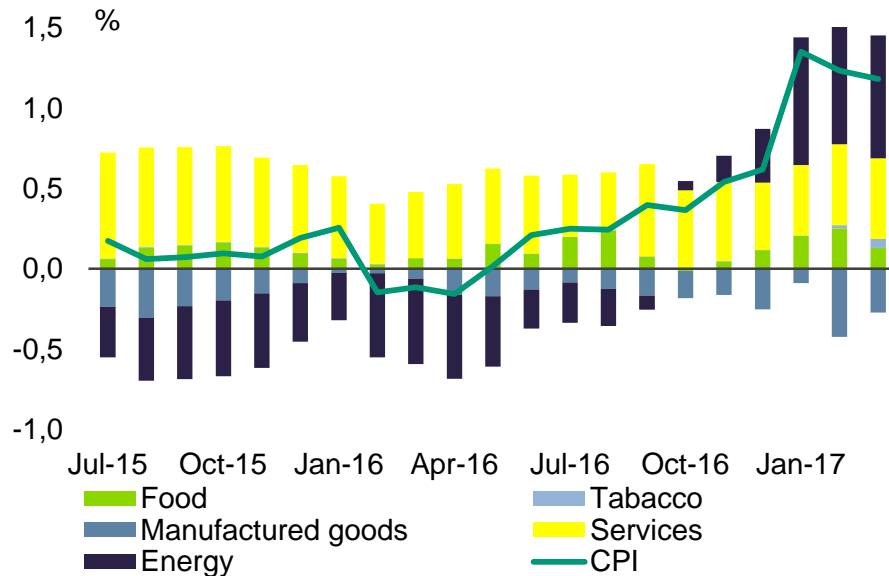
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The rate of increase in consumer prices is gathering pace. After 0.2% on average in 2016, it is forecast to reach 1.2% in 2017 and 1.3% in 2018 (*Insee definition, total inflation*).

Contributions to variations in the Consumer Price Index



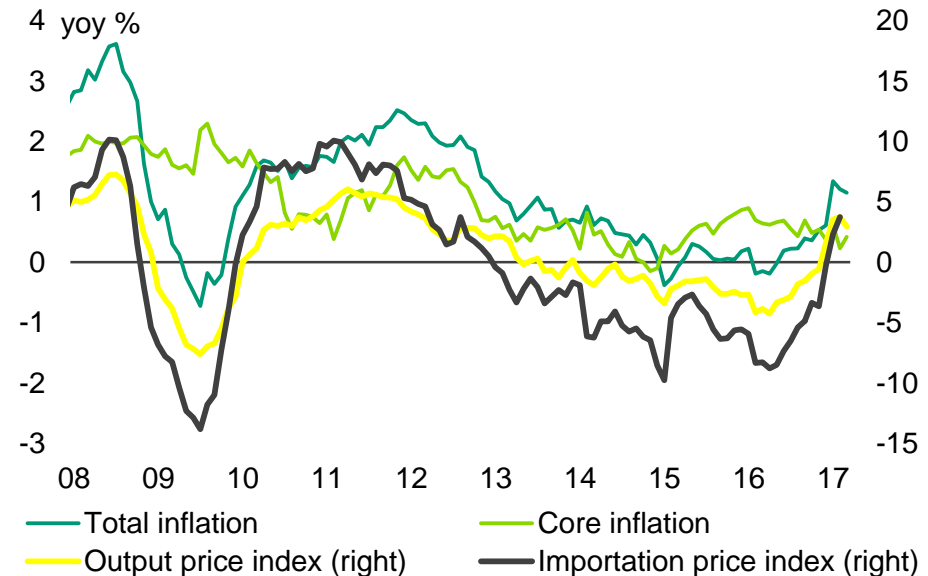
Source : Insee, Crédit Agricole S.A.

A tendency towards a resumption in inflation

After two years of near-zero inflation in 2015-2016, inflation saw a marked rebound in late 2016. The rebound was above all driven by base effects in connection with changes in energy prices. But the rebound is forecast to subside gradually.

Several factors are set to drive a modest increase in prices in 2017-2018: 1) The gradual recovery in commodity prices; 2) Producer prices are picking up in some emerging countries such as China, which may trigger an increase in imported inflation, in an

Price changes



Source : Insee, Crédit Agricole S.A.

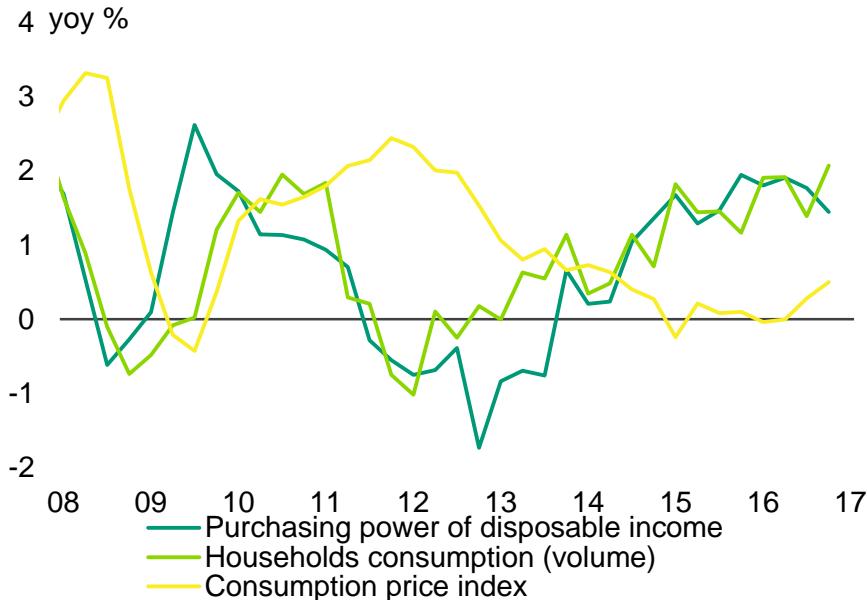
environment where the euro remains fairly weak.

But inflation should be contained...

Core inflation is resilient, but lacks momentum. It should nevertheless converge gradually on the total inflation level. Several factors are limiting inflation pressures in France: 1) The unemployment rate remains high and is being absorbed only slowly, which is generating little wage inflation (Phillips curve); 2) Prices for manufactured products are falling.

Household consumption is still driving growth, but it could slow (+1.4% in 2017 and +1.4% in 2018, compared with +1.8% in 2016).

Purchasing power and consumption

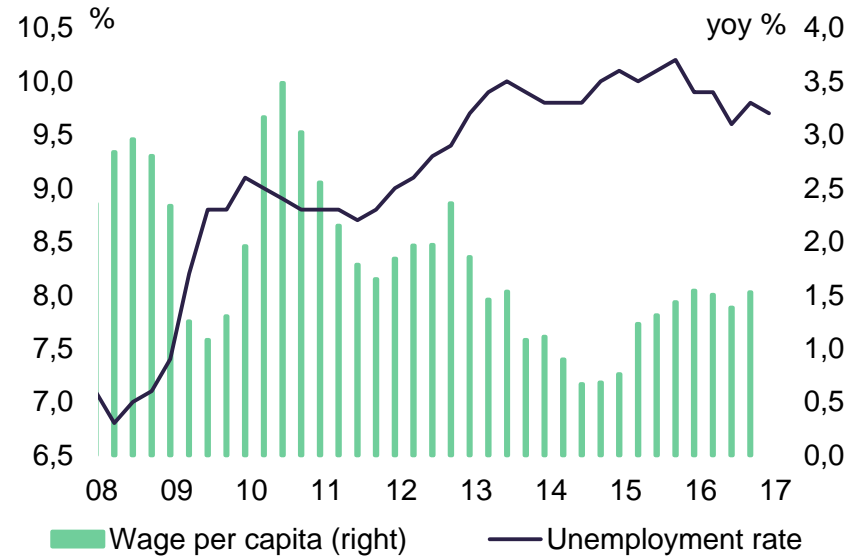


Source : Insee, Crédit Agricole S.A.

Incomes up and a lesser need to save

Private consumption is forecast to remain the main driver of growth. In 2015-2016, the household consumption trend benefitted from gains in purchasing power due to low, near-zero annual inflation over the period. In 2017-2018, the purchasing power of disposable incomes is forecast to rise fairly modestly as higher inflation returns. Wages will also continue to rise at a virtually unchanged pace of around 1.5% a year, and the unemployment rate looks set to fall modestly (to 9.3% in 2018, Insee figure for

Labour market



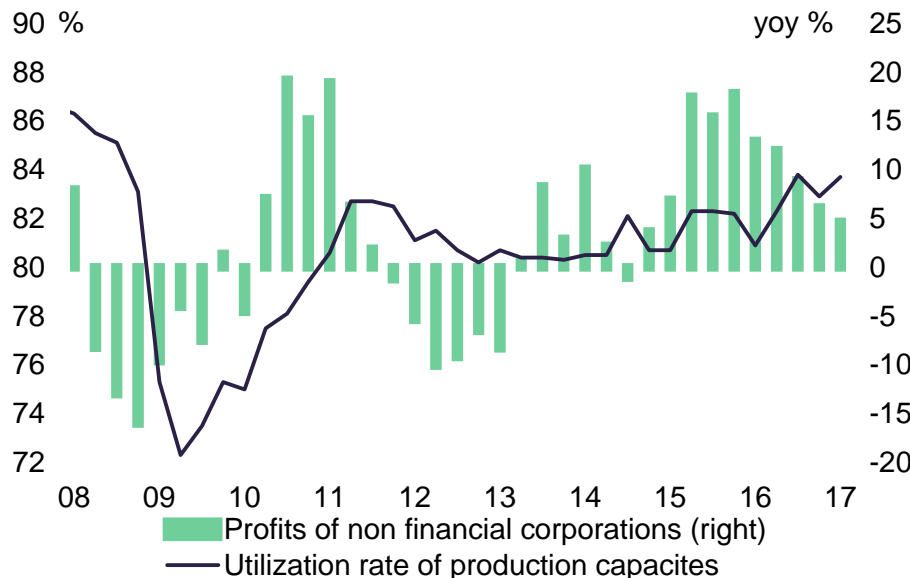
Source : Insee, Crédit Agricole S.A.

Continental France, compared with 9.7% in early 2017).

To offset the higher inflation, changes in consumption patterns will also be tributary to households' savings behaviour. However, since the 2008 crisis, households have tended to increase their personal savings rate, which stood at 15% at end-2016. In 2017-2018, they are forecast to ease back on this behaviour, which is consistent with the recent improvement in confidence.

The progressive recovery in business investment is set to continue in 2017 (+3.7%), followed by +4.7% in 2018, compared with +3.9% in 2016.

Profits and industrial capacity utilisation rate

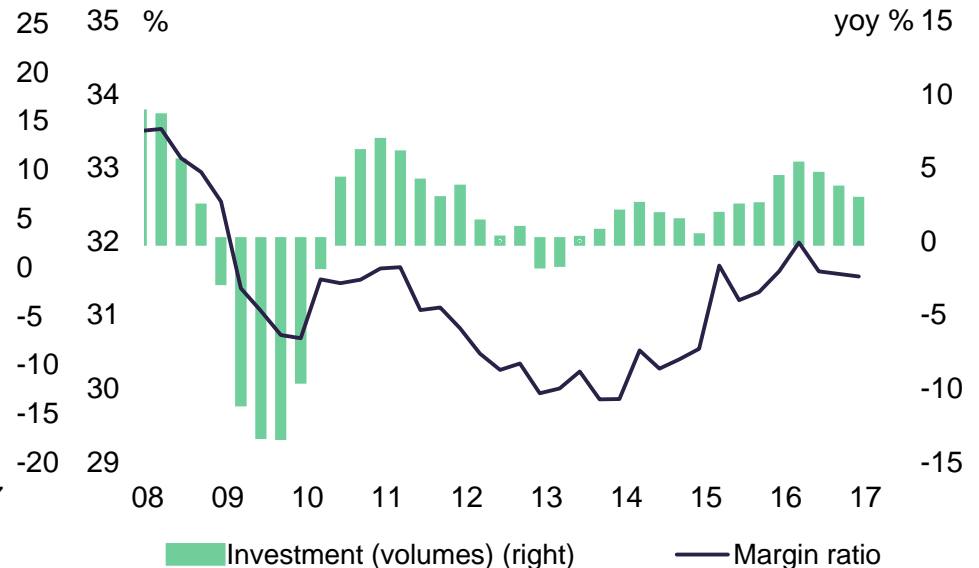


Source : Insee, Crédit Agricole S.A.

Support factors that are likely to drive investment

Business investment is forecast to see further modest growth, reflecting the improvement in corporate margins driven by economic policy measures such as the CICE tax credit and the Responsibility Pact. The margin ratio for non-financial companies reached 31.7% at end-2016, its highest since 2009, and earnings after dividends rebounded by 8% in 2016 after a 15% increase in 2015. Business cycle surveys signal honourable levels of investment intentions. We may also note that the industrial capacity utilisation rate is rising once more.

Margin ratios and investment



Source : Insee, Crédit Agricole S.A.

... but obstacles are affecting the outlook

For one thing, firms continue to sit on their hands in view of the European electoral timetable. For another, the expected impact of the economic policies implemented (CICE and Responsibility Pact) should not be underestimated because, if the economic policy measures to reduce payroll taxes have a positive impact, we cannot rule out the risk of a dilution of those same measures. In addition, there is no certainty that firms will use this stimulus to invest.

Foreign trade to make a less negative contribution to growth: -0.7 of a point in 2017 and -0.2 of a point in 2018, compared with -0.8 of a point in 2016.

PMI: new export orders and producer prices

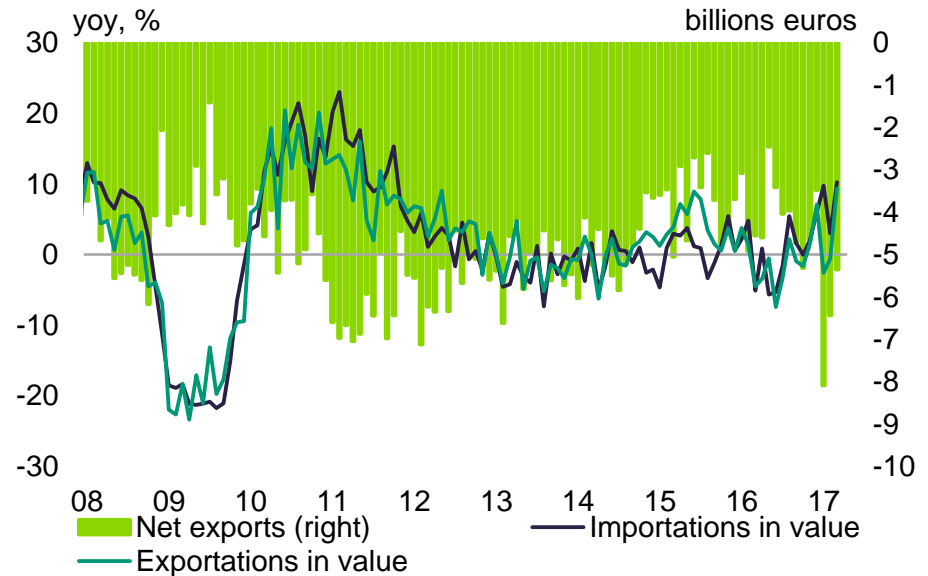


Source : Insee, Crédit Agricole S.A.

Slight improvement in exports...

We can look forward to a slight improvement in connection with stronger demand addressed to France and a fairly weak euro. The improved prospects in some emerging countries (oil producers, Russia, Brazil) and the slightly upwards revision of US growth have led to an uptick in demand. From a sectoral point of view, the delivery of certain large military contracts and the aerospace sector are having a favourable impact. The tourism sector should also see an improvement after a difficult year.

Foreign trade



Source : Insee, Crédit Agricole S.A.

... But France is saddled with a persistent competitiveness deficit and imports are still sustained...

Conversely, the French economy's structural competitiveness deficit (cost and non-cost) continues to be a hindrance, even if we can observe an improvement in the recent period. Imports, for their part, are forecast to continue growing in the wake of higher domestic demand.



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