

# Prospects

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## FRANCE – ECONOMY

### A lasting improvement?

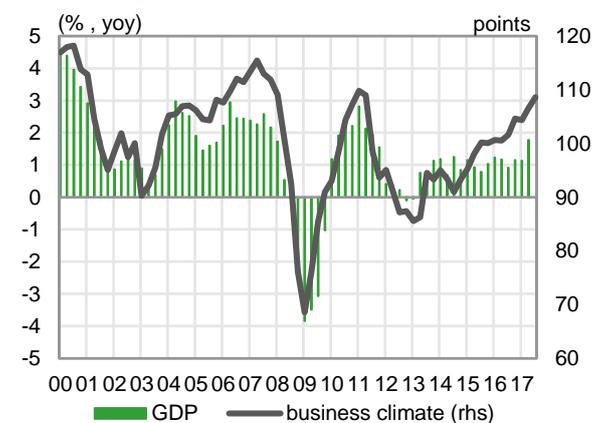
- Tangible signs of improvement in the economy have been perceptible for a number of weeks (GDP growth, business climate, labour market).
- Recent data suggest that the domestic drivers of recovery are more dynamic than initially forecast in our scenario. A self-sustaining recovery cycle seems to be falling into place.
- Several factors, however, qualify this optimistic view.
  - A number of temporary factors are sustaining growth in 2017, namely the accelerated depreciation measure, the rebound in the tourism sector, in agricultural production, and in aerospace and naval exports. Normally, these factors will not operate in 2018.
  - The financial environment remains upbeat, but long-term interest rates and above all the euro are starting to rise.
  - Some obstacles to growth persist. France continues to suffer from a shortfall in cost- and non-cost competitiveness. In addition, the need to bring down the public deficit through spending cuts may also hinder the ongoing economic expansion.
- As a result, we have revised our growth forecast upward for 2017 in view of the more dynamic than initially forecast trend and one-off catch-up phenomena. In 2018, on the other hand, growth seems unlikely to accelerate. We are forecasting growth of 1.7% in 2017 and of 1.6% in 2018.

### Tangible signs of an economic improvement

*A build-up of pleasant surprises for the French economy.*

**GDP growth.** In Q2, and for the third consecutive quarter, GDP grew by 0.5% over the quarter, slightly beating our forecast of 0.4%. That figure leaves a carry-over of 1.4% for 2017 (ie, with zero growth in Q3 and Q4). As a result, 2017 growth should reach a level unseen since 2012. In Q2 in particular, both (non-inventory) domestic demand and foreign trade should make a positive contribution to growth of respectively 0.4 and 0.8 of a point. The positive contribution from foreign trade is linked to a sharp rebound in exports (+3.1% after -0.7% in Q1) and to the marked slowdown in imports (+0.2% after +1.2%). The contribution from inventories is negative, however (-0.6 of a point after +0.7 of a point in the previous quarter).

**GDP and business climate**



Source : Insee, Crédit Agricole S.A.

**Business climate and household confidence.** Insee's business climate surveys have risen significantly since the start of the year and remain upbeat. In August, the business climate improved for the fourth month in a row to 109 points, its highest level since April 2011, and well above its trend level of 100. Note that this improvement can be seen across all sectors covered by the survey (manufacturing, construction, services, retail).

Household confidence also remained strong in August, despite falling slightly in June, and remains above its trend level, at 104 points. In particular, fears in connection with the risk of unemployment are at their lowest since 2008. The slight erosion should no doubt be put down to the elections, as a similar phenomenon was observed in 2012.

**Labour market.** The labour market is also seeing an improvement. After a rise of 0.3%, wage employment rose by 0.5% in Q2. This was the eleventh quarterly increase in a row. Over 12 months, wage employment rose by 1.5%. The improvement is particularly marked in the Temping sector (a sector that acts as a leading indicator for the labour market trend); excluding Temping, the Q2 rise was 0.3% over the quarter and 1% over 12 months. Note that the construction sector has also started to pick up, with modest job creation in the past two quarters, whereas previously it had been shrinking since 2008. The overall increase in employment has contributed to the drop in the unemployment rate, which was down 0.1 of a point in Q2, to 9.2% in continental France, back at its early 2012 level.



Source : Insee, Crédit Agricole SA

### A return of confidence as part of a self-sustaining cycle in Europe and France?

**Partly, yes.** In 2015-2016, the resumption of growth in France was driven by a combination of positive external factors, with a low oil price, rock-bottom financing rates, and the euro at a level favourable to exports. In 2017-2018, French growth is more likely to be based on a self-sustaining cyclical recovery.

Recent data have confirmed a more virtuous dynamic. Higher profits, high corporate margins, a more positive business climate, and low interest rates are driving a recovery in investment and employment underpinning a return to a strong consumption trend. The improvement in confidence and the fall in the unemployment rate could also contribute to a fall in the household savings ratio. This is leading to new job creations while improved activity levels are encouraging new investment decisions by businesses, etc. The virtuous circle is fragile, however. Unlike Germany, exports are making only a marginal contribution to this cyclical recovery and the recovery in domestic demand is largely benefitting imports.

**Recent data therefore tend to show that the engines driving recovery are slightly more dynamic than initially forecast. But several factors point to the need to qualify this view.**

### Temporary factors underpin growth in 2017

Growth in 2017 is being underpinned by a number of one-off factors, which are by definition not lasting. Among them:

- **The accelerated depreciation measure applied between April 2015 and April 2017** triggered a windfall effect on investment spending in the early part of the year as business leaders acted before the end of the measure. Acquiring new manufacturing equipment gave firms a one-off tax break allowing them to deduct 40% of the asset's cost price from their taxable income.

- **The tourism sector**, which had suffered from a difficult economic environment following the terror attacks of 2016, has also seen a year of catch-up. In 2016, the tourism balance (exports minus imports of goods and services in the tourism sector) had significantly deteriorated, shaving 0.2 of a point off GDP growth. In 2017, we may see a return to a more upbeat situation, with the tourism balance not making a negative contribution to growth. In the first quarter of 2017, the recovery in use of collective tourist accommodation in continental France has been confirmed. Overnight stays increased by 1.1% compared with the same period in 2016, after a 3.8% rebound in Q4.

- **Agricultural production** is recovering following a pronounced fall in 2016 due to poor weather. The added value of the agricultural sector (2% of total added value) fell by 9.8% in 2016. If it continues at its present growth rate, it would increase by around an annual 6% in 2017, adding 0.1 of a point of growth to GDP.

- **Exports have also seen a one-off sustained increase in 2017 due to the timetable for**

**deliveries of major aerospace and naval contracts.** For example, exports were boosted in Q2 by shipyard activity, with STX France delivering a giant cruise ship during that period. French exports are nevertheless hampered by a lack of competitiveness.

**Another factor that could temper the current optimism is developments in the financial environment.** The environment is accommodative, it is true, with an oil price struggling to gain upward traction and still-low interest rates, but the impact of these factors should progressively decrease. We are forecasting a rise in the oil price to around 59 dollars a barrel (Brent) by end-2018 and modest upward pressure on OAT rates, which should rise to 1.35% at end-2018, as against the current 0.7%. Moreover, the recent strengthening of the euro, partly due to improved forecasts for eurozone growth prospects, could erode some of the price competitiveness of French products, adversely affecting the outlook for exports. Our scenario assumes a euro/dollar exchange rate of 1.21 by end-2018 (vs. the current 1.19). According to the OECD's interlink model, a 10% strengthening of the euro against all other currencies leads to a 0.5% loss of GDP growth in the first and second years<sup>1</sup>. Since early 2017, the increase in the effective nominal exchange rate has been about 5%, which therefore represents around 0.2-0.3 percentage points of growth a year, but the impact is believed to have been partly offset by the recovery in world trade.

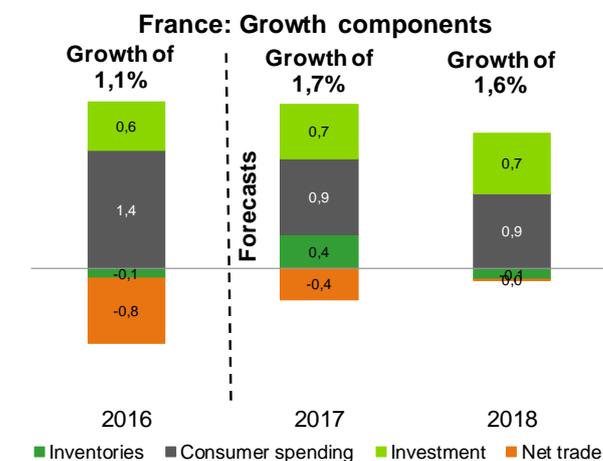
**Last, the French economy's more structural handicaps continue to have an adverse impact on the outlook for growth.** France continues to suffer from a lack of competitiveness, both cost- and non-cost, as testified especially by the balance of foreign trade in manufactures. The cumulative deficit over the 12 months from July 2016 to June 2017 amounted to 59.8 billion euros, compared with 50.2 billion for 2016. Moreover, the need to reduce the public deficit via fiscal restrictions may also partly restrict the ongoing economic expansion. Fiscal consolidation is set to continue in 2018. A massive programme of tax cuts and payroll taxes totalling 15 billion euros has been announced, but

at the same time, some 20 billion euros' worth of spending cuts will be implemented, for a slightly negative net impact on growth, in the short term, at least. A fall in consumption or government investment has a direct impact on GDP. Conversely, the effects of tax cuts are less immediate and are cushioned by a rise in savings (for households) and the import content of demand. In the mid-term, however, the fiscal measures have a greater impact and tend to improve potential growth.

**Consequently, it seems likely that most of the pleasant economic surprises are now behind us and that growth will struggle to sustain the same pace over the coming quarters.**

### Our scenario for 2017-2018

**As a result, we have revised our growth forecast up for 2017 in view of the slightly more dynamic than expected domestic momentum and one-off catch-up phenomena. For 2018, however, we expect that growth will not accelerate. We are therefore forecasting growth of 1.7% in 2017 and of 1.6% in 2018.** The growth will mainly derive from non-inventory domestic demand, with positive contributions from investment and consumption. Conversely, the contribution from foreign trade is likely to be virtually zero over the same period. ■



<sup>1</sup> Les effets de l'appréciation de l'euro sur l'économie française, Franck Cachia, June 2008.

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