CRÉDIT AGRICOLE S.A.

13 May 2019

FRANCE
2019-2020 SCENARIO

OLIVIER ÉLUÈRE

“Gains in purchasing power in 2019-2020, will limit the growth slowdown.”

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FRANCE
SCÉNARIO 2019-2020

1 EXECUTIVE SUMMARY
2019: PURCHASING POWER MORE UPBEAT … IN A SLIGHTLY LESS UPBEAT GLOBAL ENVIRONMENT

GDP growth in France came in at 1.6% in 2018, an honourable rate, and above the potential figure of 1.3%, although it marked a slowdown relative to 2017 (2.3%).

Quarterly growth was lower in the first half of 2018 (0.2% per quarter). It was more sustained in the second half (0.3% per quarter) despite the upheavals linked to the *gilets jaunes* crisis, which cost 0.1-0.2 percentage points of GDP in Q4. Growth again stood at 0.3% in Q1 2019.

We are forecasting a very slight growth slowdown in 2019 and 2020, to 1.4% a year. For one thing, the roll-out of two series of measures to boost purchasing power (December 2018 and April 2019) will stimulate household consumption, even if the significant gains in income will be partly put into savings. For another, the dip in global growth and the political, geopolitical and economic uncertainties (trade wars, Chinese slowdown, Brexit, etc.) are likely to have a downside effect on exports and business investment.

Compared with the rest of the eurozone, the growth slowdown in France is less marked in view of the support measures and of the less direct exposure than in Germany and Italy, for example, to the global manufacturing cycle.

Main scenario components

1. Household consumption will benefit from the lower taxes and contributions included in the 2019 budget, from the support measures announced in late 2018 in the wake of the *gilets jaunes* crisis and the new measures announced in April 2019 in response to the findings of the Great Debate (*Grand Débat)*. Adding up all three packages, households will benefit from a "net" 13 billion euros' worth of support measures in 2019 and 10 billion euros' worth of new measures in 2020. These measures will generate substantial purchasing power gains of respectively 2.6% and 1.5%. The rate of increase in consumption will be moderate in 2019, however, at 1.4%, due to a significant increase in the personal savings rate, in connection with a very lacklustre climate of confidence. Consumption is forecast to grow 1.5% in 2020.

2. Investment by nonfinancial companies is forecast to continue growing for the sixth year in a row due to trends in corporate profits (stimulated in 2019 by switching the CICE to a reduction in contributions) and a very low cost of borrowing. We have nevertheless revised our forecast downwards given the international uncertainties and the slowdown in export markets. Business investment should rise by 3% in 2019, and by 2.8% in 2020, compared with 3.9% in 2018.

Household investment, which saw a marked rebound in 2016-2017 due to strong momentum in new-build home sales, suffered a sharp slowdown in 2018, partly due to the refocusing of the Pinel buy-to-let scheme and the PTZ interest-free loan on areas of tight supply. This trend looks set to accelerate in 2019 and 2020.

3. Foreign trade's net contribution to growth was, for once, positive in 2018 (+0.6 of a point), as imports have been less dynamic in the recent period. It should return to slightly negative territory in 2019-2020, (-0.1 then -0,3 of a point), as imports resume their upward momentum in the wake of further strong domestic demand, fuelled in particular by consumer spending. Exports, for their part, will feel the effects of the global slowdown, with the added unfavourable effect of a rise in the nominal effective exchange rate.

4. The **unemployment rate** is forecast to edge back in the wake of the extended economic recovery. It is forecast to stand at an average 8.5% in 2019 and 8.3% in 2020, after 8.7% in 2018 (Insee data, continental France). This fairly slow decline is linked to a lower annual level of job creations (+0.5% a year in 2019-2020 compared with +1% in 2018). This can be explained by the reduction in the number of assisted contracts, the tail-off in the positive effects of the CICE and the Responsibility Pact, and the slight growth slowdown.

1 OVERVIEW

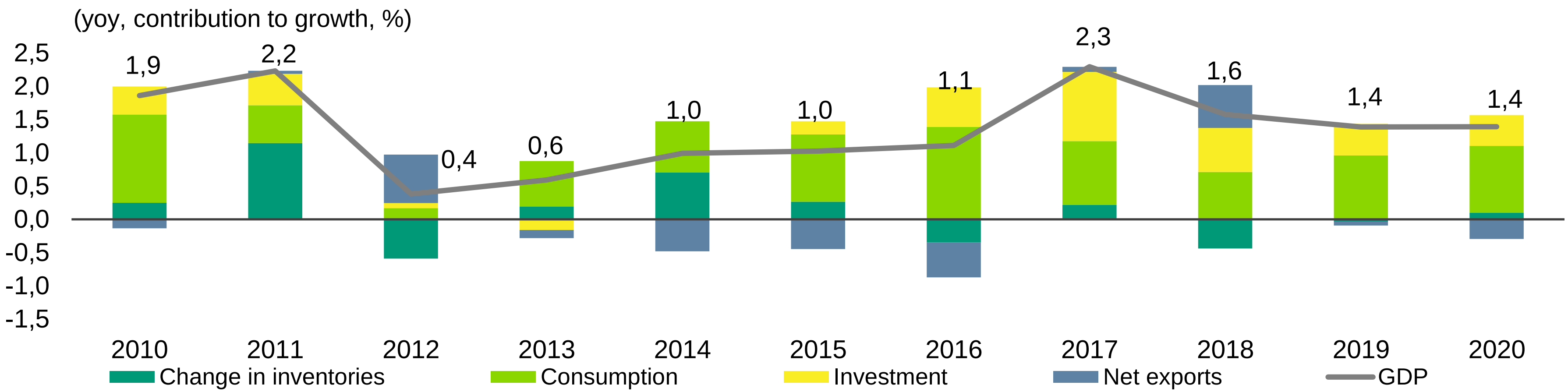
GROWTH FORECAST TO RELY EXCLUSIVELY ON DOMESTIC DEMAND, AND ON CONSUMPTION IN PARTICULAR

France	Yearly average (YoY, %) 2016	2017	2018	2019	2020
GDP	1,1	2,3	1,6	1,4	1,4
Households consumption	2,0	1,1	0,8	1,4	1,5
Investment	2,7	4,7	2,9	2,1	2,0
Corporate investment	3,4	5,2	3,9	3,0	2,8
Change in inventories*	-0,3	0,2	-0,4	0,0	0,1
Net exports*	-0,5	0,1	0,6	-0,1	-0,3
Unemployment (Insee)	9,8	9,1	8,7	8,5	8,3
CPI Insee (yoy)	0,2	1,0	1,9	1,0	1,2
Government deficit (% of GDP)	-3,4	-2,8	-2,5	-3,3	-2,2

France	Quaterly growth (QoQ, %) 2017 Q1	2017 Q2	2017 Q3	2017 Q4	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q5	2019 Q6	2019 Q7	2019 Q8
GDP	0,8	0,7	0,6	0,7	0,2	0,2	0,3	0,3	0,3	0,4	0,4	0,4
Households consumption	0,0	0,3	0,5	0,2	0,3	-0,2	0,4	0,0	0,4	0,6	0,5	0,5
Investment	2,3	0,8	1,3	1,0	0,1	0,9	1,0	0,4	0,3	0,6	0,5	0,5
Corporate investment	3,0	0,7	1,6	1,3	0,0	1,2	1,6	0,4	0,4	0,8	0,7	0,7
Change in inventories*	0,8	-0,7	0,2	-0,2	0,0	0,2	-0,5	-0,1	0,3	0,0	0,0	0,0
Net exports*	-0,6	1,0	-0,3	0,5	0,1	-0,2	0,3	0,3	-0,3	-0,1	0,0	0,0
Unemployment (Insee)	9,3	9,1	9,3	8,6	8,9	8,7	8,8	8,5	8,7	8,6	8,4	8,1
CPI Insee (yoy)	1,2	0,9	0,9	1,1	1,4	1,9	2,2	1,9	1,3	1,0	0,9	1,0
Government deficit (% of GDP)												

* Contributions to GDP growth

Source : Crédit Agricole SA, estimates



Source : Insee, Crédit Agricole S.A.

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FRANCE
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1 OVERVIEW

2 | FOCUS: RESPONSE TO THE GREAT DEBATE

3 RECENT ACTIVITY TRENDS

4 OUR SCENARIO FOR 2019-2020

2 FOCUS: RESPONSE TO THE GREAT DEBATE
PRINCIPAL DEMANDS EMERGING FROM THE GREAT DEBATE

In the wake of the *gilets jaunes* crisis, a great national debate was organised in January-March 2019. The consultation came in a variety of forms, especially online contributions. In the economic and social sphere, two main demands stand out from the 530,000 contributions analysed. First is a sense of fiscal exasperation, with twin desires for tax cuts and a fairer tax system. Second was strong demand for public services.

Tax cuts

Households massively asked for tax cuts. The measure most often cited was a cut in VAT (28.2% of respondents), especially on essentials, followed by cuts to income tax (18.8%), local taxes (11.6%) and social security contributions (7.7%).
Eco-taxes, which kicked off the *gilets jaunes* rebellion, were a point of contention: 58% of respondents rejected ”punitive taxation” (eg, carbon taxes), designed to encourage people to change their behaviour, while 55% felt that an increase in diesel or petrol taxes would have scant impact on their behaviour.

A fairer tax system

Respondents also asked for greater fiscal justice, via several proposals:
- Broaden the tax base: 34.7% wanted everybody to pay income tax;
- Increase the contribution from the highest incomes (27,8%), in particular by abolishing tax loopholes (11.8%) and bringing back the ISF wealth tax (10.3%);
- Revise corporate taxation (12%), especially via a tax on GAFA (3%) and a fairer balance between SMEs and major corporates (6%);
- Combat tax fraud and evasion 11.3%).

Improve public services

Respondents wanted public services nearer to home, accessible throughout the country and stepped up in certain areas: healthcare, education, and the ecological transition.

- Healthcare: the area most cited when it came to bolstering social protection (27.8%) and where access to public services is deemed to be insufficient (30.4%). Suggested avenues: measures to counter medical deserts, creation of healthcare centres in rural areas.
- Ecological transition: a major concern. The main avenue suggested: improving public transport networks (43%). Moreover, 86% feel they can contribute to safeguarding the environment.
- Improving the territorial balance and the need for more local services: a rebalancing between large regional capitals and small and mid-sized town; more everyday transport, and more grass-roots public sector workers.
- Administrative simplification. Some 49% say they have already given up on applying for a benefit due to the complexity of the application process, and 86% feel there are too many administrative layers

Control public spending

At the same time, to narrow the deficit, the vast majority (75%) of respondents would prefer to see cuts in public spending rather than higher taxes (4%).

- Priority goes to cutting state spending (56%), mainly in the areas of defence (28%) and housing policy 22%), rather than to cutting local government spending (18%) and welfare spending (16%).
- Main avenues for spending cuts: revise the conditions for allocating welfare benefits (52%); increase weekly working hours (24%); raise the retirement age (22%).

2 FOCUS: RESPONSE TO THE GREAT DEBATE

RESPONSES TO THE DEMANDS

In the face of these multiple demands and of the ongoing *gilets jaunes* crisis, the French President made a speech on Thursday 25 April, once again setting out the main lines of his economic policy and announcing a number of new measures.

Main lines retained

Main outlines of the economic policy, for the most part retained :

- the supply-side policy and continuing effort to restore the cost and quality competitiveness of French firms via tax cuts; the switch from the CICE to lower contributions; and the PACTE Act, among others;
- support for innovation, research, and high-growth sectors;
- redeployment of resources in favour of labour (labour law reform and the ongoing reform to unemployment insurance);
- priority for education and the fight against poverty and downward social mobility (aid for education, vocational training and apprenticeship reform; support measures for work).

Restatement of the objective to pursue ongoing reforms over the coming months, especially to pensions and unemployment insurance.

Incentives to work more. No further easing of the 35-hour week but measures applying to retirement. The statutory retirement age is likely to be kept at 62, but an incentive system will be put in place designed to encourage households to work longer and to encourage (but not require) a longer contribution period.

New purchasing power support plan

The fourth aspect has been clearly strengthened. The supply-side policy will now go hand-in-hand with a **new raft of measures to stimulate demand**, mainly aimed at the middle classes.

These measures will come into play from 2020 and will cost a total of around 8 billion euros.

- A cut in personal income tax valued at 5 billion euros in 2020, mainly aimed at the middle classes. The terms have yet to be defined and will be announced in June.
- Re-indexation of pensions of less than 2,000 euros a month in 2020 (cost: around €1.4 billion) and of all retirement pensions in 2021. The lowest pension will be increased to 1,000 euros a month.
- An exceptional premium for firms net of tax and contributions to be renewed in 2020 (cost: around €1 billion).
- Recovery of unpaid alimony by child benefit agencies

Support for education and territorial rebalancing

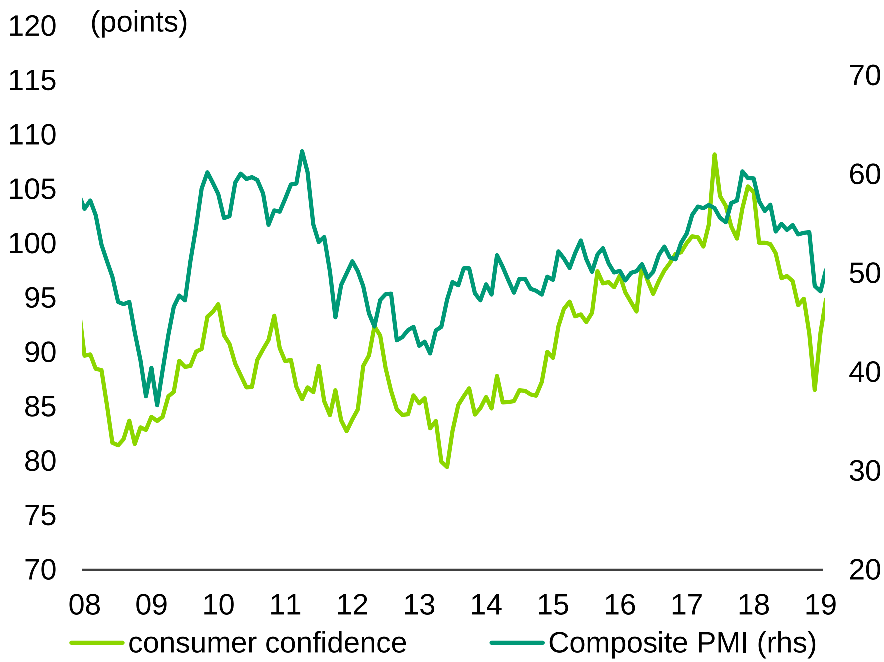
- **Education**. No class from reception to Year 3 may exceed 24 students. This would lead to the creation of around 10,000 new teaching posts.
- **Territorial rebalancing**. School and hospital closures without the mayoral agreement to be halted by 2022. Creation of “France services” branches able to deliver a number of public services in each local government district. Following the 2014 reorganisation, there are new 2,054 such districts in France, or 20 in each *département*.

For more details, see our *France Political Issues, Response to the Great Debate*

2 FOCUS: RESPONSE TO THE GREAT DEBATE

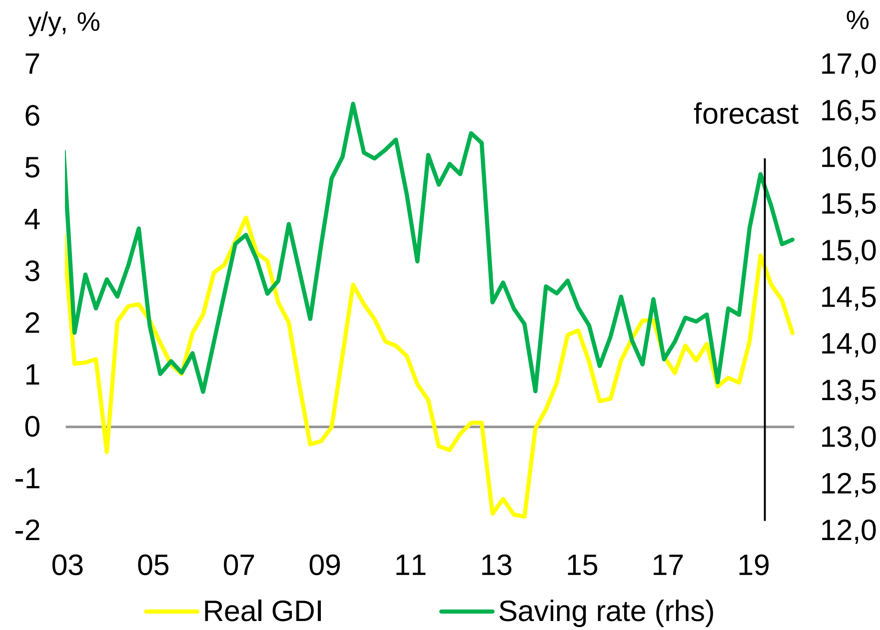
IMPACT OF THE SUPPORT MEASURES

Household confidence



Source : Insee, Crédit Agricole S.A.

Incomes and savings rate



Source : Insee, Crédit Agricole S.A.

The support plan announced comes on top of a recent series of tax and social security contribution cuts rolled out in the 2019 budget and in last December's purchasing power support plan. Adding the three sets of measures together, households look set to benefit from a "net" 13 billion euros in support measures in 2019 and 10 billion euros in new measures in 2020.

In view also of a relatively favourable trend in per capita wages and staffing levels, households' nominal income is likely to grow by a substantial 3.6% in 2019 and 2.7% in 2020. Households should see marked gains in purchasing power of 2.6% in 2019 and 1.5% in 2020.

Consumption should also pick up, but to a lesser extent. In 2019, it is forecast to grow only 1.4% due to a sharp rise in the personal savings rate, to 15.3% compared with 14.4% in 2018. Households will persist with their precautionary savings behaviour and will only gradually spend the gains delivered by the support plans.

This is because household confidence is still poor. It had severely deteriorated in 2018, although it picked up slightly in early 2019 but is still below its trend level. The balance of household opinion on their future financial situation remains low and fears concerning unemployment trends have firmed in recent months.

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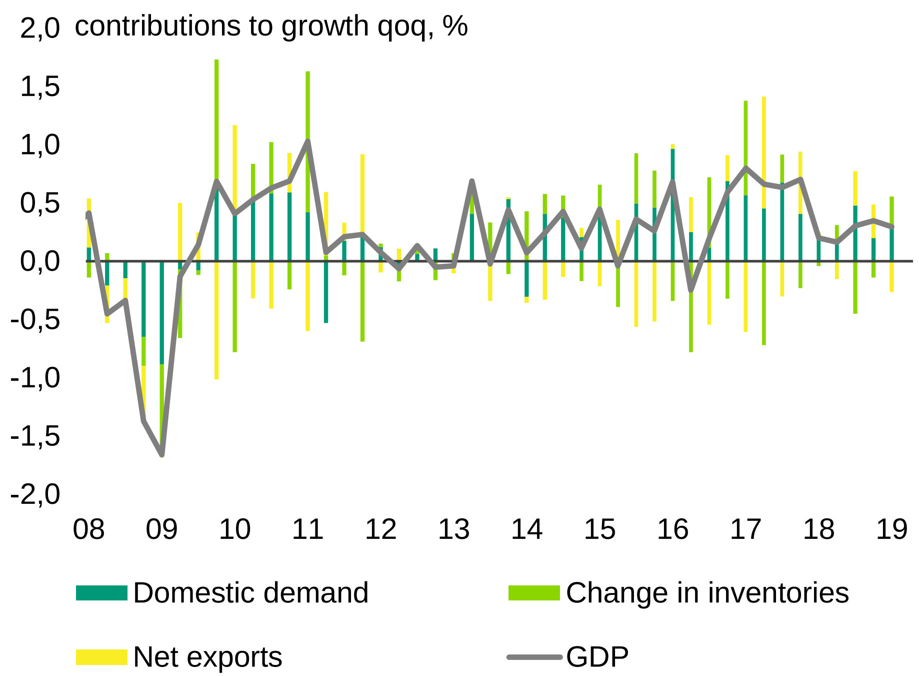
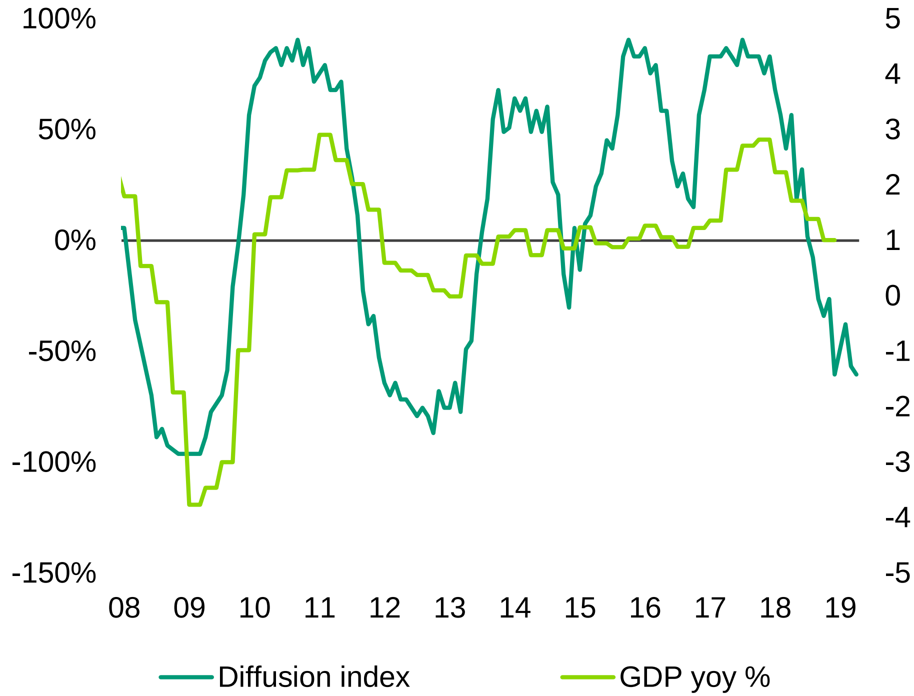
3 RECENT ACTIVITY TRENDS
GROWTH RESILIENT, BUT STILL MODEST

Quarterly growth and contributions



Source : Insee, Crédit Agricole S.A.

Diffusion index and growth



Source : Insee, Crédit Agricole S.A.

In Q1 2019, volume GDP grew 0.3% quarter-on-quarter (initial Insee estimate), a pace similar to that observed in the previous quarter.

Over the quarter, household consumption rebounded to 0.4%, compared with 0% in Q4 2018, partly due to the marked increase in incomes on the strength of the December 2018 support measures in the wake of the *gilets jaunes* crisis.

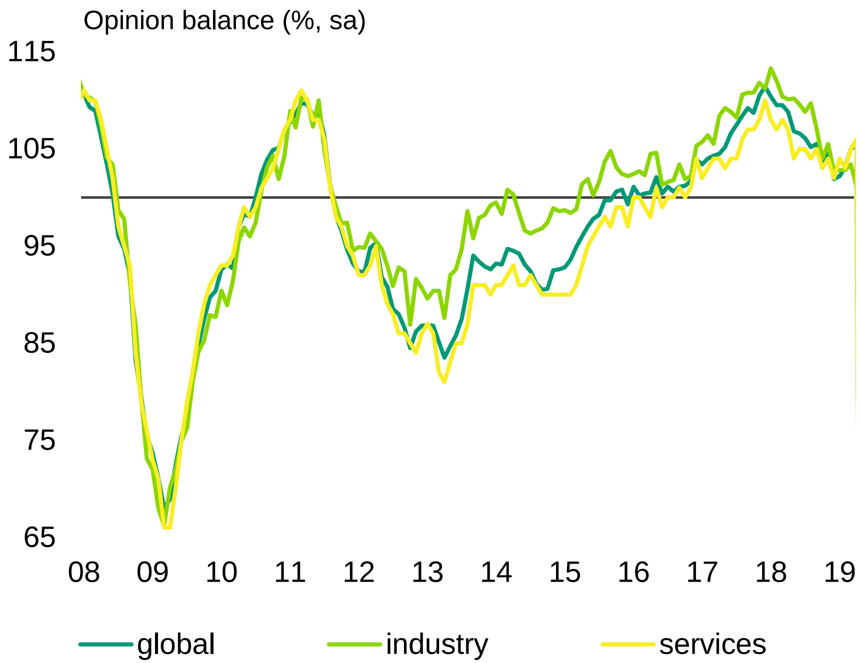
Business investment, on the other hand, saw a modest increase, of 0.4%, while exports slowed sharply, to +0.1%, as a result of the carryover effects of large-scale aircraft deliveries recorded in late 2018.

The (trend) diffusion index is in negative territory, at -60% in April. Around 80% of the variables used to calculate the diffusion index are running at a lower level than last year. The indicator is at its lowest level since 2013, and has been in a relentless decline since year-end 2017. Survey data largely explain the fall, while the “hard” data are a tad more upbeat.

3 RECENT ACTIVITY TRENDS

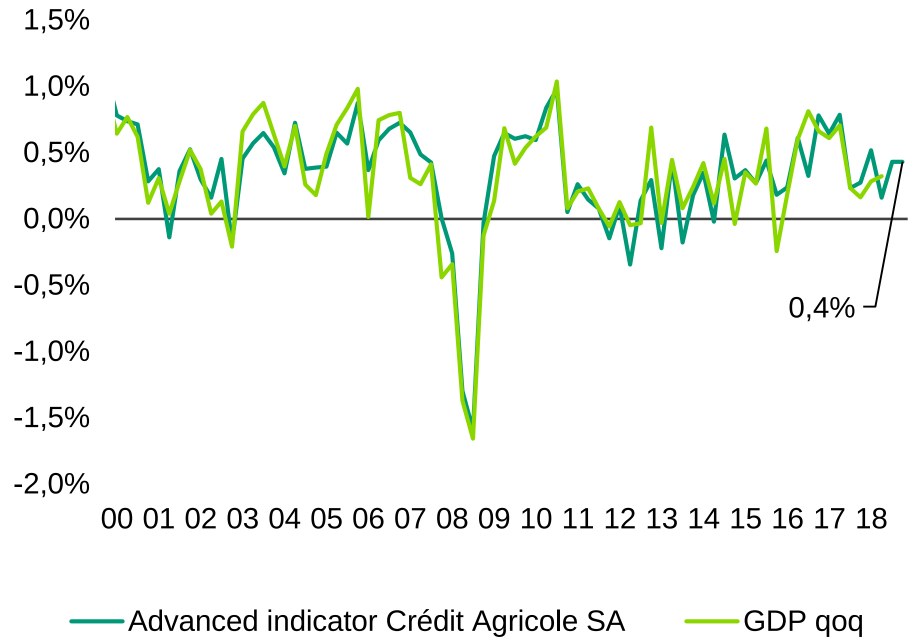
SURVEY DATA PICK UP SLIGHTLY AT THE START OF THE YEAR

Insee Business climate



Source : Insee, Crédit Agricole S.A.

Lead GDP growth indicator



Source : Insee, Crédit Agricole S.A.

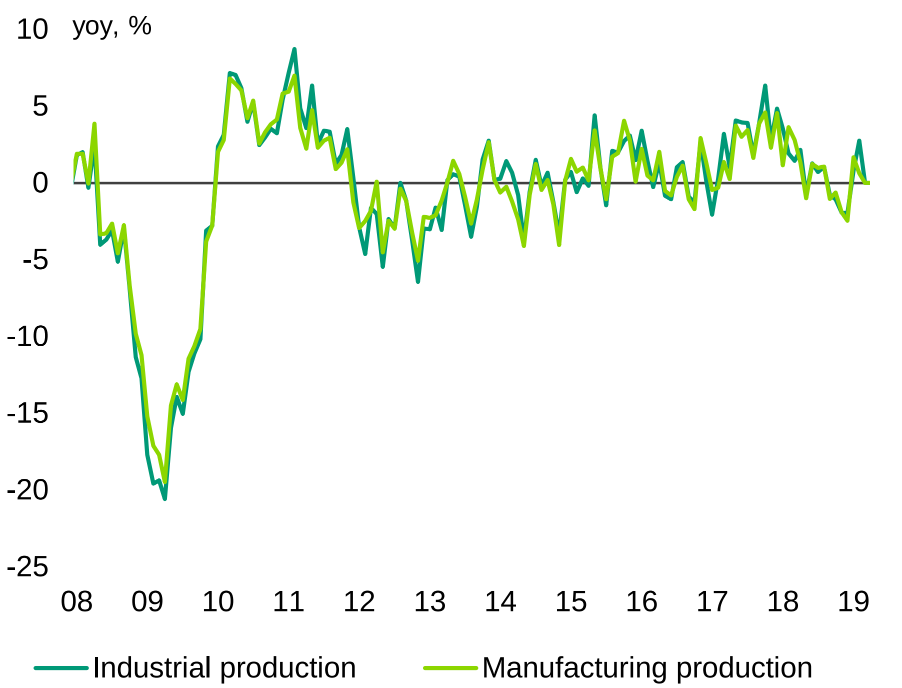
The Insee business climate indicator stood at 105 points in April, as in March, 3 points above its December 2018 low as a result of a slight improvement in services and retail. On a sector-by-sector basis, and relative to the previous month, the business climate indicator shed two points in manufacturing (101 points) and one point in the construction sector (111). It gained one point in services (106) and 2 points in retail (105). Elsewhere, the employment climate deteriorated after rising during the first three months of the year.

Note that the PMI business climate calculated by Markit picked up a little in April (50), a two-month high, on the strength of an increase in services, while the manufacturing sector is still below the 50-point threshold and falling slightly (a 4-year low). The PMI business climate gives a more degraded view of the economy than the business climate calculated by Insee, given the marked drop recorded in December at the time of the events triggered by the *gilets jaunes* demonstrations.

The level of the business climate calculated by Insee is consistent with our own Q2 GDP growth forecast of +0.4%, a slight acceleration relative to Q1's 0,3%. Our lead GDP growth indicator also suggests that growth could reach 0.4% in Q2,

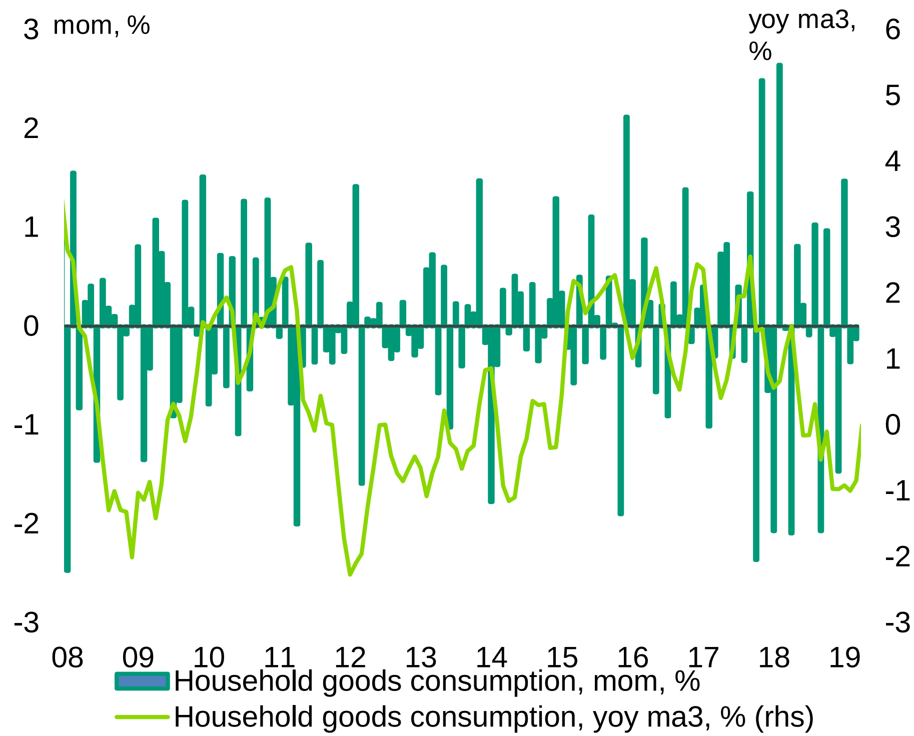
3 RECENT ACTIVITY TRENDS
ACTIVITY DATA STILL UNEVEN IN Q1, ESPECIALLY IN CONSUMPTION

Industrial production



Source : Insee, Crédit Agricole S.A.

Household consumption of goods



Source : Insee, Crédit Agricole S.A.

Production accelerated in manufacturing industry in February (+1.1% from +0.7%) as across the whole of industry (+0.4% from 1.2%). Over the last three months relative to the previous three months, industrial production rose by 0.7% (+1.0% for manufacturing production). The growth carryover for Q1 is markedly positive at +1.2% at end-February. Note that added value in the industrial sector accounts for around 13% of GDP. This favourable growth carryover is consistent with GDP growth of 0.3% in Q1.

In March, households' consumer goods spending fell by 0.1% by volume compared with -0.4% in February and 1.5% in January.
Q1 goods consumption rose by 0.2% relative to the previous quarter. Following the 0.6% fall observed in Q4 2018 as a result of the *gilets jaunes* movement, for the time being we have not observed any very marked catch-up despite the support measures.

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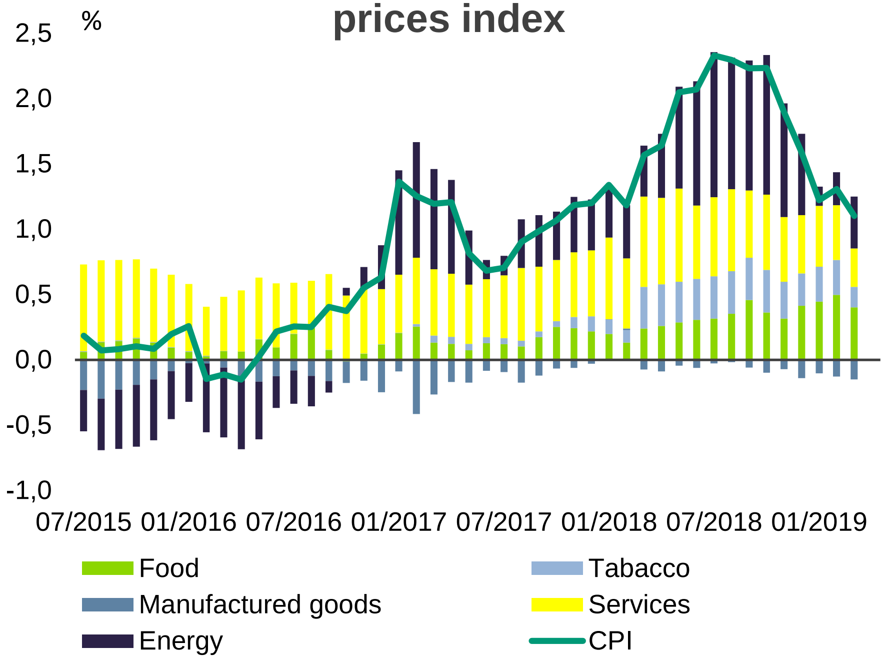
4 OUR SCENARIO FOR 2019-2020
CONSUMER PRICES

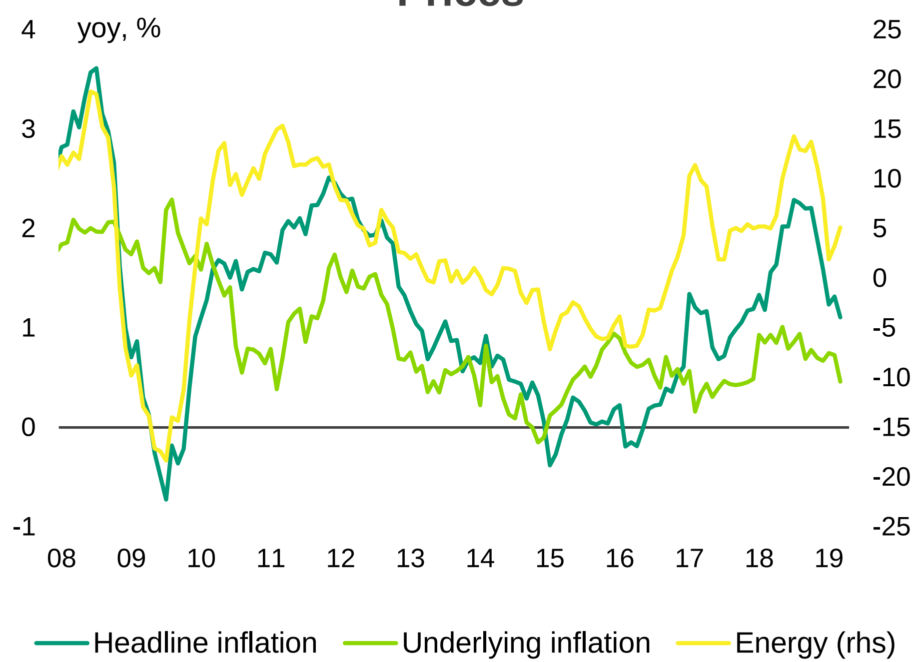
Inflation is set to slow sharply in 2019, after an annual +1.9% in 2018, it is forecast to come in at just +1.0% in 2019 and 1.2% in 2020 *(Insee definition, total inflation).*

Contributions to changes in the consumer prices index



Source : Insee, Crédit Agricole S.A.

Prices



Source : Insee, Crédit Agricole S.A.

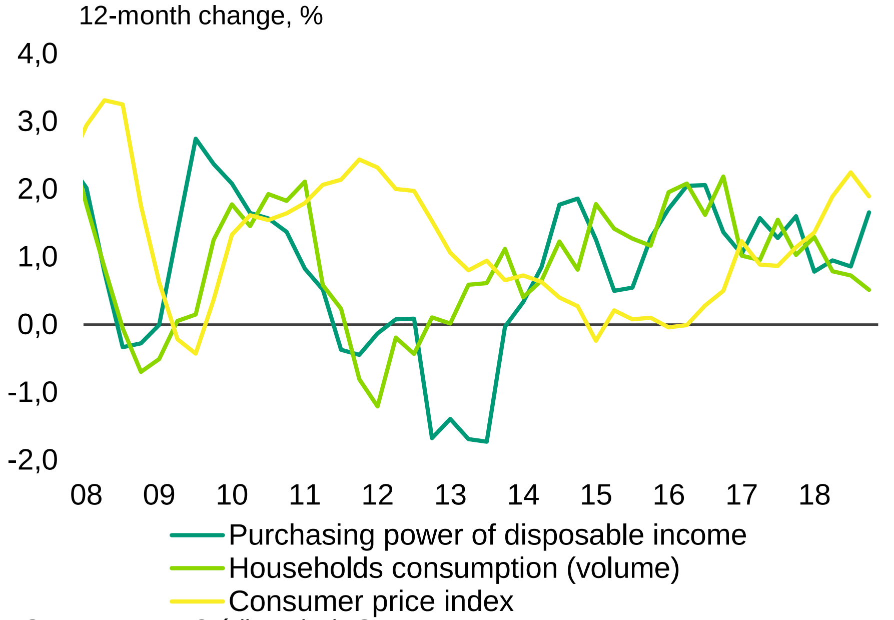
Inflation picked up sharply in 2018, sustained by one-off, short-lived actions, chief among which were base effects from the energy component. In 2019, inflation expectations have been undermined by the drop in oil prices in late 2018. After peaking at 87 dollars in early October, the per-barrel price shed around 35%, falling to 55 dollars at end-December. Note that a 10-dollar per-barrel drop in the oil price implies a 3% year-on-year fall in the energy component and of 0.3% in headline annual inflation over twelve months by direct effect. In addition, the announced freeze on energy taxation and gas and electricity prices in France will hold inflation figures down.

We have, therefore, revised our inflation forecasts for France down, given the slowdown in energy prices. The CPI inflation rate reached an annual 1.9% in 2018 and should be held to 1.0% in 2019 before picking up to 1.2% in 2020. Core inflation, which was lifeless in 2017, picked up slightly in 2018 (an annual +0.8% compared with +0.4 % in 2017). In 2019, it should stay around the same, at an annual 0.8%. The very gradual decline in unemployment and the persistence of a fairly significant unemployment halo suggest that core inflation will remain modest.

4 OUR SCENARIO FOR 2019-2020
HOUSEHOLD CONSUMPTION

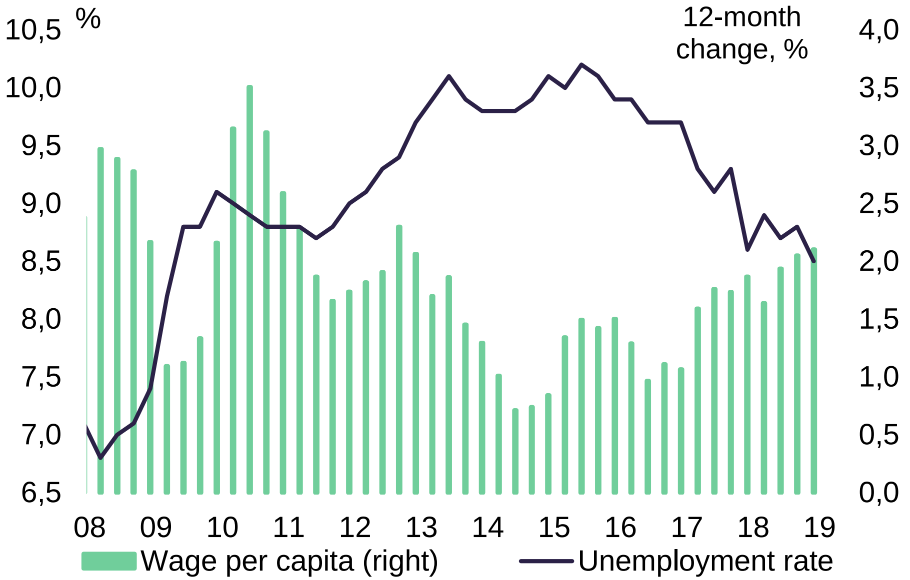
Following modest growth in 2017-2018, household consumption is forecast to be slightly more dynamic in 2019 and 2020 (+1.4% and +1.5%).

Purchasing power and consumption



Source : Insee, Crédit Agricole S.A.

Labour market



Source : Insee, Crédit Agricole S.A.

Averaged over the year, household consumption rose modestly in 2018, by +0.8%, a slower rate than in 2017 (+1.1%).

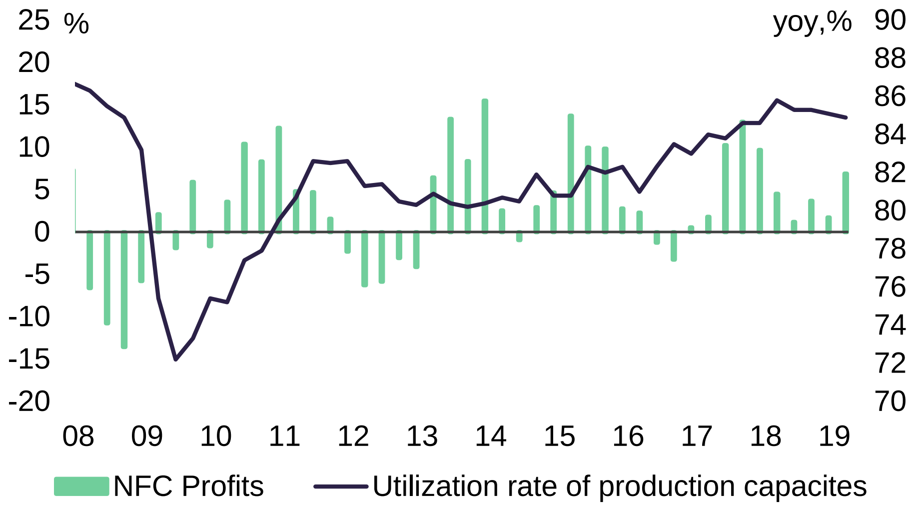
It is forecast to pick up in 2019 to +1.4% given a sharp rise in purchasing power. The wage bill should be fairly markedly up, by 2.8%, with an acceleration in per-capita wages (2.2%) and a slowing in employment (0.6%, 150,000 job creations). In addition, households will benefit from the support measures announced in the wake of the *gilets jaunes* crisis. The measures total around 10 billion euros, are targeted at wage earners and retirees on modest-to-average incomes, and should deliver an additional 0.7% in purchasing power. In view of the already planned tax cuts, (especially to council tax) and the slowdown in the pace of inflation, households' purchasing power should see substantial gains in 2019, of 2.6% (from 1% in 2018). This should mean a rebound in consumption, although not as large as the rise in incomes, for a series of reasons: stagnating consumption at end-2018, very poor household confidence levels, the slowdown phase in the consumer durables cycle, and precautionary savings behaviour. The personal savings rate is forecast to rise sharply, to 15.3% from 14.4% in 2018.

Household consumption is forecast to rise by 1.5%, in 2020, in line with purchasing power gains of 1.5%. These gains will be driven by the new support measures announced in April 2019 (see Focus). Employment should see a modest increase, of +0.5% (fewer creations of assisted jobs, and tailing off of the effects of the CICE and the Responsibility Pact). The unemployment rate looks set to ease back very gradually, to 8.3% in 2020, from 8.5% in 2019.

4 OUR SCENARIO FOR 2019-2020
BUSINESS INVESTMENT

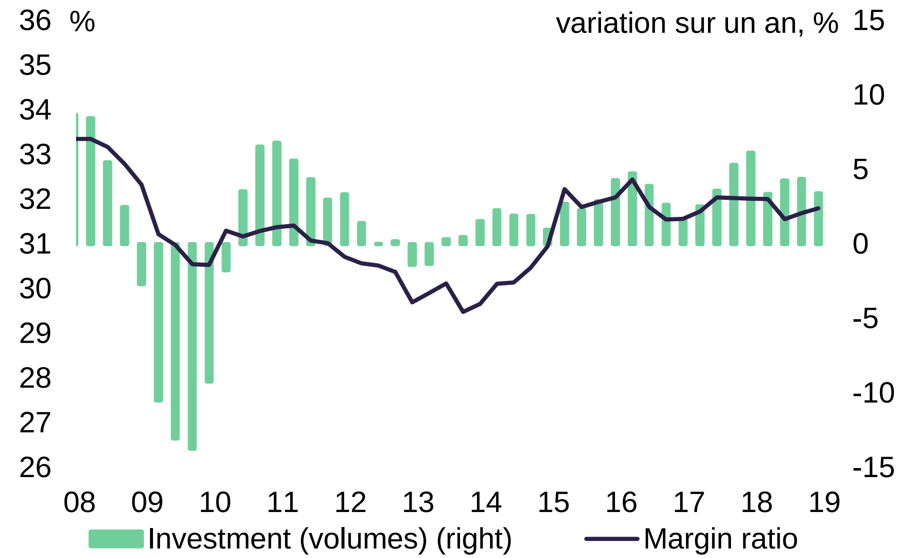
Business investment looks set to remain dynamic, from +3.9% in 2018, it is forecast to grow +3% in 2019 and +2.8% in 2020.

Profits and production capacity utilisation rate



Source : Insee, Crédit Agricole S.A.

Margin ratio and investment



Source : Insee, Crédit Agricole S.A.

In 2019, investment by non-financial companies looks set to continue growing for the sixth consecutive year, driven by firms' value-added momentum and a very low cost of borrowing. The resilience of corporate profits and margins, combined with an increase in the production capacity utilisation rate, suggest a further marked rise in investment spending.

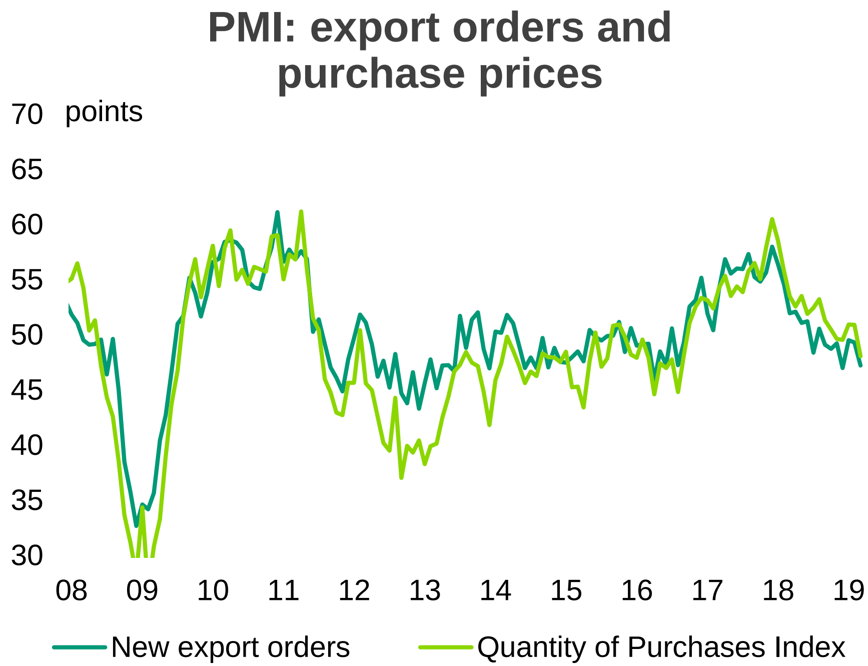
This is because, after a marked recovery in 2015, due in particular to the roll-out of the CICE, the margin ratio of non-financial companies has remained fairly stable ever since. It is believed to have reached 32% in 2018, ahead of a short-lived, sharp increase in 2019, to 33.5%, due to the conversion of the CICE into a reduction in employer social security contributions, leading to a (one-off) gain of 20 billion euros.

In addition, according to the April 2019 Insee business climate survey of investment in industry, industries are aiming to increase their investment in 2019 (+11% by value, after remaining stable in 2018). Industrialists have thus revised their January expectations up by 1 point, slightly more than the average at this time of the year (no revision on average between 2004 and 2018).

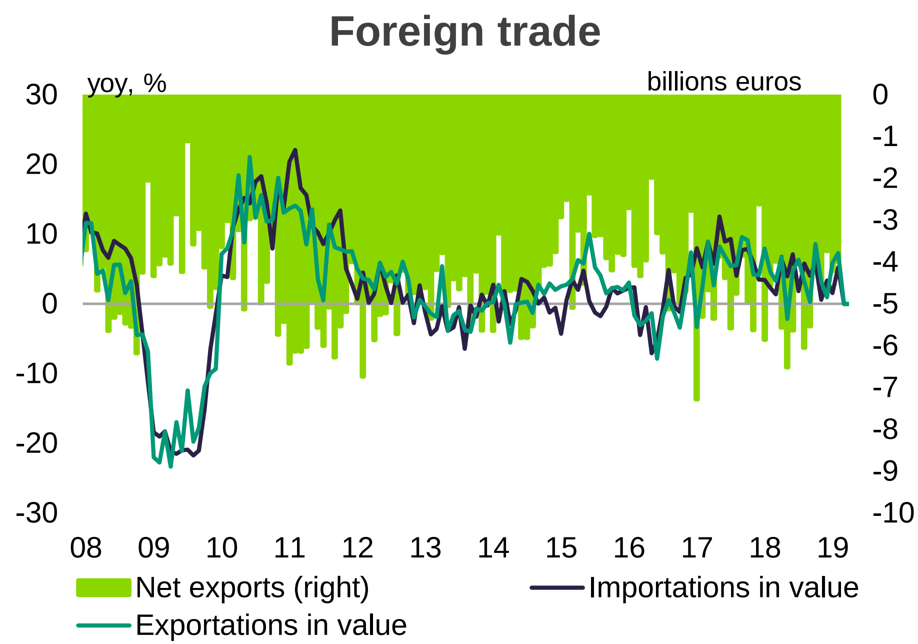
We are nevertheless keeping our investment forecasts fairly moderate, at +3% by volume over 12 months, in view of the lacklustre business climate and forecasts of foreign sales, especially in industry.

4 OUR SCENARIO FOR 2019-2020
FOREIGN TRADE

For once, the contribution from foreign trade will be positive in 2018 (+0.6 of a point) and slightly negative again in 2019 and 2020 (-0.1 and -0.3 of a point).



Source : Insee, Crédit Agricole S.A.



Source : Insee, Crédit Agricole S.A.

Foreign trade's net contribution to growth was for once positive in 2018 (+0.6 of a point), as imports have been less dynamic in the recent period; it is forecast to be slightly negative in 2019 and 2020.

This is because exports should become more upbeat (at around 3% a year) as a result of further strong domestic demand, especially from investment and consumer spending. Exports look set to slow slightly in 2019 (+3.1%) and slow further in 2020 (+2%), due to the slowdown in global demand and the adverse effect of the increase in the nominal effective exchange rate out to our forecasting horizon. Note also that in the first half of 2019, exports are seeing the carryover effects of the large-scale aircraft deliveries in late 2018.

Last, despite the policies implemented since 2014 to narrow the French economy's structural price and competitiveness deficits, exports continue to grow at a lower rate than that of French global addressed demand. The process of clawing back the market share lost since the early years of the century does not seem to have kicked in as yet.

Consult our last publications

Date	Title	Theme
07/05/2019	France – Political issues: Response to the Great Debate	France
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ECO
Études Économiques Groupe

Olivier ELUERE
Economist – France
+33(0)1 43 23 65 57
olivier.eluere@credit-agricole-sa.fr

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