FRANCE
2024-2025 SCENARIO

ECONOMY RECOVERING AS SHOCKS DISSIPATE

January 2024

Marianne Picard

WORKING EVERY DAY IN YOUR INTEREST AND FOR SOCIETY

CONTENTS

SUMMARY

A RECENT SLOWDOWN LINKED TO INFLATION AND MONETARY TIGHTENING

The French economy is making a soft landing following the post-COVID economic recovery in 2021 and the adverse effects of the outbreak of the war in Ukraine in 2022. The economy is in fact dealing with two powerful shocks: high, albeit falling, inflation affecting household consumption in particular, and the fastest monetary tightening in the ECB's history, which is weighing on investment.

After two quarters of positive growth in early 2023 (+0.1% qoq in the first quarter and +0.6% in the second quarter)**, activity decreased slightly in the third quarter (-0.1%) but the economy is expected to avoid a technical recession, with a slight increase in activity expected in the last quarter (+0.2%). Disinflation should pave the way for a rebound in household consumption and thus a gradual acceleration in activity in 2024. The end of monetary tightening, followed by the start of normalisation, should see investment pick up again by the very end of 2024, then accelerate in 2025. Annual growth is expected to come out at 0.9% in 2023, 1.0% in 2024 and 1.3% in 2025.**

Growth stalled in Q3 2023, due to a decline in foreign trade and inventory changes. It is important to put this decline in activity into perspective, however. Total domestic demand excluding inventories recovered after three quarters of sluggish activity, with a notable rise in household consumption (which had previously been lacklustre) and resilient business investment. Certain factors are driving activity, helping the French economy withstand an unfavourable environment, including the normalisation of global value chains which fuels supply and helps lower inflation. Caution continues to prevail among households, however, with confidence on the low side (but increasing in recent months) and a high savings rate. **Government support for businesses is less abundant, but margins have been restored in many sectors and tax pressure continues to ease.**

Uncertainty remains high, particularly since the outbreak of the conflict in the Middle East, and downside risks persist in our economic activity scenario. Energy prices are currently lower than last year but could rise again, for example if the conflict in Ukraine or the Middle East further deteriorates. Lastly, with the rise in interest rates weighing on investment, the aggressive continuation of the monetary tightening cycle could curb investment and have significant repercussions on the labour market, especially as fiscal policy will be less expansionary going forward.

Main components of the scenario:

- **Household consumption** should continue to rebound at the end of 2023 and more significantly in 2024, remaining dynamic in 2025. This trend should be driven by declining inflation, dynamic wages and a savings rate set to decrease slightly over the forecast horizon.
- **Business investment** is expected to dip slightly at end-2023 and in H1 2024, affected by amid tighter financial conditions. It should start to recover in late 2024 and then more significantly in 2025, as the tightening cycle comes to an end and monetary normalisation begins.
- **Inflation** should continue to wane but remain above the European Central Bank target of 2% over the entire forecast horizon. In particular, service inflation is liable to persist, triggered by wage hikes.
- **Foreign trade** is expected to make a slight contribution to growth starting in H1 2024, stemming from sluggish global demand for French goods and services. For full-year 2023, however, it will make a positive contribution owing to strong overhang from H1 2023.

SUMMARY

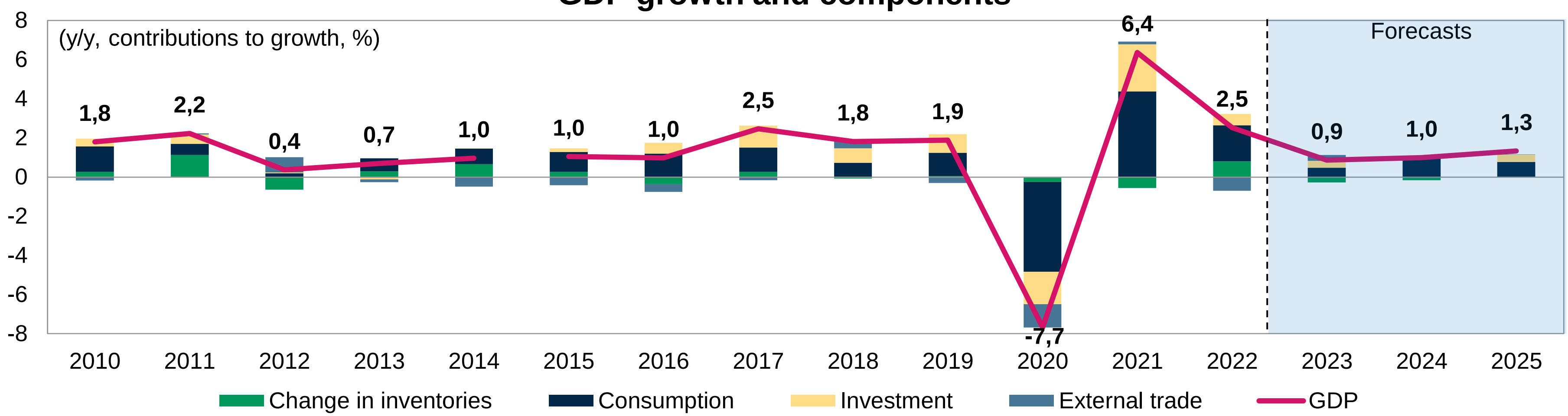
A GRADUAL RECOVERY IN ACTIVITY ON THE HORIZON

Key figures of our outlook

	Annual growth (y/y, %)						Quarterly growth (q/q, %)											
							2023				2024				2025			
France	2020	2021	2022	2023	2024	2025	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP (volume)	-7,7	6,4	2,5	0,9	1,0	1,3	0,1	0,6	-0,1	0,2	0,2	0,3	0,4	0,4	0,4	0,3	0,3	0,4
Household consumption	-6,7	5,1	2,1	0,6	1,5	1,3	0,3	-0,1	0,6	0,1	0,4	0,5	0,5	0,4	0,3	0,2	0,2	0,2
Investment	-7,0	10,2	2,4	1,5	0,2	1,5	-0,4	0,6	0,2	-0,1	-0,1	0,0	0,1	0,3	0,4	0,5	0,6	0,6
Corporate investment	-6,8	10,4	3,9	3,2	0,3	1,8	-0,3	1,1	0,4	-0,2	-0,2	0,0	0,1	0,5	0,7	0,6	0,7	0,8
Change in inventories*	-0,2	-0,6	0,8	-0,3	-0,2	0,0	-0,5	0,5	-0,2	-0,1	-0,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Net exports*	-1,2	0,1	-0,7	0,3	0,0	0,0	0,6	0,0	-0,4	0,2	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Unemployment rate (Metropolitan France)	7,9	7,7	7,1	7,1	7,6	7,6	6,9	7,0	7,2	7,4	7,6	7,7	7,7	7,6	7,6	7,5	7,5	7,5
Inflation (CPI, y/y)	0,5	1,6	5,2	4,9	2,7	2,7	6,0	5,2	4,7	3,8	2,9	2,5	2,6	2,7	2,8	2,7	2,6	2,6
Public debt (% of GDP value)	114,7	113,0	111,8	109,7	109,7	109,6												
Government deficit (% of GDP)	-9,0	-6,5	-4,8	-4,9	-4,6	-4,2												

* Contributions to GDP growth
Last observations: Q3 2023
Sources: Insee, Crédit Agricole S.A./ECO calculations and forecasts

GDP growth and components

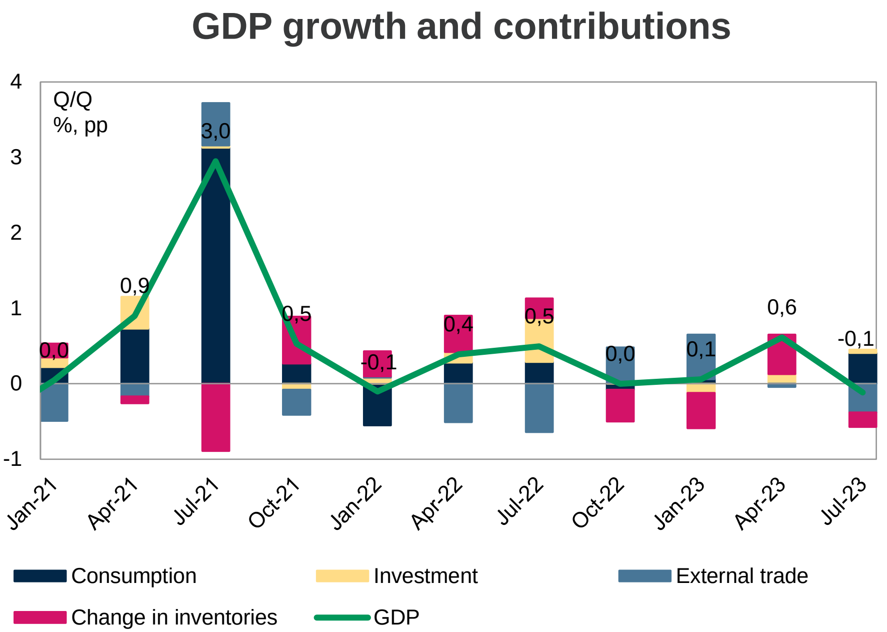


Last observations: 2022
Sources: INSEE, Crédit Agricole S.A./ECO calculations and forecasts

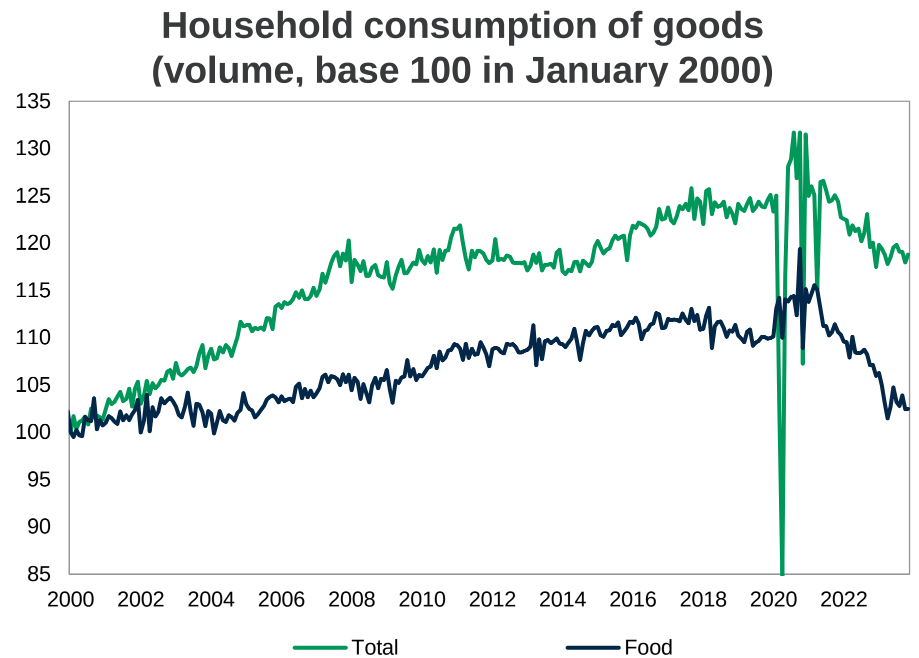
CONTENTS

RECENT TRENDS IN ACTIVITY

FRANCE AVOIDED RECESSION DESPITE THE DECLINE IN DOMESTIC DEMAND



Last data points: Q3 2023
Sources: INSEE, Crédit Agricole S.A. /ECO



Last data points: November 2023
Sources: INSEE, Crédit Agricole S.A. /ECO calculations

Despite a recent slowdown, the French economy has held up well, with France steering clear of a technical recession (two consecutive quarters of declining activity). After climbing 0.6% (qoq) in the second quarter of 2023, largely due to inventory changes, activity fell slightly in the third quarter (-0.1%). This decline should be put into perspective, being attributable to foreign trade and inventory changes, and total domestic demand (excluding inventories) recovered after three quarters of lacklustre activity, with a significant increase in household consumption (which had been sluggish up to that point) coupled with resilient business investment.

Household consumption rebounded in Q3 2023. In detail, consumption of manufactured goods picked up, as did consumption of food goods, albeit more timidly. Year-on-year, however, consumption of goods was down nearly 2%, with food down 5%.

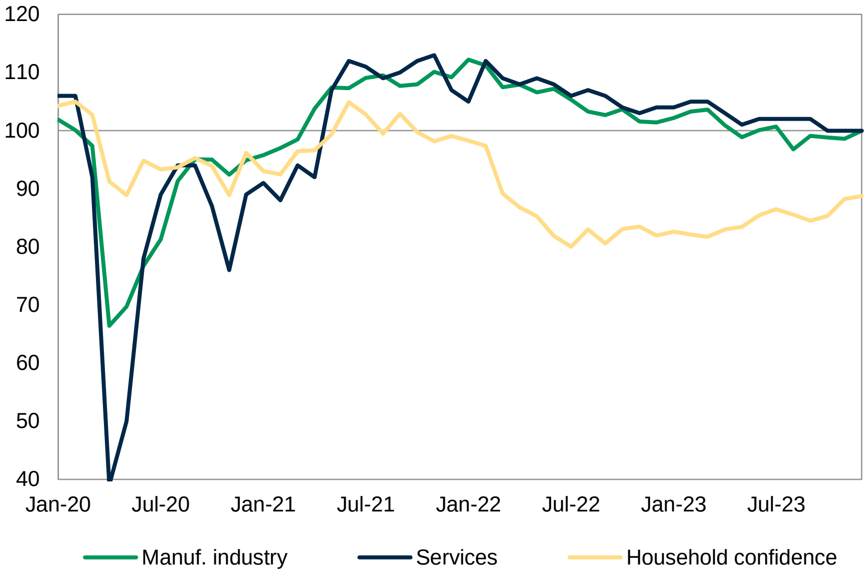
Household investment fell in Q3 2023 for the fifth consecutive quarter. Monetary tightening is also hitting investment by non-financial companies, which has slowed significantly but is still resilient and has yet to contract.

In H1 2023, the trade balance benefited from a drop in imports, while exports remained stable. On the downside, exports contracted in Q3 while imports remained virtually stable.

RECENT TRENDS IN ACTIVITY

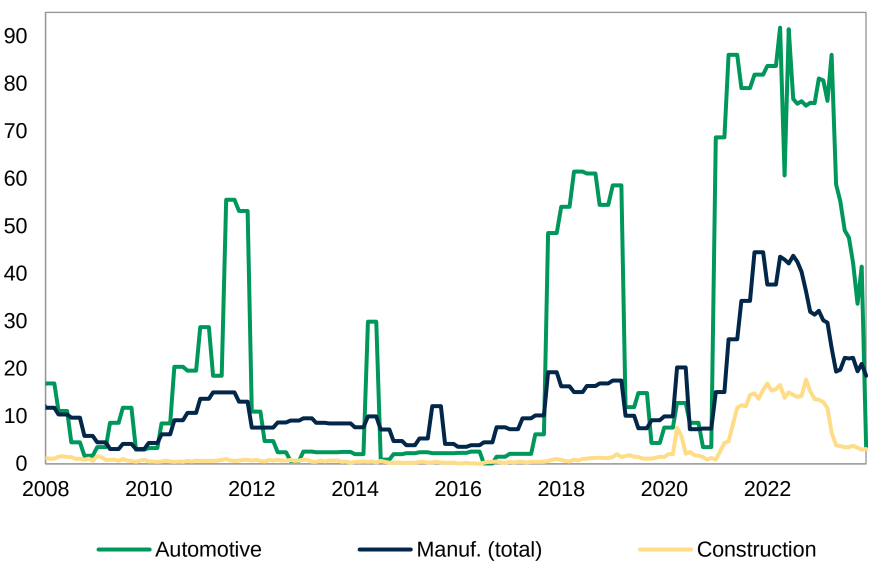
DEMAND REMAINED SLUGGISH DESPITE EASING SUPPLY TENSIONS

Business climate and consumer confidence



Last data points: December 2023
Sources: INSEE, Crédit Agricole S.A. /ECO

Companies hindered by supply shortages (%)



Last data points: December 2023
Sources: INSEE, Crédit Agricole S.A. /ECO

The easing of supply constraints is freeing up the productive capacities of businesses and reducing upward pressure on prices. That said, the business climate in France is far from brisk, with weak business prospects in the coming months and persistently sluggish demand. The overall business climate has held up around its long-term average (100) for several months, but has been slightly below average since October. This is consistent with a slight uptick in activity in Q4 2023.

Consumer sentiment is still weak, hovering significantly below its long-term average, but has improved over the last three months.

Households are still erring on the side of caution and building up substantial precautionary savings. The savings rate decreased slightly in Q3 2023, but remains high in terms of historical comparison.

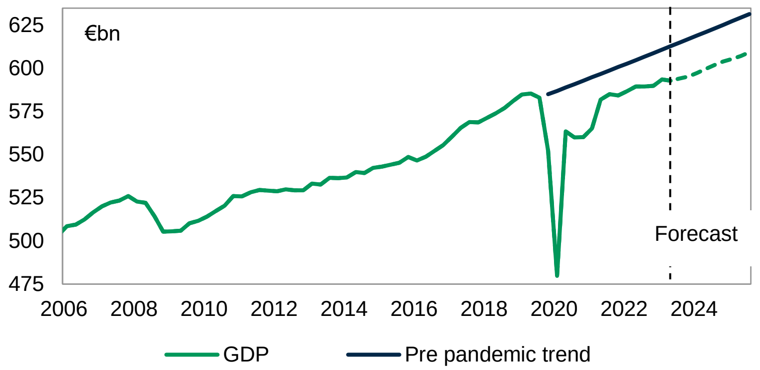
Households expect the disinflation process to continue, however, according to the consensus on future price trends. Meanwhile, fewer business leaders are planning to hike their selling prices for services in the coming months, while more business leaders expect to see a decline in industry. These factors support our scenario of a gradual decline in inflation, which should lead to a rebound in consumption.

CONTENTS

OUR SCENARIO FOR 2024-2025

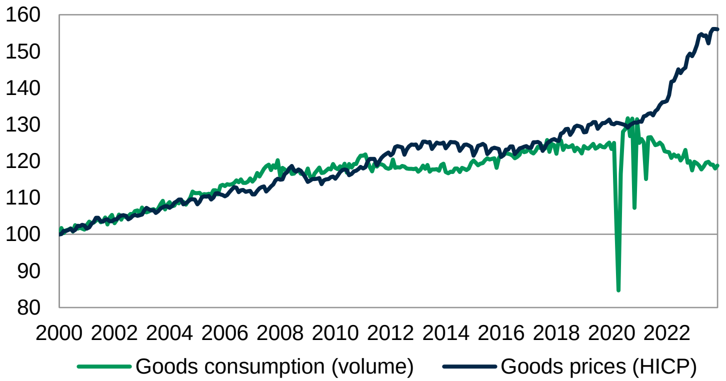
DEMAND: INFLATION AND MONETARY POLICY POISED TO LEAD THE WAY

Quarterly GDP



Last observations: Q3 2023
Sources: INSEE, Crédit Agricole S.A./ECO calculations and forecasts

Consumption and prices of goods
Base 100 in January 2000



Last data points: November 2023
Sources: INSEE, Eurostat, Crédit Agricole S.A./ECO calculations

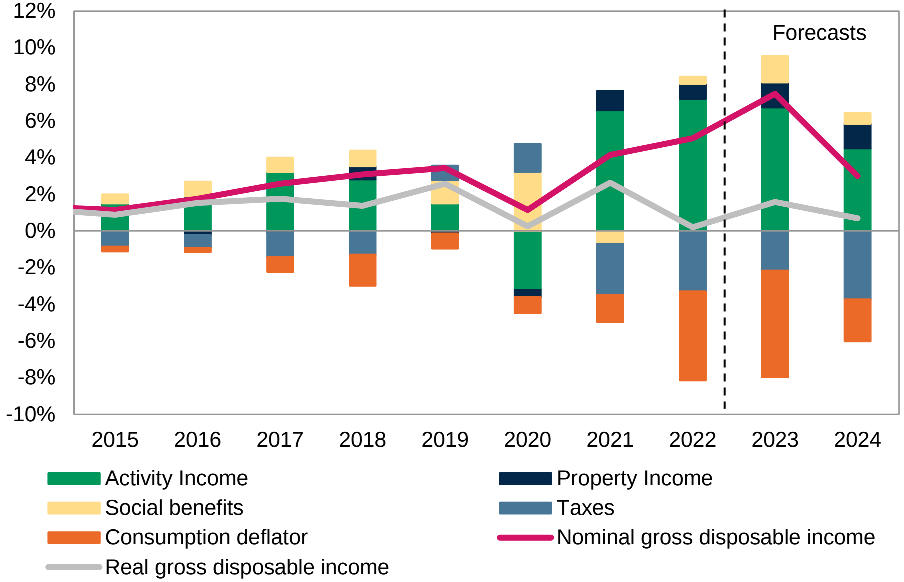
Inflation has been the number-one brake on growth since 2021, first by limiting supply through higher input costs and then by eroding demand, with businesses gradually able to pass cost increases on to sales prices. Inflation plateaued at a high of around 6% year-on-year according to the consumer price index (CPI) between June 2022 and April 2023. It then receded to 3.7% in December 2023 (slightly higher than in November). Food inflation has fallen since its year-on-year peak in March (+15.9%) yet remains high (+7.2% in December). Due to high inflation and waning household confidence, consumption of goods fell, underperforming Q4 2019 levels by 5%. But inflation is expected to fall further in the coming months and could generate a recovery in consumption, with household savings remaining extremely high.

With inflation falling year-on-year over the last several months, the European Central Bank (ECB) kept its key interest rates unchanged in October and December 2023, after implementing a hike in September that is expected to be the last. Overall, key rates have risen 450 basis points since July 2022, the fastest monetary tightening in the history of the ECB, and key rates could remain high for a sufficiently long period to ensure that inflation returns to its 2% target. The effects of monetary tightening can currently be seen on investment: household investment has already fallen for the last five quarters, and business investment is slowing despite proving resilient up to now. Real interest rates, which until recently had been negative (with inflation above nominal interest rates), are turning positive while interest rates remain high and inflation is falling. As the impact of tighter financing conditions takes time to be felt by the real economy (12 to 18 months according to economic research), investment should continue to slow in the coming quarters. The rise in interest rates has already had a visible impact on real estate, new and old properties alike. In terms of fiscal policy, measures to support the economy are being gradually decreased in 2023-2024.

OUR 2024-2025 SCENARIO

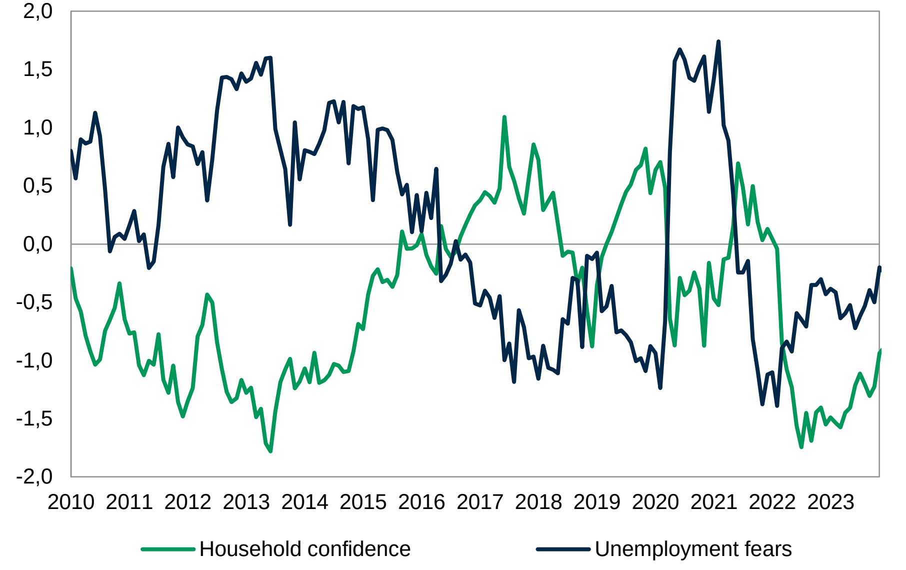
INFLATION EXPECTED TO CONTINUE FALLING AND TO BOLSTER CONSUMPTION

Growth in purchasing power and contributions



Last observations: 2022
Sources: INSEE, Crédit Agricole S.A. /ECO calculations

Consumer confidence (normalised balance of opinion)



Last data points: November 2023
Sources: INSEE, Crédit Agricole S.A. /ECO calculations

The decline in inflation should keep the recovery in household consumption going strong in the coming quarters. Although inflation remains high, household purchasing power is expected to increase in 2023, then more slightly in 2024. Business income is expected to be dynamic, in line with wage increases and, to a lesser extent, salaried employment. Purchasing power bonus (PPV) payments should support wages, especially at end-2023, and wages are expected to climb more than prices starting in H2 2023. Property income is looking brisk, consistent with the increase in dividends and rates, and social benefits are also on the rise, as they are indexed to inflation.

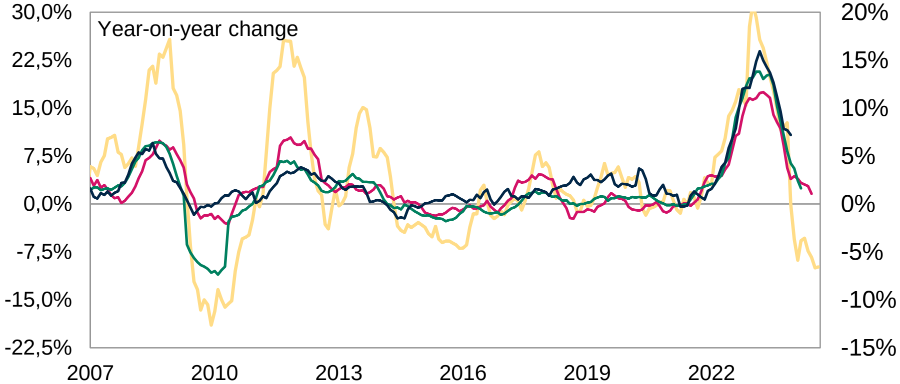
But households remain cautious and continue to put their faith in savings. Purchasing power held relatively steady in Q2 and Q3 2023 (after sliding in Q1), but the household savings rate remains high at over 17%, compared with 15% in 2019. Consumer sentiment remains very low (89 vs. a historical average of 100) and the decline in inflation has yet to trigger a rebound in intentions to make large purchases.

As mentioned earlier, the consumption of goods in volume terms is down sharply, but the consumption of services has held up so far, mainly because inflation is lower. After gaining 2.1% in 2022, household consumption is expected to improve slightly on average in 2023 (+0.6%) and should only truly pick up again in 2024 (+1.5%) and 2025 (+1.3%).

OUR 2024-2025 SCENARIO

A GRADUAL DECLINE IN INFLATION ALREADY WELL UNDER WAY

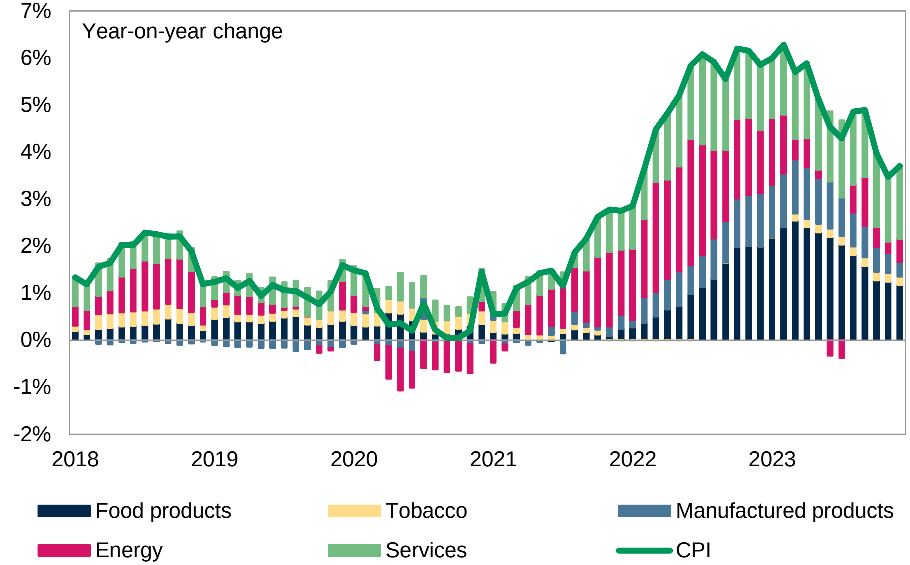
Food prices



*Production prices for the domestic market (food processing industry)

Last data points: December 2023 (CPI), November 2023 (IPPAP and IPPI)
Sources: INSEE, Crédit Agricole S.A./ECO calculations

Total inflation (CPI) and contributions



Last data points: December 2023
Sources: INSEE, Crédit Agricole S.A./ECO calculations

Following the post-COVID economic recovery and the outbreak of war in Ukraine, the rising prices of energy and other commodities significantly increased production costs starting in late 2021. This increase was gradually passed on to consumer prices, first through the energy component and then through other household consumer basket items. Though still higher than before COVID, energy and major commodity prices have fallen from their peak in 2022. As a result, production prices have slowed sharply since their year-on-year peak a little over a year ago.

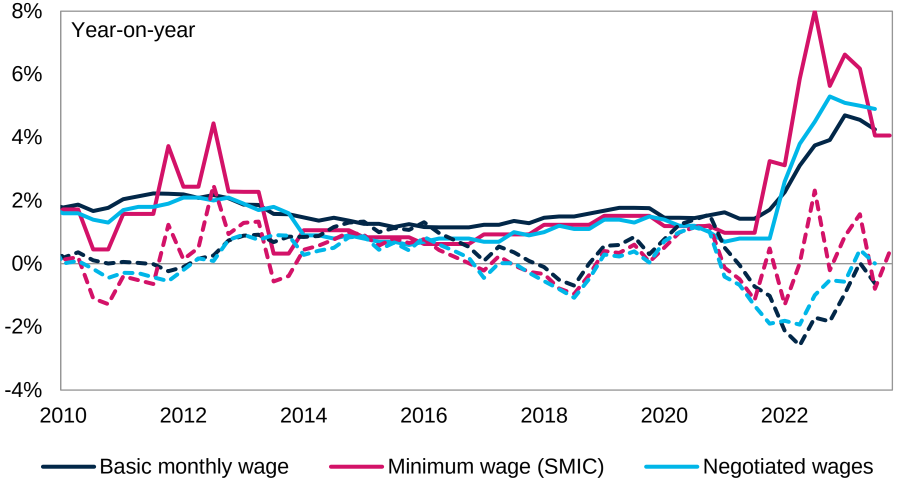
Oil prices dropped in late 2023, ending slightly below its year-on-year level in December. Energy once again contributed positively to headline inflation since August, due to base effects linked to the fuel discount a year earlier as well as increases in regulated electricity tariffs enacted in 2023. Food inflation remains high but has fallen since its early 2023 peak: it has no longer been the leading contributor to headline inflation since October 2023, and leading indicators (production and import prices) suggest that the decline is likely to continue. Service inflation has sat at around 3% year-on-year (in the sense of the consumer price index or CPI) since autumn 2022, and recently became the leading contributor to headline inflation. It should prove persistent in forecasts, driven by dynamic wages.

CPI inflation averaged 4.9% in 2023 (vs. 5.2% in 2022) and is expected to come out slightly below 3% in 2024 and 2025.

OUR 2024-2025 SCENARIO

WAGES ARE PICKING UP BUT COMPANIES ARE HOLDING UP WELL OVERALL

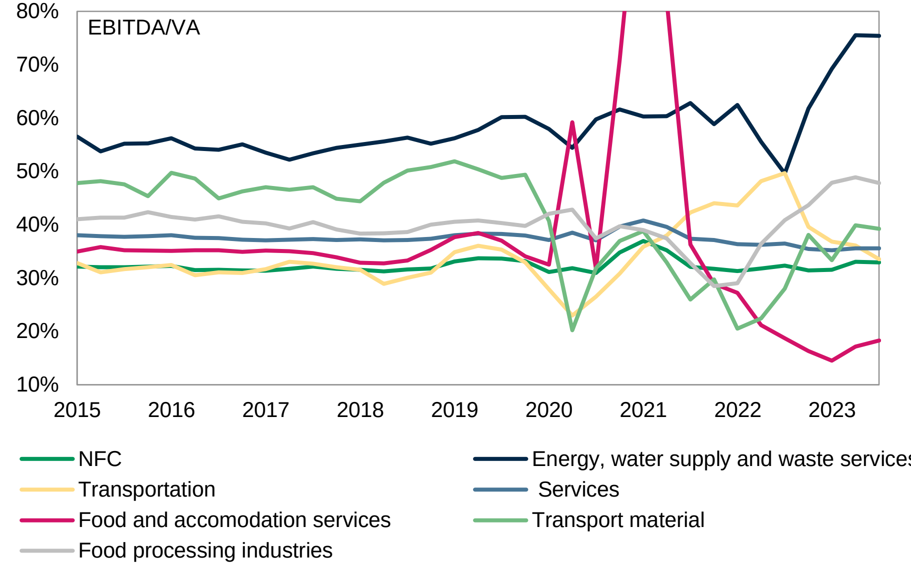
Trend in nominal and real wages



NB: Dotted lines show trends in real wages (wages deflated by total CPI).
End-of-quarter data.

Last data points: Q4 2023 (minimum wage), Q3 2023 (basic monthly wage and negotiated salaries)
Sources: DARES, INSEE, Banque de France, Crédit Agricole S.A. /ECO calculations

NFC margin rate



Last data points: Q3 2023
Sources: INSEE, Crédit Agricole S.A. /ECO calculations

Businesses have managed by and large to restore their margins after bearing some of the increases in production costs in 2021-2022. In the third quarter of 2023, the margin rate of non-financial companies (NFC) sat above 2018 levels. Some sectors, such as energy and agrifood, have more than made up for their past decline, with margin rates now substantially higher than before COVID.

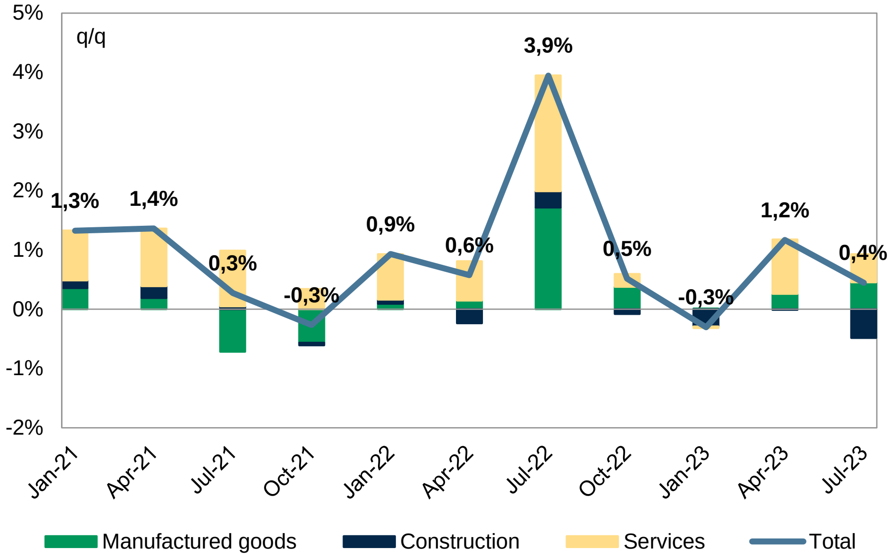
With fears over demand taking shape, the margin rate is no longer expected to increase on average, but should end up globally stabilising over the forecast horizon. It may continue recovering in retail services, such as hospitality & catering, where demand is more stable and there is still room for margins to catch up.

Wages are rising sharply but the increases have so far been undermined by inflation. In real terms they have decreased, with the exception of minimum wage which is automatically indexed to inflation. Minimum wage has also caught up to certain industry-level wage floors, leading to wage rises in many sectors (negotiated salaries), although some wage floors are still below minimum wage. However, overall wages were less dynamic than minimum wage, and the change in the monthly base salary was almost nil year-on-year in Q3 2023.

These factors attest to the absence of a price-wage loop, despite a resilient labour market. Inflation is expected to continue to decline, and wage increases – arriving late in the game – should support core inflation through 2025.

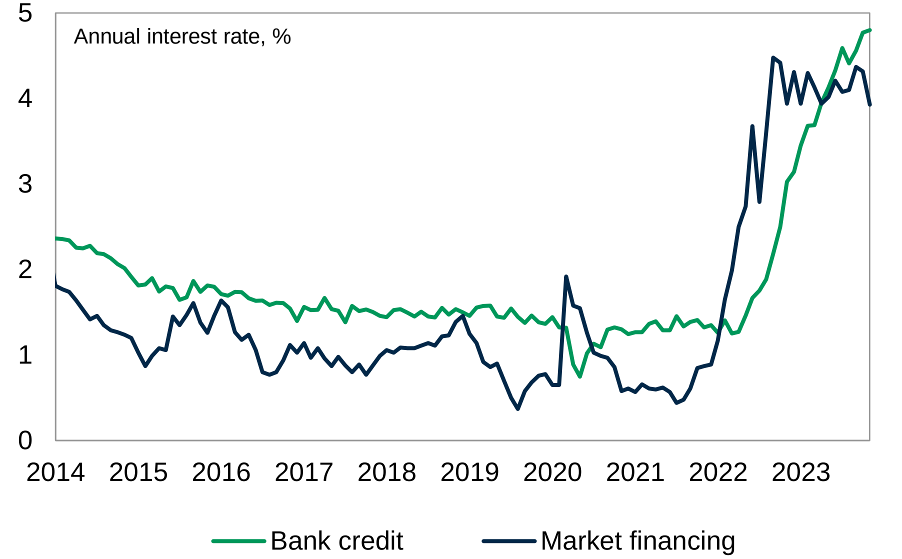
A SOFT LANDING FOR NFC INVESTMENT?

Growth in NFC investment and contributions



Last data points: Q3 2023
Sources: INSEE, Crédit Agricole S.A. /ECO calculations

Cost of financing (new flows)



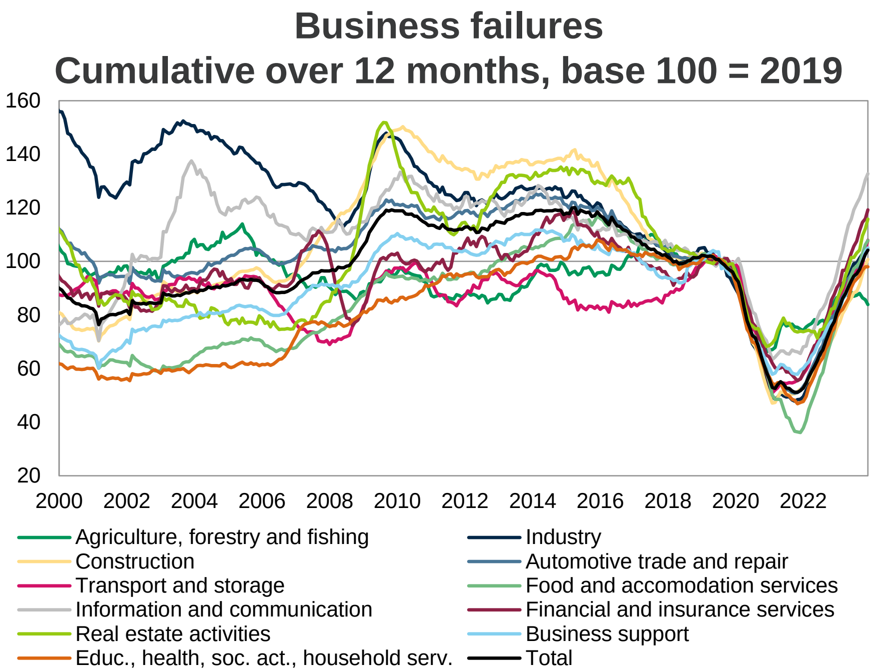
Last data points: November 2023
Sources: Banque de France, Crédit Agricole S.A. /ECO

NFC investment improved 3.8% in 2022, driven by easing constraints on global value chains and by persistently strong investment in services. It then slowed significantly, and the monetary tightening that began in July 2022 should make its full impact on investment in the coming quarters. Bank lending rates, long below-market, have now risen, limiting the use of bank financing versus bond financing previously observed among large corporates. Moreover, even though businesses have rebuilt their margins, they are concerned about slowing demand, both domestically and in neighbouring European countries. Lastly, NFC investment has been strongly supported by public spending and economic stimulus plans since H2 2020, exceeding Q4 2019 levels by 10% in Q3 2023. This means that the potential for investment growth is becoming more limited, and even if tax cuts last, direct investment support is becoming less abundant.

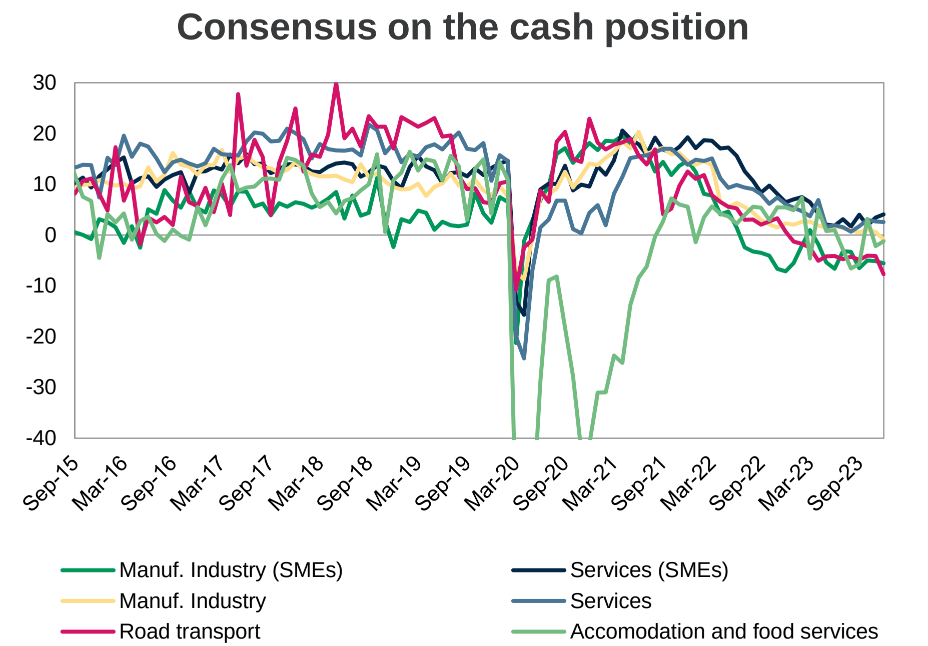
We expect NFC investment to dip slightly at end-2023 and in H1 2024, with monetary tightening having persisted until summer 2023, interest rates set to remain higher for longer, and real rates to return to positive territory as inflation slows. Investment should then rebound in 2025, in the wake of the expected monetary normalisation. NFC investment should climb 3.3% in 2023, owing to substantial overhang, then +0.3% in 2024 and +1.8% in 2025.

OUR SCENARIO FOR 2024-2025

BUSINESS FAILURES ON THE RISE, BUT NOT TO WORRY FOR NOW



Last data points: December 2023
Sources: Banque de France, Crédit Agricole S.A. /ECO calculations



Last data points: December 2023
Sources: Banque de France, Crédit Agricole S.A. /ECO

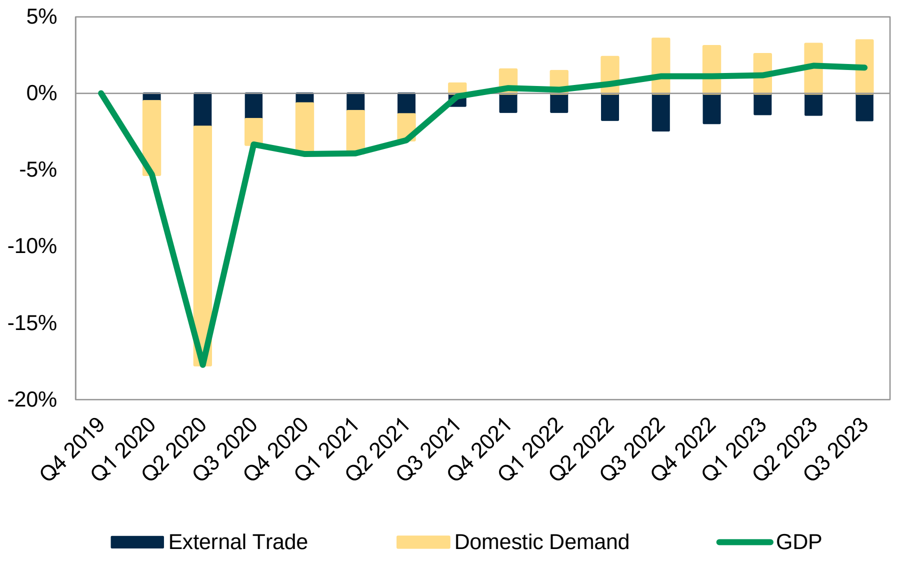
Business failures have been on the rise since 2022. In cumulative terms over twelve months at end-2023, business failures thus exceeded end-2019 levels. Companies appear to have a somewhat weaker cash position, and payment terms have lengthened, but a wave of bankruptcies is unlikely. The rise in business failures is actually first and foremost a sign of normalisation: the abundance of public support measures implemented during the health crisis and the suspension of receivership proceedings in 2020-2021 protected businesses across the board, including unprofitable companies. Some businesses are also suffering from the current environment and tighter access to financing, while gradually paying off state-guaranteed loans. The percentage of vulnerable companies remains relatively small, however.

While the risk of seeing business failures take off is on the moderate side, it is important to keep a close eye on the numbers, particularly at the sector level. Some sectors are more exposed than others, with an especially high number of failures in information and communication technologies, financial and insurance activities, and real estate. However, the rise in failures should be viewed in light of the multiple business creations recorded (particularly in information and communication technologies), thus expanding the business pool compared to the pre-pandemic period, and thus mechanically driving up the number of insolvencies, but without creating a cause for concern.

OUR SCENARIO FOR 2024-2025

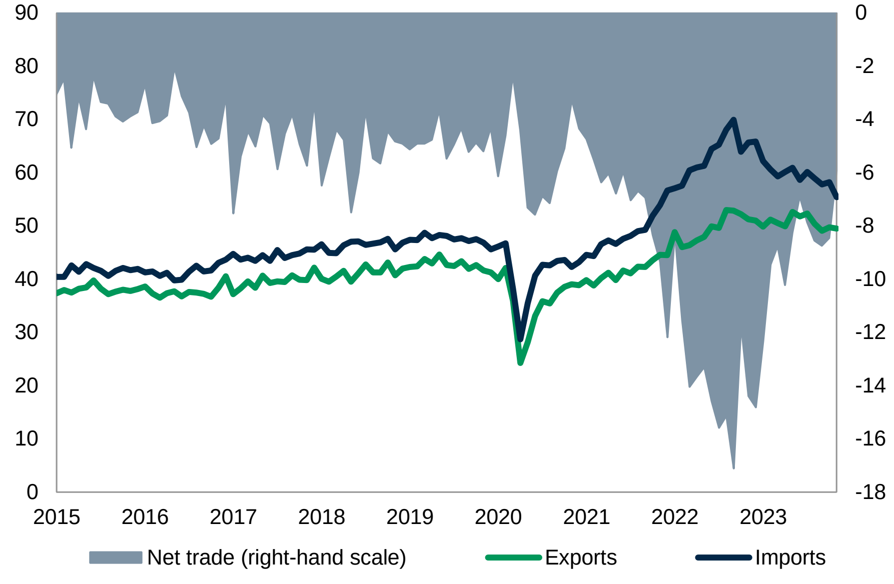
ONGOING IMPROVEMENT IN THE TRADE BALANCE AFTER RECORD DEFICITS

GDP, domestic demand and foreign trade (difference vs. Q4 2019 and contributions)



Last data points: Q3 2023
Sources: INSEE, Crédit Agricole S.A./ECO calculations

Trade in goods (monthly data, €bn)



Last data points: November 2023
Sources: Customs, Crédit Agricole S.A./ECO

After the COVID-19 pandemic, domestic demand and particularly investment recovered more strongly than foreign trade. The trade balance is still low compared to Q4 2019 levels, despite improving since end-2022 and into 2023.

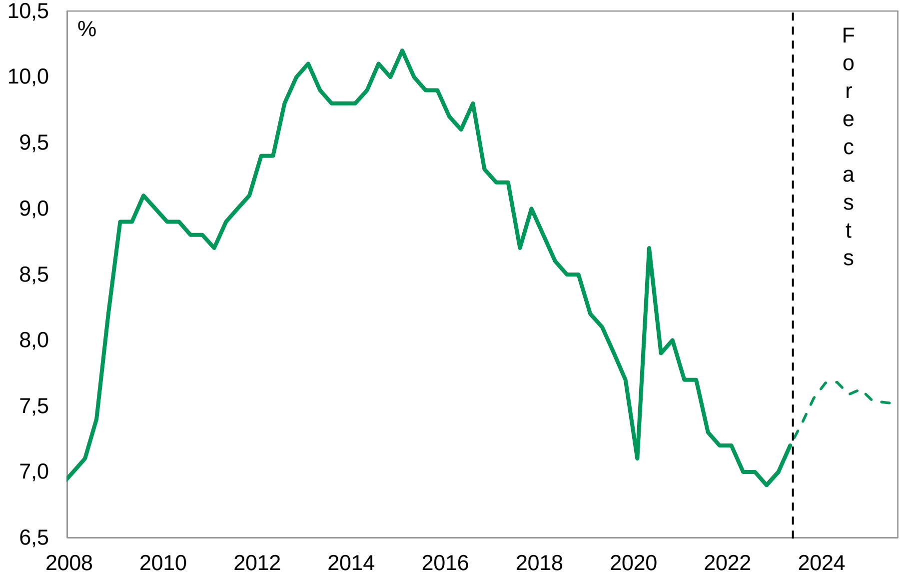
The trade deficit reached a record level in 2022, exacerbated by the rise in import prices, and above all the increase in energy prices. Exports were also adversely affected by the relatively slow recovery of sectors usually reporting surpluses, including tourism and aviation. The rise in energy prices following the Russian invasion of Ukraine will have a lasting impact on competitiveness for the eurozone relative to other major world regions. However, while energy prices in Europe remain high, they are down year-on-year after peaking in 2022. This helps to reduce France's trade deficit, especially as energy consumption in volume is down. Some export sectors, including aviation, should also continue to recover and contribute to this improvement.

Overall, foreign trade is expected to contribute positively to GDP growth in 2023 after a negative contribution in 2022. It should then make a negligible contribution in 2024 and 2025.

OUR SCENARIO FOR 2024-2025

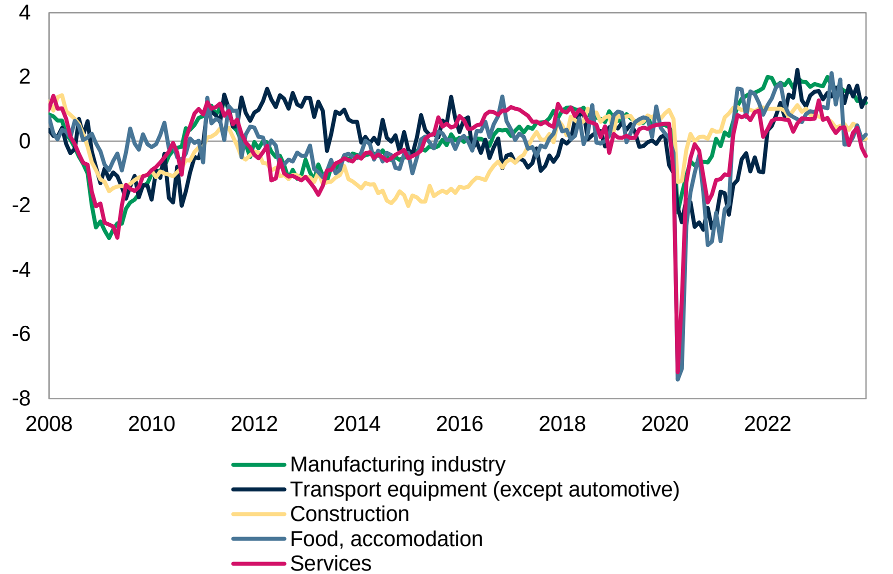
UNEMPLOYMENT EXPECTED TO RISE, BUT STILL BELOW PRE-PANDEMIC LEVELS

Unemployment rate (mainland France)



Last observations: Q3 2023
Sources: INSEE, Crédit Agricole S.A. /ECO

Hiring intentions (normalised indicators)



Last data points: December 2023
Sources: INSEE, Crédit Agricole S.A. /ECO

The unemployment rate increased slightly in Q2 and Q3 2023, after hitting a record low rate in Q1 (6.9%). In Q3 2023, France recorded 1.8 million more actively employed individuals than in Q4 2019. Job creation momentum had thus far been driven by the easier (and subsidised) use of apprenticeships. According to INSEE, work-study contracts have accounted for one-third of salaried job creations since the end of 2019. While the reform has proved successful in accounting terms, some of these job creations have replaced the creation of jobs with other statuses and has contributed to the deterioration in productivity, the increase in economic activity having been slower than job creation since 2020.

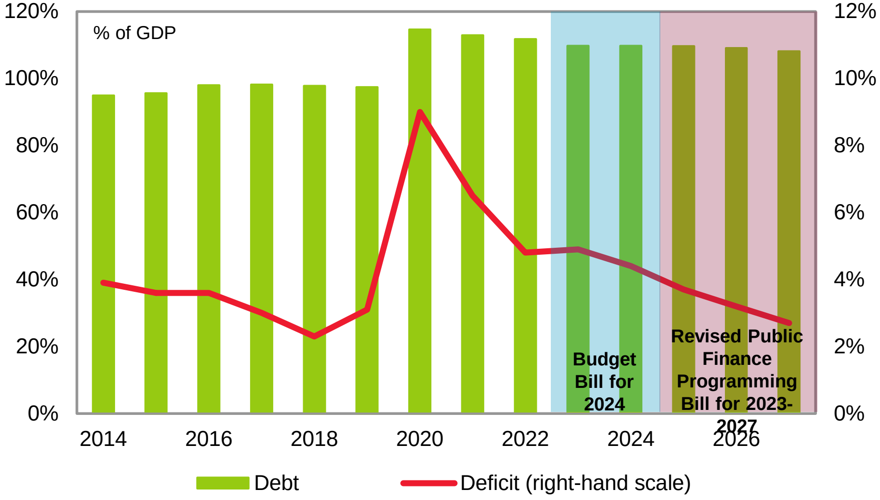
The slowdown in job creations seen in recent quarters is expected to continue in late 2023. Employment should be stable on average in 2024, then increase slightly in 2025, in line with the acceleration in economic activity.

The effects of the pension reform should offer some support to the working population, and the unemployment rate should rise in 2024, albeit moderately. The unemployment rate is expected to climb slightly, to 7.4% by end-2023, and then average 7.6% in 2024 – still considerably lower than before the pandemic – before stabilising in 2025.

CONTENTS

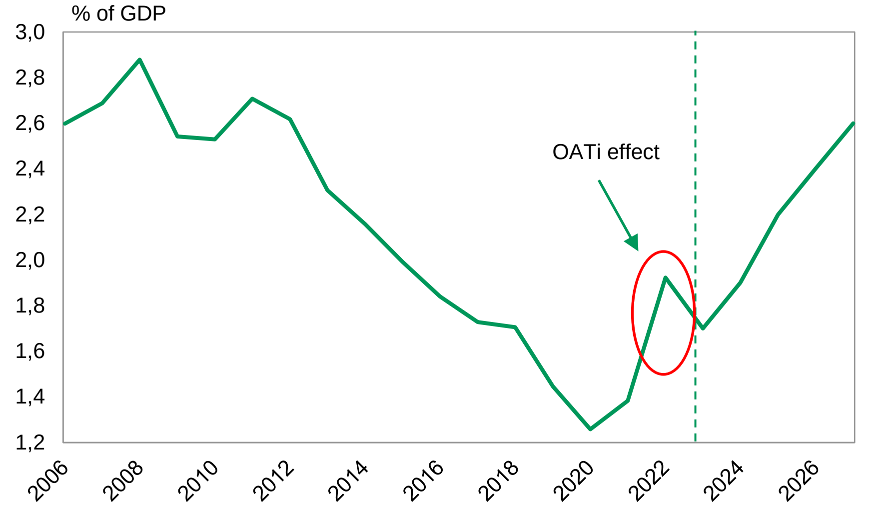
UNAMBITIOUS DEFICIT REDUCTION BASED ON OPTIMISTIC ASSUMPTIONS

French government debt and deficit within the meaning of Maastricht



Last observations: 2022
Sources: INSEE, 2024 PLF (budget bill) and revised 2023-2027 PLPFP (public finance programming bill)

Interest expense on debt



Last observations: 2022
Sources: INSEE, revised 2023-2027 PLPFP, Crédit Agricole S.A. /ECO

According to the government, the public deficit should be virtually stable in 2023, at 4.9% of GDP, then decrease in 2024 (to 4.4% vs. 4.6% in our forecast). Public debt is expected to fall sharply in 2023, to 109.7% of GDP, then stabilise in 2024. The deficit should then gradually decrease to 2.7% of GDP by 2027, with debt dipping slightly to 108.1% of GDP.

The government's growth assumptions are high, at 1.0% in 2023, 1.4% in 2024, 1.7% in 2025 and 2026, and 1.8% in 2027. That said, forecasts see the deficit dropping only moderately (>3% of GDP through 2026) and debt remaining excessive at nearly 110% of GDP (>60%). Furthermore, spending cuts for 2024 are largely the result not of structural efforts but of the phasing-out of support measures for businesses and households made possible by easing energy prices, while spending cuts announced for subsequent years will not be spelled out in detail until the current spending review is completed.

According to the European Commission, France's draft budget plan for 2024 may not be in line with its previous recommendations. France could find itself facing an excessive deficit procedure in 2024, bearing in mind that the general escape clause of the Stability and Growth Pact ended in 2023.

The risk for public finances appears low, however, despite the rise in interest rates: existing debt has skyrocketed, but does not cost much in terms of public finances. Although the debt burden is expected to rise gradually, it should remain below 2006 levels, meaning no "debt wall", with very low risk French public debt being unsustainable.

CONSULT OUR LAST FREE PUBLICATIONS ON-LINE

Date	Title	Theme
18/01/2024	The Critical Raw Materials Act: Europe’s metals sector expresses its desire for independence	Mines & metals
16/01/2024	United Kingdom – 2024-2025 Scenario: a fragile recovery expected later in the year	United Kingdom
22/12/2023	World – Macro-economic Scenario 2024-2025: Fluctuat nec mergitur	World
14/12/2023	Sub-Saharan Africa: how is climate change affecting the region’s economies?	Africa
07/12/2023	Between China and the US, South Korea still needs the benefits of globalisation	Asia
30/11/2023	En route to Dubai: let’s talk about COP28	Climate challenge
23/11/2023	Xi Jinping’s visit to San Francisco is both politically and economically important	USA/China
21/11/2023	China – The long road to transition	Asia
17/11/2023	Geopolitics – The brick wall of reality	Geopolitics

Marianne PICARD
+33 (0)1 57 72 53 71
marianne.picard@credit-agricole-sa.fr

THANKS FOR YOUR ATTENTION

YOU CAN SUBSCRIBE TO OUR PUBLICATIONS ON OUR WEBSITE : http://economic-research.credit-agricole.com/

Access and subscribe to our free online publications:
application available in App Store and in Google Play

Crédit Agricole S.A. — Group Economic Research
12 place des Etats-Unis – 92127 Montrouge Cedex

Publication Manager: Isabelle Job-Bazille - **Chief Editor:** Armelle Sarda
Information centre: Elisabeth Serreau - **Statistics:** DataLab ECO
Editor: Véronique Champion
Contact: *publication.eco@credit-agricole-sa.fr*