Prospects

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FRENCH GROWTH – Starting to foot the bill of politics

- **Due to latest political developments and recent soft data (BdF survey, PMIs etc.), we are currently reviewing into details our forecast for France. The final and official version will be published in CASA Eco next 'World scenario' that will be published on 20 December. In this paper, we introduce some key preliminary figures that we obtained.**
- **We will cut our growth call for France from 1.0% to 0.8% for 2025. Main rationale is the surge in political uncertainty since last summer, which is currently and will continue to weigh on growth.**
- **Into details, despite higher public consumption due to the absence of proper fiscal consolidation that mechanically adds 0.2ppt of growth for 2025, we mostly see a brake in corporate investment (forecast for total investment would drop from +1.0% to +0.0%) while even higher precautionary savings would keep up weighting on household consumption (revised down from +1.0% to +0.7%). The sum of those three effects begets a 0.15-0.20ppt drop in our growth forecast to 0.8%. Due to this slowdown and more pronounced wait-and-see attitude on the part of businesses, unemployment is expected to rise more. We revised up it from 7.4% to 7.8% for the end of 2025.**
- **Due to slower growth and higher public spending, we increase our public deficit forecast from 5.5% to 6.0% of GDP. Higher public spending accounts for +0.3ppt, while weaker growth including the effect on public revenues adds +0.2ppt to the forecast. This is in line with the Special Law rolled for some time and a future budget bill for 2025 at some point at the beginning of next year that will need to find a complicate balance at the assembly and buy compromises.**
- **We also introduce for the first time forecasts for 2026. They assume reduced political and fiscal uncertainty (that can result either from a more stable grand coalition without the RN and LFI or from new general elections in H225). This would imply growth returning to 1.1% (i.e. the level of potential growth, although the output gap would remain negative at the end of 2026), despite a slightly more ambitious but still weak fiscal consolidation, resulting in a 5.5% public deficit. The debt-to-GDP ratio would therefore rebound to almost 120% on that horizon. On the top of that, risks are mainly tilted toward even higher deficit and debt ratios over that outlook due to execution risks and downward risks on growth.**

We are trying to include the latest political developments, with the toppling of Barnier's government, and the failure of its Budget Bill for 2025.

Our central scenario now assumes a 'special law' adopted before the end of the year, with funding voted for 2024 extended to 2025, ensuring continuity of public service. The Council of State clarified in an opinion this week what is possible or not in a special law[1]. We confirm that under the special law, the deficit will be around 6% on a yearly basis.

A proper Budget Bill would then be submitted by a new government and probably passed in H125.

[1] *In particular, it clarified the two main interrogations we had. It affirmed that:*
a/Some amendments could be put into the Special Law even if relative to the social security Bill. So ACOSS will be authorized to issue debt and the social security deficit will likely rise from EUR18bn to EUR33bn on a yearly basis.
b/ Personal tax income brackets cannot be changed in a Special Law. An ad hoc law could be voted at the start of 2025 to authorize this though. This measure is almost systematic in French Budgets and was supported by the whole National Assembly. It amounts to c.EUR4bn per year.

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Why do we cut our French growth outlook from 1.0 to 0.8% for 2025?

The growth figure for 2024 would not be revised, as the carryover at the end of Q3 is already at 1.1% (which is the level of our forecast), and as the latest political developments occurred in December, so it is unlikely that any potential effect will show up in the Q4 figures.

In addition, the Banque de France is still expecting zero growth in the fourth quarter according to its monthly business survey at the beginning of December, in line with our forecast, which, in fact corresponds to an underlying growth in activity of 0.2%, combined with a backlash of -0.2ppt from the effect of the Olympics.

However, the 2025 outlook has quite materially changed.

A brake on corporate investment, as Bernanke would say

In 1980, Ben Bernanke wrote a seminal paper called "Irreversibility, Uncertainty, and Investment" that showed that a substantial part of corporate investment is 'irreversible'. It means that corporate investment is usually difficult or impossible to reverse without incurring significant costs (eg, if a company builds a factory or invests in long-term equipment, it cannot easily sell or repurpose these assets if the investment turns out to be unwise).

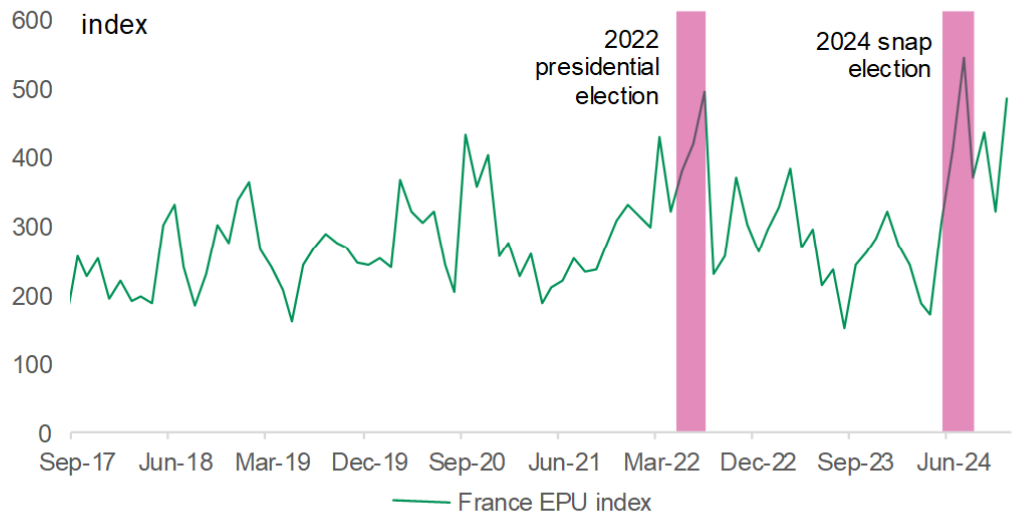
Uncertainty provides strong incentives for firms to cut or postpone large, irreversible investments if they are uncertain (typically because of political or fiscal change) about the future because they risk locking themselves into a bad decision[2].

At a macro level, empirical evidence supports Bernanke's take: **economic cycles—particularly recessions or periods of high uncertainty—can have a disproportionate impact on investment behaviour.**

In France, business investment was showing signs of slowdown in 2024 already after years of outperformance. In Q324, gross fixed capital formation, the nickname for investment, was down by 3.1% YoY for non-financial businesses. This fall is clearly related to the past tightening of financial conditions, the effects of which are still being felt. A massive uncertainty shock occurred with the dissolution of the national assembly in June. Economic policy uncertainty (EPU) indices that quantify those shows a surge in June 2024 that has not clamed since then.

Note that the current global uncertainty on trade policies in addition to this internal political situation, can add noise and affect investment decisions as well.

EPU Indices France



Source: Economic policy uncertainty based on 'Measuring Economic Policy Uncertainty' by Scott R. Baker, Nicholas Bloom and Steven J. Davis, Crédit Agricole CIB

[2] *More into details, Bernanke's model incorporates economic uncertainty into investment decisions. It is an early contribution to real options theory, which treats investment decisions as options. In this context, the firm has the option (but not the obligation) to invest in the future. This option has value, and its value depends on the level of uncertainty in the market. The uncertainty Bernanke talks about is not just about whether the investment will be profitable but also about the broader economic conditions that could affect future profitability, such as market demand or government policies. The idea is that firms might delay investment until uncertainty is resolved because, just like with financial options, the value of waiting can be high. If a firm invests too early and the investment turns out to be wrong, they lose the option to wait and re-evaluate. So, the more uncertain the economic future, the greater the value of waiting.*

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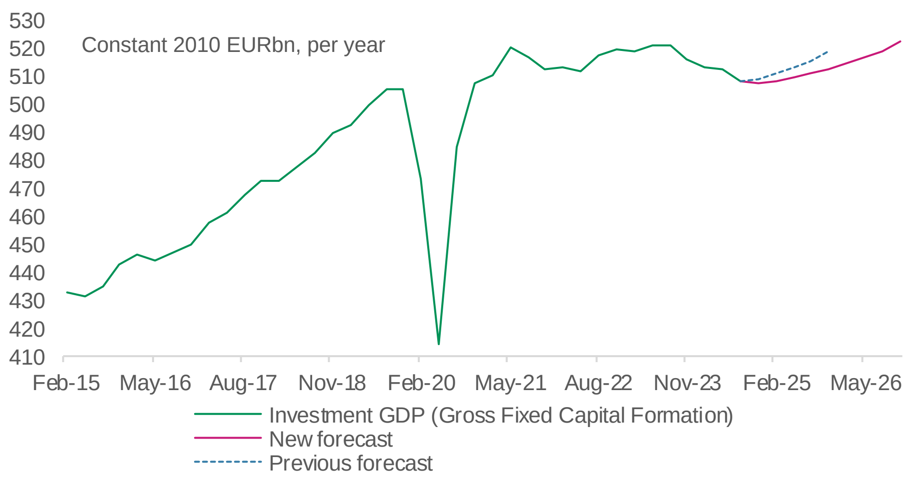
French economist Laurent Ferrara [recently estimated in a blog article] that "the economic policy uncertainty shock observed in the third quarter 2024 represents approximately five standard deviations [on EPU], this would imply an additional 2% decline in the level of investment within a year and a half". He computes those figures using an impulse response function to an EPU shock using the local projections method on the French corporate investment case[3]. He finds that "a one-standard-deviation shock to the EPU indicator leads to a significant reduction in the log-level of investment of about 0.4% six quarters after the shock".

In another post on the OFCE blog early December, Raul Sampognaro quantified the effect of the recent political uncertainty level at -0.3pt of growth in 2025, especially through a weaker non-financial companies' investment as well. This estimate preceded the collapse of Barnier's government, but at this time we believed that uncertainty would be reduced by the vote on a budget.

Considering the latest developments, it was now time to incorporate the effect of uncertainty into our forecasts. The failure of Barnier's government and the postponement of a budget may be adding some uncertainty, but with no certitude on the impact. **Thus, in line with those estimates, we took a relatively conservative take and reduced our non-financial corporate investment forecast from +1.1% to -0.2% for 2025[4].**

Our quarterly profile now displays a very limited rise in H125 that would increase progressively afterwards, but the rebound would occur essentially in 2026, in line with the lag in the monetary policy easing, and less uncertainty anticipated at this horizon.

Investment in level and our forecasts (old and new)



Source: Refinitiv, Crédit Agricole S.A./ECO & Crédit Agricole CIB

Accordingly, our downward revision of investment by non-financial companies accounts for -0.15ppt of growth in 2025, including -0.05ppt due to carryover effect at the end of Q3 2024 that is not related to the effect of the latest political developments.

Households savings rate to stay even higher for even longer

On the labour market, we revised a bit our forecasts, with an unemployment rate that would raise more than previously anticipated, to an average of 7.7% in 2025 up 0.2ppt from our previous forecast, and from 7.4% in 2024. This revision is in line with the growth revision and a more pronounced wait-and-see attitude on the part of businesses in terms of recruitment. The ILO unemployment rate[5] would nonetheless stay at a relatively low level by historical standards over the forecast horizon (7.8% in 2026): as a reminder, it averaged 9.6% between 2010 and 2019 for France excluding Mayotte.

With regard to the attitudes of households, we also expect greater wait-and-see behaviour, with a savings rate even rising a bit in Q4 2024 and staying at this very high level through H125 (at 18.5%), reflecting substantial precautionary savings. The savings rate would then decline progressively, but only slightly, to 17.5% in Q4 2026. As a comparison, the savings rate in France was close to 14% before the

[3] He identifies the uncertainty shock by controlling for log-GDP and the 10-year sovereign interest rate.
[4] With a negative carryover at the end of 2024.
[5] *The measure allowing international comparisons.*

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Covid crisis (2015-2019). This high level of the savings rate would largely be the result of uncertainty in the short run, but could also result from some Ricardian effects given the current state of public finances.

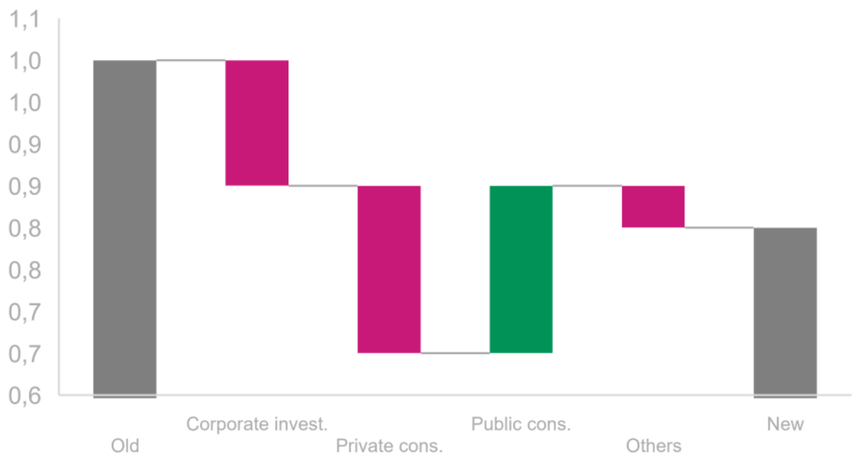
The downward revision of household consumption accounts for -0.2ppt of growth in 2025. Overall, the revision to the growth scenario due to more wait-and-see behaviour on the part of households and businesses because of political uncertainty is therefore around 0.4ppt in 2025.

Higher public consumption as deficit does not recede

An upward revision on public consumption, due to a smaller fiscal adjustment, offset the previously mentioned drag by half (+0.2ppt on 2025 growth).

Overall, we cut our growth forecast from 1.0% to 0.8% for 2025.

Waterfall 2025 French growth forecast: from +1.0% to +0.8%



Source: Crédit Agricole S.A./ECO & Crédit Agricole CIB

Impact on budget metrics already significant with a 6.0% deficit in 2025

For 2024, our new public deficit forecast (6.2% of GDP) is a bit higher than the one by the departing government (6.1% in Barnier's budget bill for 2025), but in line with the November forecast of the European Commission, which is more recent.

For 2025, our baseline assumption is based on a Budget Bill passed in H125 but that will not be materially different from the Special Law. We estimate that the deficit will reach EUR178bn, around EUR27-28bn higher that the figure put by Barnier in this first draft in October. However, this is not far from where we would have landed after the concessions he tried to make to the RN at the end of November.

Without taking into account our growth cut, our deficit projection would have been around 5.8% of the GDP. This represents c.EUR30-35bn of fiscal consolidation relative to a pure unchanged fiscal policy.

On the top of that, lower growth increases the deficit ratio further through two channels: (1) a pure denominator effect and (2) a lower public revenues / tax receipt. We estimate that in total, this growth effect contributes to a further 0.2ppt increase in the deficit as a % of GDP.

We therefore reach a final deficit number of 6.0% for 2025. It should be remembered, however, that this represents a certain adjustment compared to the trend deficit of 6.9% of GDP calculated by Bercy and mentioned in the Barnier government's draft finance bill for 2025.

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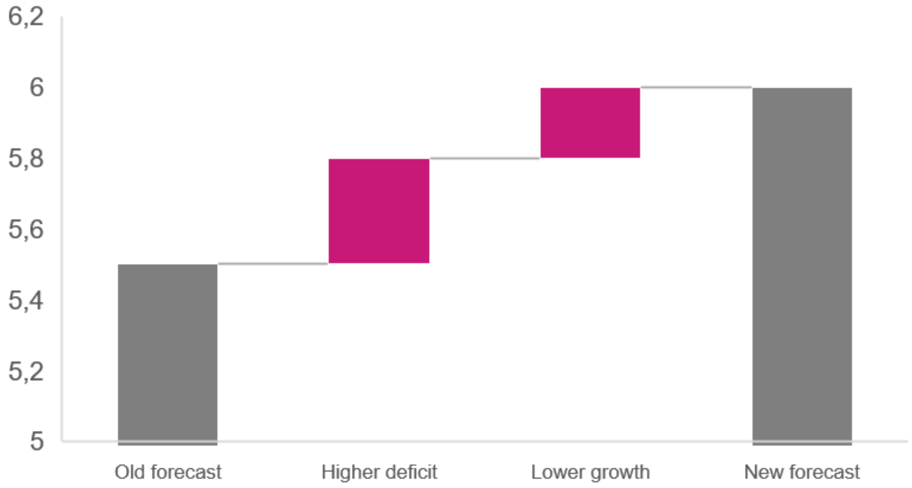
Waterfall 2025 French deficit forecast: from +5.5% to +6.0%



Source: Crédit Agricole S.A./ECO & Crédit Agricole CIB

What about 2026? Some hopes…

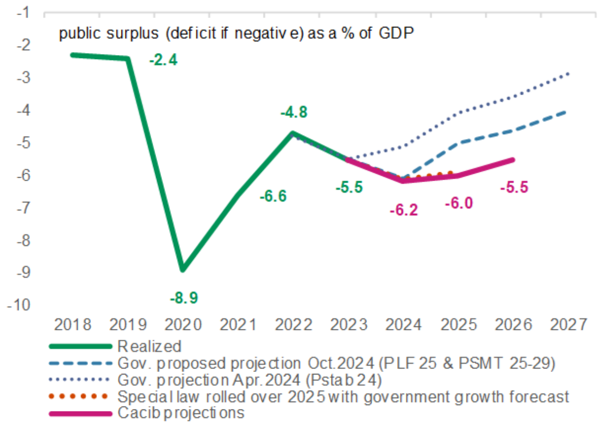
We also introduce for the first time forecasts for the year 2026.

We assume reduced political and fiscal uncertainty (that can result either from a more stable grand coalition without the RN and LFI or from new general elections in H225). This remains largely uncertain as of now, but it this seems a reasonable baseline scenario at this stage.

This would imply growth returning to 1.1%, i.e. the level of potential growth (although the output gap would still be negative at the end of 2026), despite a slightly more ambitious but still weak fiscal consolidation, resulting in a 5.5% public deficit. The debt-to-GDP ratio would therefore rebound to almost 120% on that horizon.

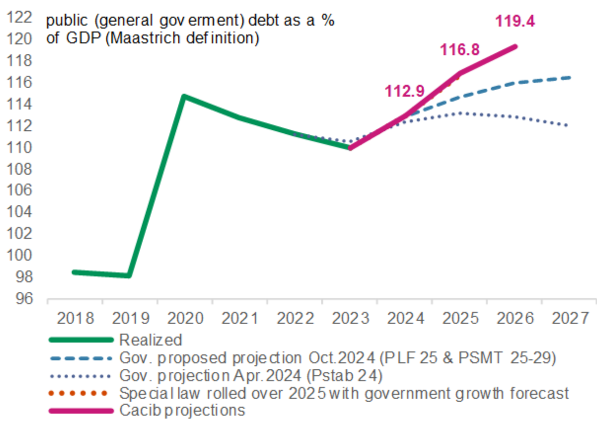
On the top of that, risks are mainly tilted toward even higher deficit and debt ratios over that outlook due to execution risks (local entities spending remains a topic that has not been addressed) and downward risks on growth due to the uncertainty (in economic and fiscal national policy, as well as global trade policy) and negative feedback loops.

Projections of deficit trajectories



Source: French Ministry of Finance, Crédit Agricole S.A./ECO & Crédit Agricole CIB

Projections of debt-to-GDP ratio trajectories



Source: French Ministry of Finance, Crédit Agricole S.A./ECO & Crédit Agricole CIB

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