



FRANCE 2022-2023 SCENARIO

STRONG HEADWINDS TO GROWTH

June 2022

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WORKING EVERY DAY
IN YOUR INTEREST



GROUP ECONOMIC RESEARCH

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SUMMARY

INFLATION WEIGHS ON DOMESTIC DEMAND

After rebounding sharply to 6.8% in 2021, GDP growth is expected to slow significantly this year. Despite a drop in first-quarter GDP (-0.2% compared to the previous quarter), France should avoid recession in the short term, as GDP is expected to grow slightly (+0.3%) in the second quarter, particularly with stronger activity in services, and to continue to grow gradually in the second half of the year. Overall, **growth is expected to reach 2.4% this year**, a relatively high figure, largely driven by a very favourable growth overhang of 1.9% at the end of the first quarter. Indeed, inflationary pressures exacerbated by Russia's invasion of Ukraine in March are holding back consumption, increasing uncertainty and forcing us to revise our growth forecasts downwards. Despite the introduction of the "tariff shield" and the "purchasing power law" that will soon be adopted, and even though the labour market remains dynamic, household purchasing power is expected to decline in 2022. The "tariff shield" would nevertheless reduce inflation by 2 points compared to the level it would have reached otherwise.

In 2023, we expect growth to remain positive, but moderate, at 1.3% with a possible acceleration in domestic demand during the year as inflation slows. However, the outlook for 2023 is uncertain. For example, the sudden halt in Russian natural gas exports would lead to a further increase in energy prices and disrupt industrial activity in some European countries, particularly in Germany. The return

of zero-Covid policies in Asia could also disrupt value chains, while the rebound in activity in these countries is a prerequisite for the recovery in production in certain sectors in Europe, in particular the automotive industry. If they were to materialise, these risks would cause new inflationary pressures that would once again hamper demand in a context of rising interest rates. The risk of recession would then be high.

Main components of the scenario:

- **Household consumption** is expected to be the main growth driver, buoyed by a significant overhang effect following the recovery in service activities in the second half of 2021. In 2022, growth in household consumption is expected to slow but remain positive despite the decline in purchasing power and rising inflation. Moreover, while it does not support consumption in volume terms, the excess savings accumulated during the crisis allow households to cope with rising prices to some extent. Consumption is expected to continue to rise in 2023 with the slowdown in inflation and a normalisation of activity in certain sectors such as the automotive industry.
- After being particularly dynamic in 2021, **business investment** should continue to be supported by the stimulus plan, particularly in certain industrial sectors. Nevertheless, the likely pressure on

margins and higher interest rates should lead some companies to postpone their investments and a significant slowdown is envisaged.

- **Inflation** is weighing on purchasing power and corporate margins and is the main reason for the slowdown in domestic demand, as well as the decline in demand from our main trading partners. Assuming that energy prices stabilise at their current high levels, inflation would slow throughout 2023.
- Despite the decline in demand due to the slowdown in economic activity in Europe, foreign trade could contribute positively to growth in 2022. The structure of French exports is less exposed to disruptions in value chains than that of our neighbours (notably Germany) and activity in the aviation sector is expected to increase throughout the year. The lifting of health restrictions in Asia would also allow some tourist flows to resume.
- The labour market is expected to remain on a sound footing despite a slowdown in job creation after an exceptional 2021. A slight rise in the unemployment rate in 2023 cannot be ruled out in the event of a sharp slowdown in domestic demand.

SUMMARY

GROWTH DRIVEN BY CONSUMPTION DESPITE A CONSIDERABLE SLOWDOWN

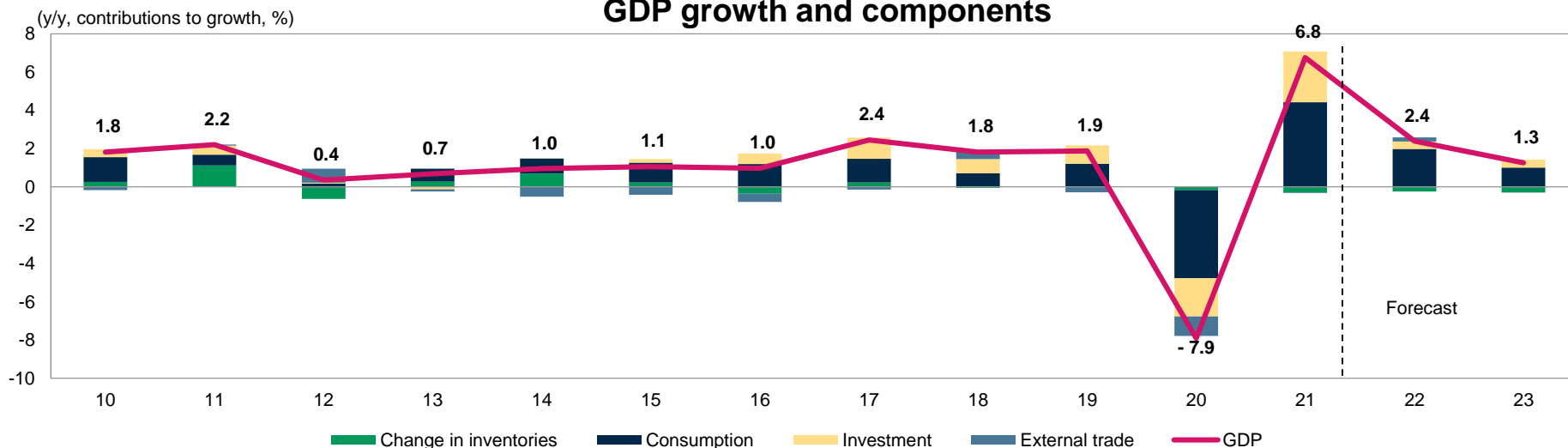
Main numbers of our outlook

France	Annual average (y/y, %)					Quarterly growth (q/q, %)											
	2019	2020	2021	2022	2023	2020				2021				2022			
						T1	T2	T3	T4	T1	T2	T3	T4	T1	T2	T3	T4
GDP	1.9	-7.9	6.8	2.4	1.3	-5.7	-13.7	19.4	-1.4	0.2	1.0	3.2	0.4	-0.2	0.3	0.2	0.3
Households consumption	1.8	-6.8	5.2	2.6	1.8	-5.5	-11.5	19.0	-5.6	0.2	1.2	5.8	0.3	-1.5	0.6	0.4	0.4
Investment	4.2	-8.4	11.3	1.6	1.7	-9.3	-14.4	24.0	2.3	1.1	2.0	0.3	-0.3	0.6	0.4	0.4	0.4
Corporate investment	3.5	-8.0	11.8	1.8	2.2	-8.9	-14.2	24.3	1.7	1.8	1.9	0.3	-0.2	0.6	0.4	0.5	0.5
Change in inventories*	0.0	-0.2	-0.3	-0.2	-0.3	0.5	0.7	-2.2	0.5	0.5	0.0	-0.7	0.3	0.4	-0.2	-0.1	0.0
Net exports*	-0.3	-1.0	0.0	0.2	0.0	-0.4	-1.6	0.8	0.6	-0.7	0.1	0.7	-0.5	0.2	0.0	0.0	0.0
Unemployment (Insee)	8.2	7.8	7.7	7.2	7.4	7.6	7.1	8.8	7.8	7.9	7.8	7.8	7.2	7.1	7.1	7.2	7.2
CPI Insee (yoy)	1.1	0.5	1.6	5.5	4.5	1.2	0.3	0.3	0.1	0.7	1.4	1.7	2.7	3.7	5.3	6.3	6.3
Government deficit (% of GDP)	-3.1	-8.9	-6.4	-5.7	-5.4												

* Contributions to GDP growth

Source : Crédit Agricole SA/ECO, forecast

GDP growth and components



Sources: INSEE, Crédit Agricole S.A. / ECO

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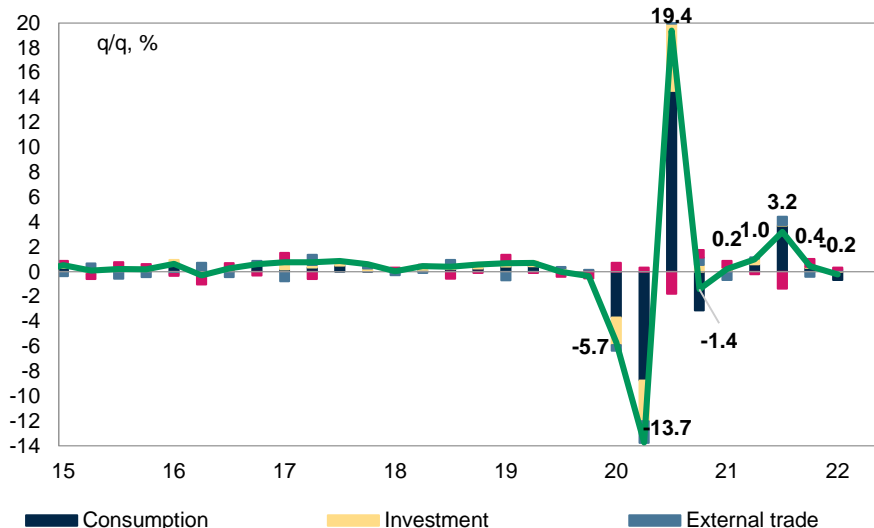
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RECENT TRENDS IN ACTIVITY

DECLINE IN GDP IN THE FIRST QUARTER

GDP growth and contributions

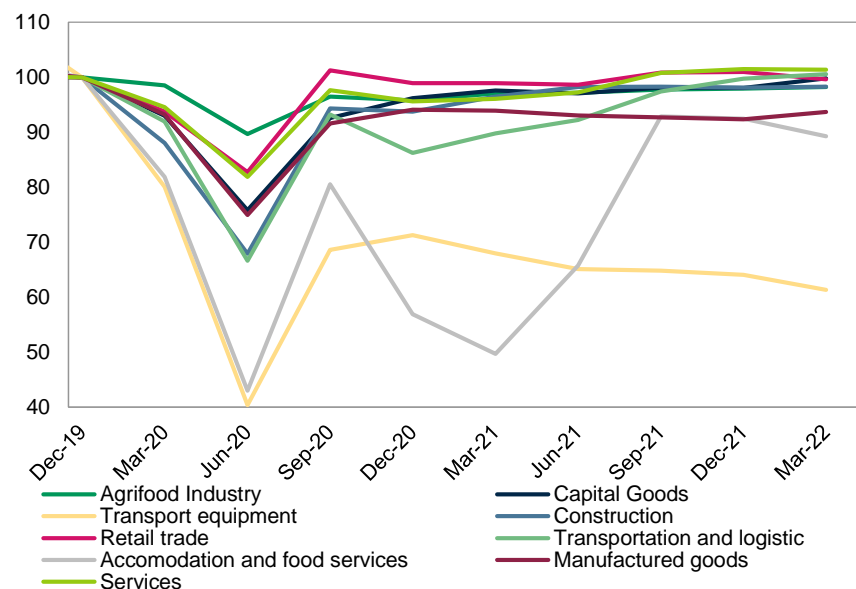


Sources: INSEE, Crédit Agricole S.A. / ECO

After returning to and then exceeding its pre-crisis level, GDP contracted slightly in the first quarter of 2022 (-0.2% vs. Q4 2021). With very dynamic growth in the second half of 2021, a slowdown was expected, but it was more marked than anticipated with a decline in domestic demand. Penalized by the health restrictions linked to the Omicron epidemic wave, household consumption fell 1.5% in the first quarter.

The acceleration in inflation also weighed on household consumption and led to a sharp decline in purchasing power. In March, the invasion of Ukraine by Russia reinforced these inflationary pressures and negatively affected consumption due to an increase in uncertainty.

Trend in value added by sector



Sources: INSEE, Crédit Agricole S.A. / ECO

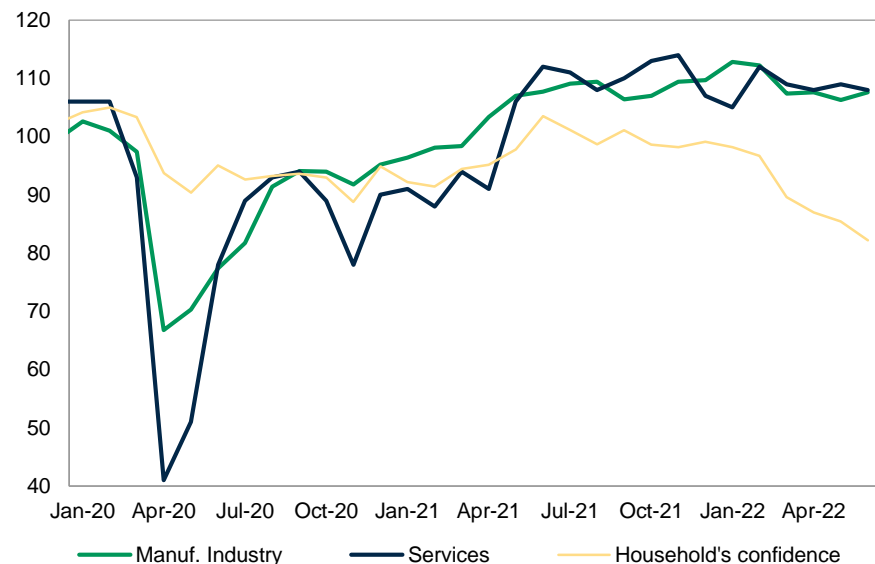
Business investment, inventory movements and foreign trade contributed positively to growth, partially offsetting the decline in consumption.

In terms of sector trends, the added value produced by the manufacturing sector increased by 1.5% compared to Q4 2021 despite a persistent decline in transport equipment production activity, which remains highly disrupted by semiconductor shortages despite strong demand. Accommodation and restaurants also declined in the first quarter, impacted by the Omicron wave.

RECENT TRENDS IN ACTIVITY

TIGHTENING OF SUPPLY CONSTRAINTS AND DETERIORATION IN CONFIDENCE

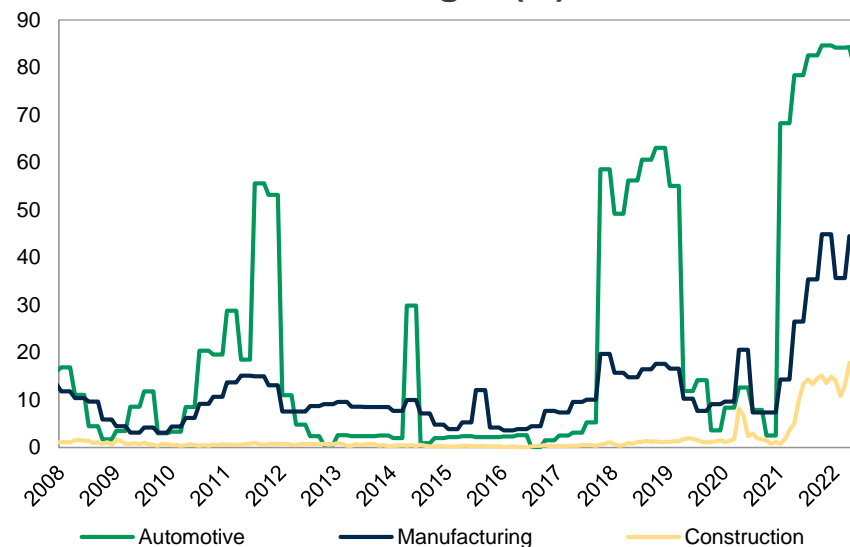
Business climate and consumer confidence



Sources: INSEE, Crédit Agricole S.A. / ECO

The conflict in Ukraine has led to a deterioration in the confidence of economic agents. Despite a moderate decline in recent months, the business climate remains relatively positive, both in manufacturing and services, even if the outlook for activity has deteriorated slightly. Consumer confidence has fallen sharply over the past six months. Inflation and purchasing power are the main sources of concern for households, even though the labour market remains dynamic. Consumer confidence stands at 82, well below its long-term average (100) and at its lowest level since 2013. Nevertheless, we expect positive growth in household consumption in the second quarter. With all health restrictions lifted, activity is expected to pick up in the service

Companies whose activity is limited by supply shortages (%)



Sources: INSEE, Crédit Agricole S.A. / ECO

sectors and, in particular, in the accommodation and restaurants sector.

On the supply side, constraints remain present. The automotive industry is the hardest hit and more than 80% of entrepreneurs in this sector believe that their activity is limited by these constraints, and in particular by the shortage of semiconductors, which explains why production remains nearly 40% lower than its pre-crisis level despite strong demand. Supply constraints are also noticeable to a lesser extent in the manufacturing and construction industries; so far this has mainly resulted in increases in production costs, but activity remains buoyant in these sectors.

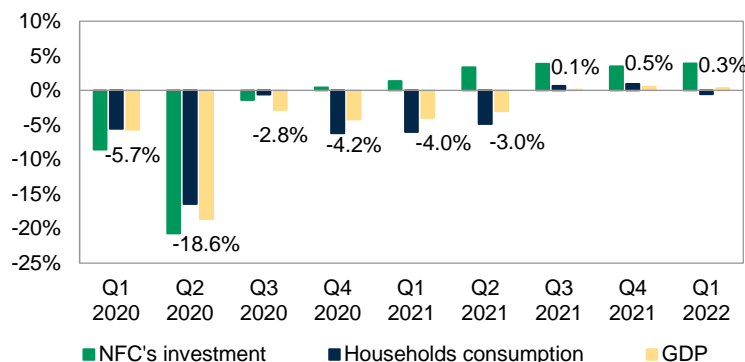
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OUR SCENARIO FOR 2022-2023

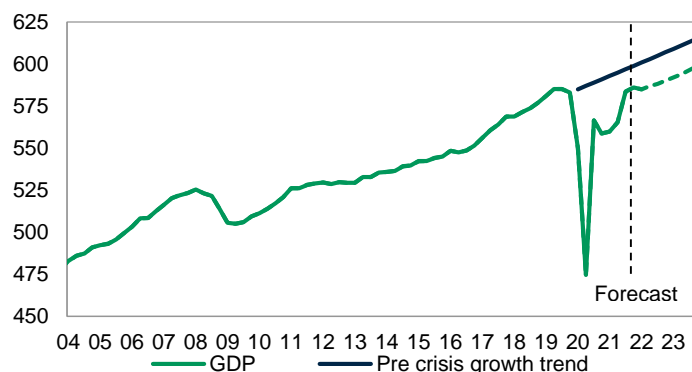
A SIGNIFICANTLY DELAYED CATCH-UP

Level compared with Q4 2019



Sources: INSEE, Crédit Agricole S.A. / ECO

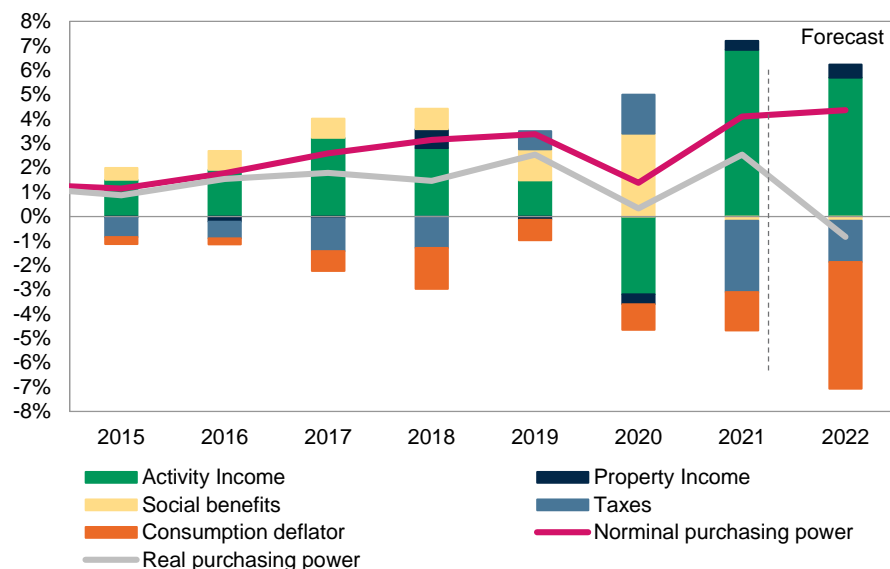
Quarterly GDP



OUR SCENARIO FOR 2022-2023

CONSUMPTION: DECLINE IN PURCHASING POWER AND SLOWING DEMAND

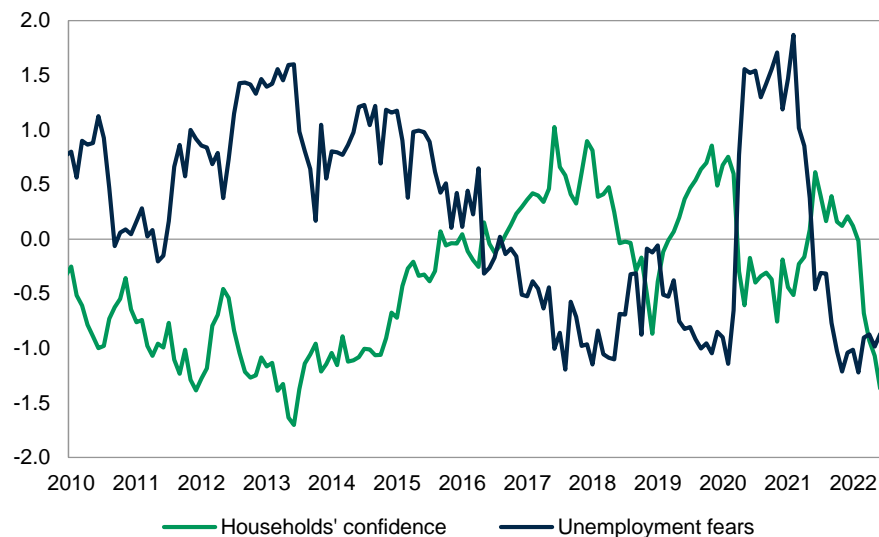
Growth in purchasing power and contributions



Sources: INSEE, Crédit Agricole S.A. / ECO

Consumer confidence has been in free fall for several months, while the labour market remains on a sound footing, as evidenced by the balance of opinion on concerns surrounding unemployment, which remains at a very low level. As such, it is the trend in prices that is worrying households and creating uncertainty about their future financial situation. This does not encourage them to incur significant spending, thus weighing on consumption. Inflation is also expected to lead to a sharp contraction in household purchasing power, which could fall by around 1% in 2022 after rising by 2.5% in 2021. However, job creation remains buoyant, but wages, although on the rise, have not offset the rise in prices. **We therefore expect a sharp slowdown in growth in household consumption.** Despite a contraction in the first quarter, it is expected to rebound slightly over the following three

Consumer confidence (normalised balance of opinion)



Sources: INSEE, Crédit Agricole S.A. / ECO

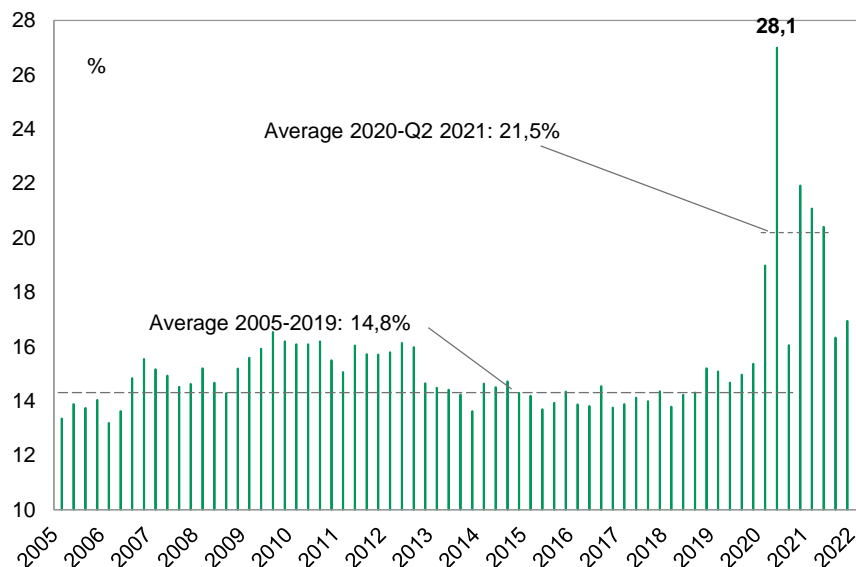
quarters and thus reach 2.6% on average in 2022, a figure seemingly high but achievable thanks to the strong performance of consumption at the end of 2021, which led to a carryover of 1.8% at the end of Q1. In 2023, while inflationary pressures are expected to gradually decline throughout the year, household consumption is expected to increase by 1.8%.

The fiscal measures limiting inflation (tariff shield) and the new "purchasing power law" proposed in July (reevaluation of the index point for civil servants, basic welfare benefits and basic pensions, energy and food vouchers) will not prevent the contraction in purchasing power but will limit its magnitude.

OUR SCENARIO FOR 2022-2023

DIFFICULTIES HARNESSING SURPLUS SAVINGS

Household savings rate

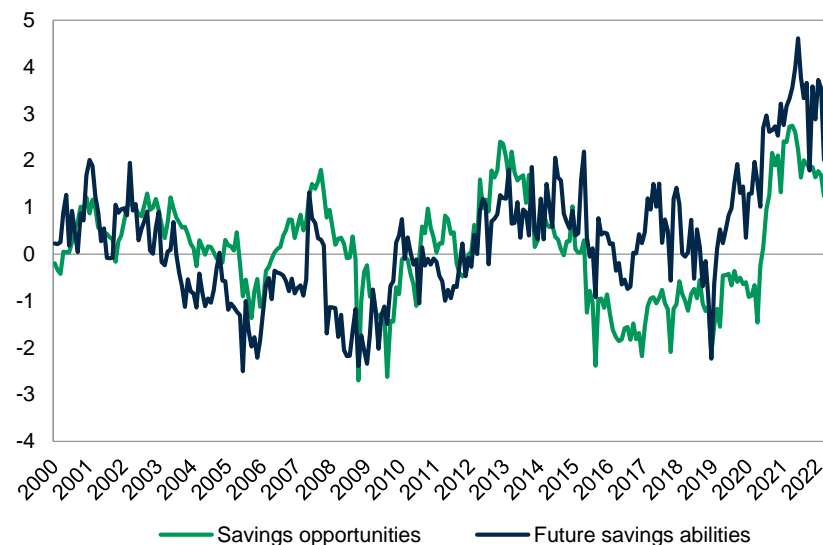


Sources: INSEE, Crédit Agricole S.A. / ECO

With inflation on the rise, households are spending part of their savings surplus to cope with the rise in prices. According to the Economic Analysis Council (EAC), the savings buffer for households with the lowest income has already been spent.

Moreover, as inflation picks up, it may seem appropriate to consume more today rather than seeing one's savings stock lose value in the future. However, **faced with uncertainty, households continue to save at a high rate**. In the first quarter, the savings rate reached 16.7%, higher than its level before the Covid-19 crisis (around 15%). In addition, while household confidence has deteriorated sharply, households' balance of opinion on their future savings capacity and

Household balances on savings



Sources: INSEE, Crédit Agricole S.A. / ECO

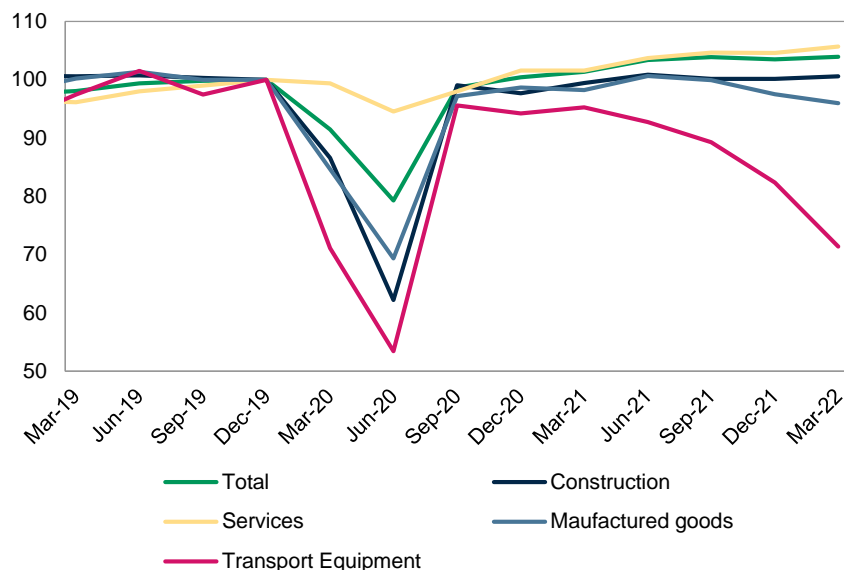
savings opportunities remains high despite a drop in recent months. This can be explained by the Real Balance effect. During periods of high inflation and uncertainty, households tend to preserve not a certain stock of savings but the value of their savings' purchasing power in order to be able to cope with future spending deemed essential. Thus, while inflation reduces the future purchasing power of savings, households are encouraged to put more aside even if this requires them to limit their current consumption, particularly in terms of non-essential goods and services.

In addition, geopolitical concerns and the risk of economic slowdown are supportive of precautionary savings.

OUR SCENARIO FOR 2022-2023

NFC INVESTMENT: BETWEEN SUPPORT FACTORS AND A WAIT-AND-SEE ATTITUDE

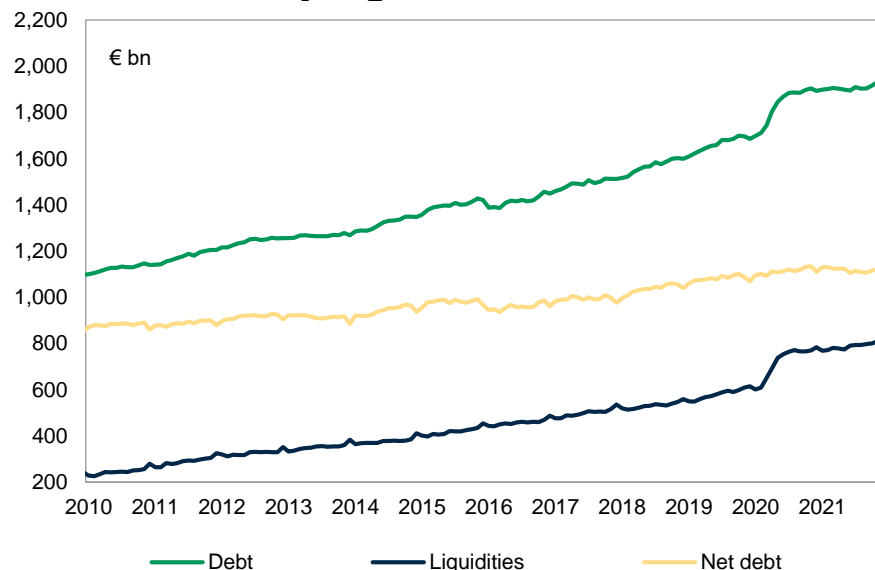
Investment of NFCs by item
(Q4 2019=100)



Sources: INSEE, Crédit Agricole S.A. / ECO

Business investment was very dynamic in 2021 and rebounded for most of the items except for transport equipment, which is still penalised by supply constraints. **After increasing by 11.4% in 2021, investment by non-financial companies (NFCs) is expected to grow by 1.6% in 2021 and 2.1% in 2023.** Several factors explain this significant slowdown. First of all, this is a return to more normal growth, while NFC investment returned to pre-crisis levels in Q4 2020 and continued to rise in 2021. Secondly, companies are caught in a vise between rising production costs on the one hand and, on the other, demand that remains limited. The pass-through of higher input costs to selling prices is therefore only partial, leading to pressures on margins (which nevertheless remain at high levels). With inflation expected to accelerate further by the end of the year and a slowdown

NFC debt and cash:
very high cash reserves



Sources: Banque de France, Crédit Agricole S.A. / ECO

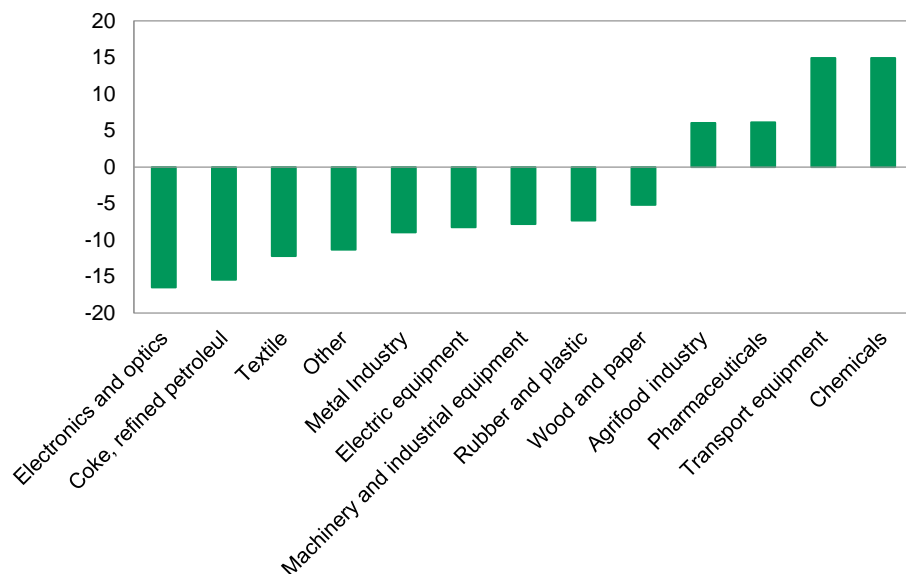
in demand, companies can be encouraged to take a more wait-and-see approach and reduce their investment projects. They still have significant cash reserves. While these reserves could have allowed them to invest, it is now likely that some of them will be used to reduce their leverage in a context of rising rates and stress on the corporate bond market. However, the rise in rates can be put into perspective: with inflation rising rapidly, real interest rates remain significantly negative.

In terms of supportive factors, we note the strong financial health of companies in the wake of the health crisis and the fiscal stimulus measures such as France Relance or the France 2030 plan, which was revised upwards from €30bn to €54bn and will prioritise supporting investment in certain industrial sectors.

OUR SCENARIO FOR 2022-2023

INTERNATIONAL GOODS TRADE: UNFAVOURABLE TRADE TERMS

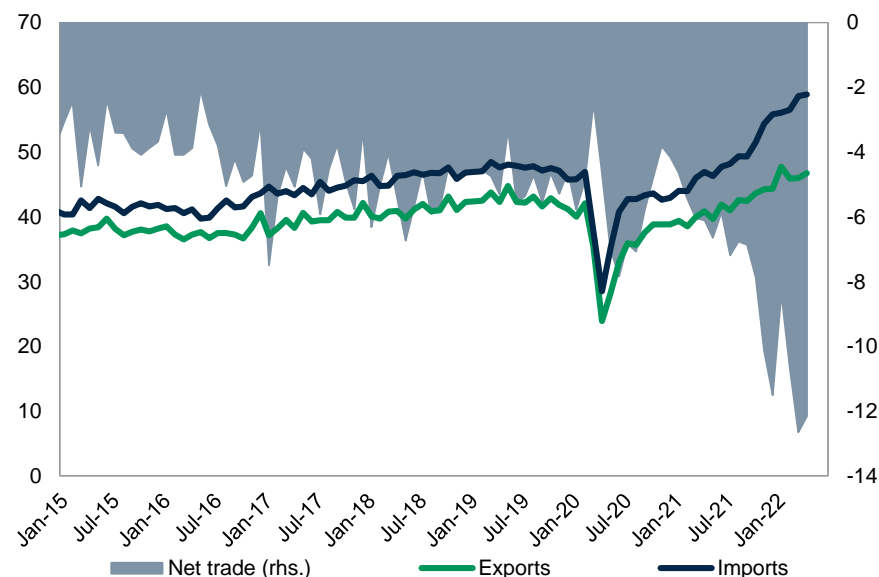
Trade balance by sub-sector
(value, €bn, 2019)



Sources: Customs, Crédit Agricole SA / ECO

The trade balance in goods has continued to worsen in recent months, particularly due to a deterioration in terms of trade, i.e. a faster rise in the price of imported goods (particularly energy) than in that of exports. In volume terms, however, exports grew at a rate higher than imports in the first quarter and foreign trade made a positive contribution to growth by 0.2 points. Moreover, despite a slowdown in demand from other European countries and a downward revision of our growth forecasts, the specifications of French exports could be slightly favourable compared to those of our German and Italian neighbours in particular. The lifting of health restrictions and the zero-

Goods trading
(monthly data, €bn)



Sources: Customs, Crédit Agricole SA/ ECO

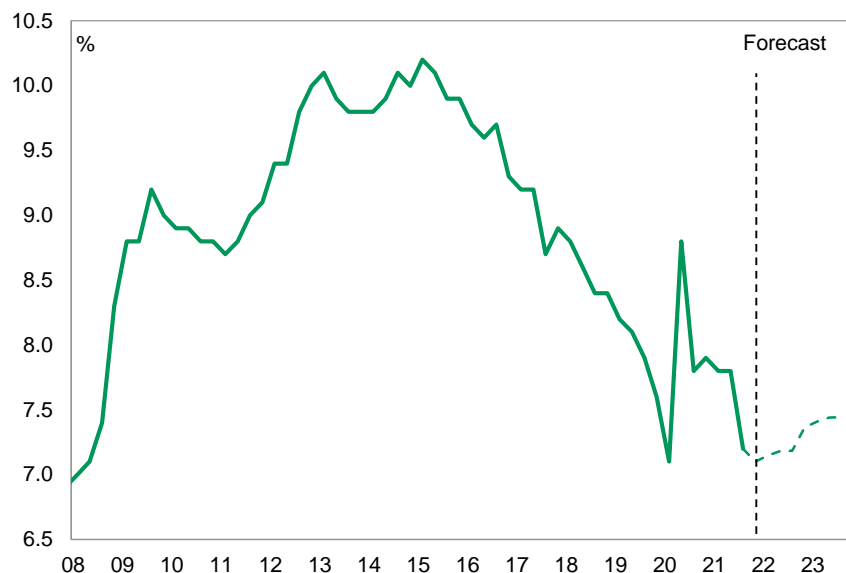
Covid policy in Asia could allow some tourists to return to France. Moreover, after having suffered order cancellations at the height of the Covid-19 crisis, production in the aviation sector is expected to pick up throughout the year, along with exports. The aviation sector is one of the pillars of French industry and accounted for 13% of exports of goods and services before the health crisis.

Overall, **foreign trade is expected to contribute 0.2 points to GDP growth in 2022.**

OUR SCENARIO FOR 2022-2023

TOWARD A STABILISED UNEMPLOYMENT RATE?

Unemployment rate
(mainland France)

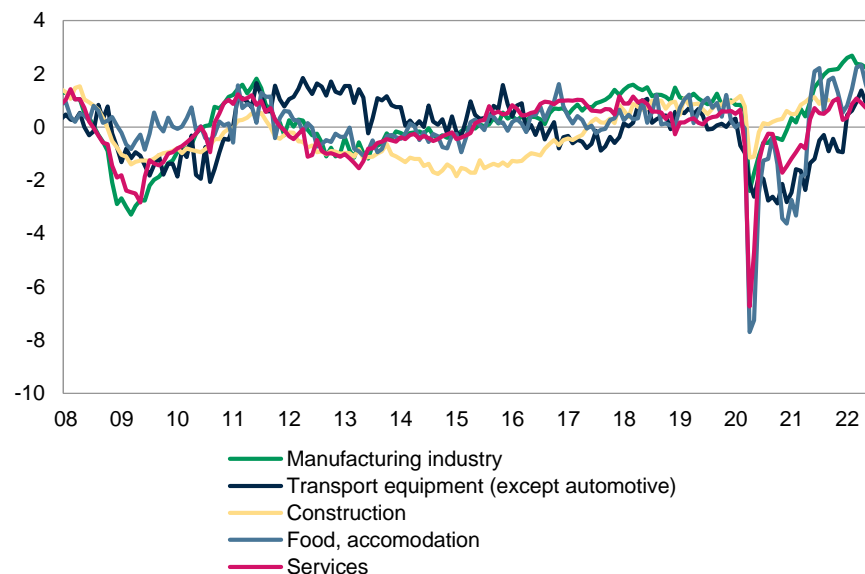


Sources: INSEE, Crédit Agricole S.A. / ECO

The unemployment rate fell again at the beginning of the year to 7.1% in mainland France, well below pre-crisis levels (7.9% in Q4 2019). After having been particularly marked in 2021 (nearly 600,000 more jobs in the private sector in one year), job creation slowed in Q1 but remained relatively strong. The slowdown in job creation is expected to continue in the coming quarters, but the labour market should remain on a sound footing, as evidenced by hiring intentions still above their long-term average in most sectors.

At the end of the year and in 2023, a slight rise in the unemployment rate cannot be ruled out. In 2021, employment grew at a faster pace

Hiring intentions
(normalised indicators)



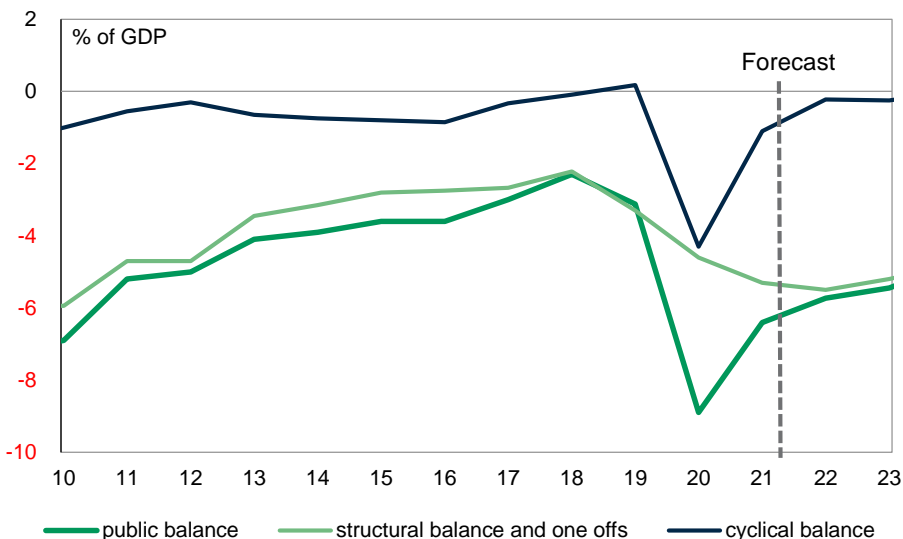
Sources: INSEE, Crédit Agricole S.A. / ECO

than economic activity, indicating a temporary deterioration in productivity as economic activity returned to its pre-health crisis growth trajectory. With the slowdown in demand and the (moderate) pressure on margins that we are anticipating following the acceleration in inflation, some companies could suspend some recruitment decisions. Thus, the unemployment rate is expected to average 7.2% in 2022 in mainland France (7.4% in France as a whole) but could rise slightly to 7.4% in 2023 (7.7% in entire France).

OUR SCENARIO FOR 2022-2023

PUBLIC FINANCES

Public deficit



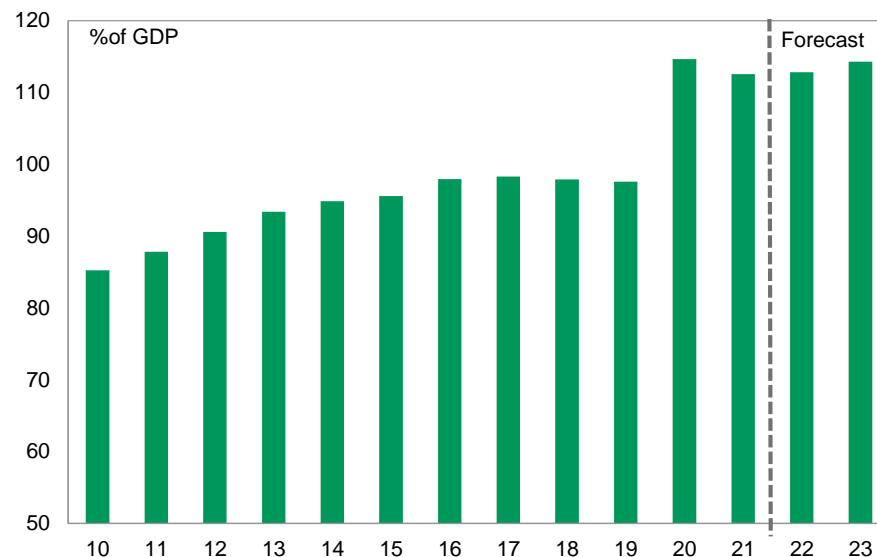
Sources: Minefi, Crédit Agricole S.A. / ECO

The public deficit remained high in 2021, at -6.4% of GDP, despite the recovery in activity. Emergency measures and the start of the stimulus plan cost €64bn. As a result, public debt increased sharply from 97.5% in 2019 to 112.6% in 2021.

In 2022, before Russia invaded Ukraine, the deficit was supposed to be reduced to 4.8% of GDP, the two main aims being to stabilise public accounts and support potential growth (with €30 billion budgeted as part of the stimulus plan). The economic recovery was also expected to contribute to reducing the deficit. Under the Stability Programme, the public deficit should be gradually reduced to 3% of GDP by 2027.

But the surge in energy prices and the conflict in Ukraine have reshuffled the deck. **The implementation of the “tariff shield” and**

Public debt



Sources: Minefi, Crédit Agricole S.A. / ECO

the purchasing power law will cost around €30 billion and the downward revision of our growth forecasts also impacts the public deficit, which is expected to be around 5.7% of GDP in 2022 and 5.4% in 2023. Public debt is expected to remain stable, at around 113%, in 2022.

The rise in bond yields has a negative impact on public finances, in particular due to inflation-linked bonds. However, prices have so far increased at a faster pace than rates, so real interest rates are still significantly negative. Finally, the average maturity of French debt is eight years, so the impact of the rise in interest rates on the interest expense will be gradual.

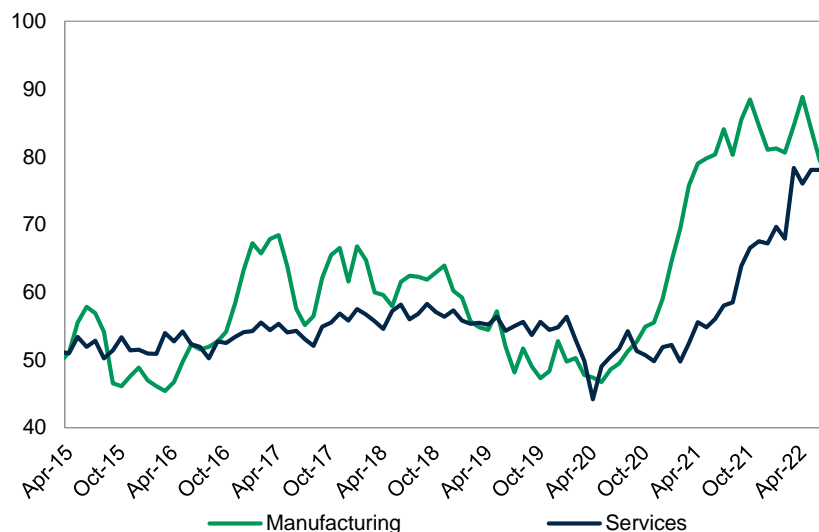
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FOCUS – INFLATION AND FISCAL BUFFERS

THE HEADACHE OF IMPORTED INFLATION

Balance of opinion on supply times and intermediate consumer prices

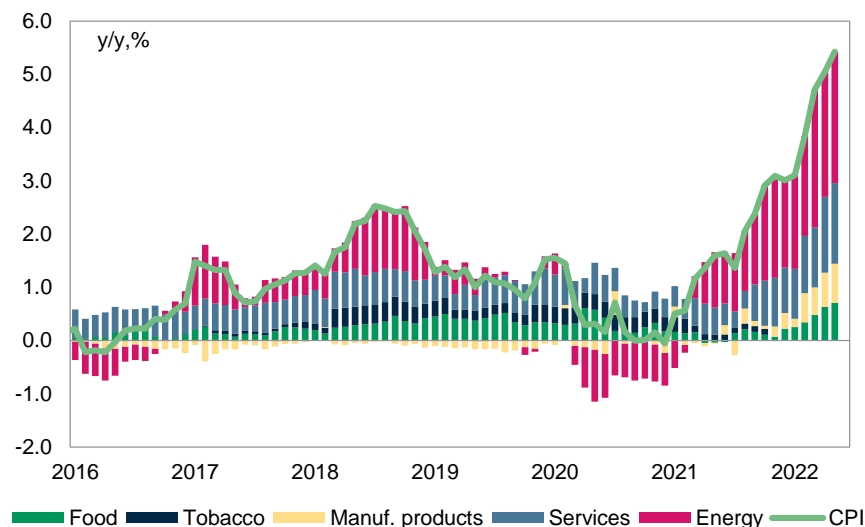


Sources: IHS Markit, Crédit Agricole SA / ECO

Initially due to an overheating of demand in the second half of 2021, inflationary pressures have accelerated significantly since the beginning of 2022, exacerbated by the invasion of Ukraine by Russia. Indeed, these two countries are important exporters of natural gas, oil and food commodities (wheat, oil seeds, etc.).

Driven by the increase in energy prices, inflation reached 5.8% year-on-year in France in June. Up 33% year-on-year, energy prices contributed 2.9 points to inflation, while energy accounts for only 9% of the average goods and services consumption basket for households. The rise in commodity prices is also spreading to the prices of goods and services, which rose 2.6% and 3.2% year-on-year in June, respectively, even though the increase in production costs is only partially reflected in sales prices.

Inflation and contributions



Sources: Insee, Crédit Agricole SA / ECO

Inflation is expected to accelerate further in the coming months and could reach a peak of over 6.5% year-on-year between September and the end of the year. On average, inflation should reach 5.5% in 2022.

Although the spread of the rise in commodity prices could continue in 2023, the gradual disappearance of base effects linked to the rise in energy prices would allow inflation to slow to 4.5% on average in 2023. However, prices would remain at high levels as inflation forecasts for 2023 are based on the assumption of a Brent barrel at around USD 120. Uncertainty around inflation forecasts for 2023 remains high.

FOCUS – ACCELERATION IN INFLATION

INFLATION: AN “INFLATION SHIELD” TO CLEAR INEQUALITY

Consumption by municipality of residence

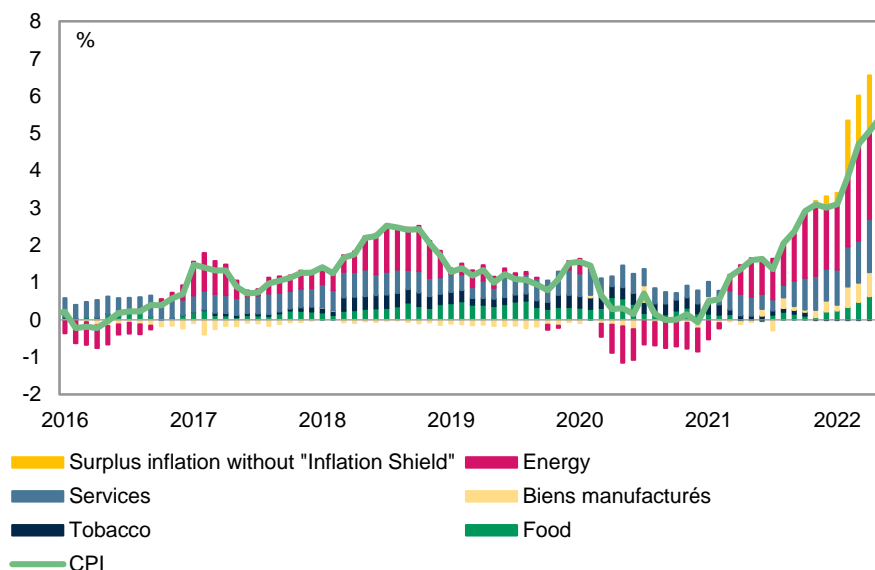
%	Food (inc. Tobacco)	Manufactured goods	Energy	Services
Overall	19.0	25.5	9.0	46.6
Rural	20.3	27.6	12.1	40.0
Small cities (< 20 000 inhab.)	19.6	26.9	10.6	42.9
Medium cities (20 000 to 100 000 inhab.)	19.0	25.2	9.6	46.2
Big cities (> 100 000 inhab.)	18.7	24.9	7.7	48.7
Paris	17.3	22.8	5.7	54.2

Sources: INSEE - 2017 Family Budget Survey, Crédit Agricole SA ECO.

Set up in October with the announcement of the freezing of gas prices and electricity prices, which were limited to 4% in February, then frozen, the “inflation shield” has since been strengthened by 18 cents per litre on fuels and measures dedicated to energy companies. The aim of this price control is to limit inequality in the face of inflation. The weight of energy in the consumption basket is doubled for Parisians compared with residents of rural municipalities. Significant inequalities in the face of inflation also exist between socio-professional categories and, to a lesser extent, according to the income decile.

Overall, the “tariff shield” reduces the rise in consumer prices in France by 2 points and therefore explains the bulk of the inflation gap

Inflation and the impact of the “tariff shield”



Source: Insee, Crédit Agricole SA / ECO

between France (inflation at +5.8% year-on-year in June) and other European countries (inflation at +8.6% on average over one year in the Eurozone as a whole).

Initially designed to combat the rise in energy prices, the “tariff shield” could be supplemented by the “purchasing power” law in July with income support measures as well as a framework for rent price trends. Some opposition groups will also propose blocking the prices of certain products, particularly food, and the contours of this future law are therefore quite unclear.

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