

## France: Business climate solid before a potentially dangerous winter

The improvement in business sentiment in October is good news for the French economy. Nevertheless, the peak of the economic recovery has probably passed. Rising energy prices are an additional problem for French companies and could weigh on economic growth this winter and into 2022



### Surprise improvement in business sentiment

At a time when the clouds are beginning to gather over the economic landscape, there is good news from French businesses: the business climate index rose by two points in October, reaching the significantly high level of 113. It has not been this high since June and it is now not far from its all-time high.

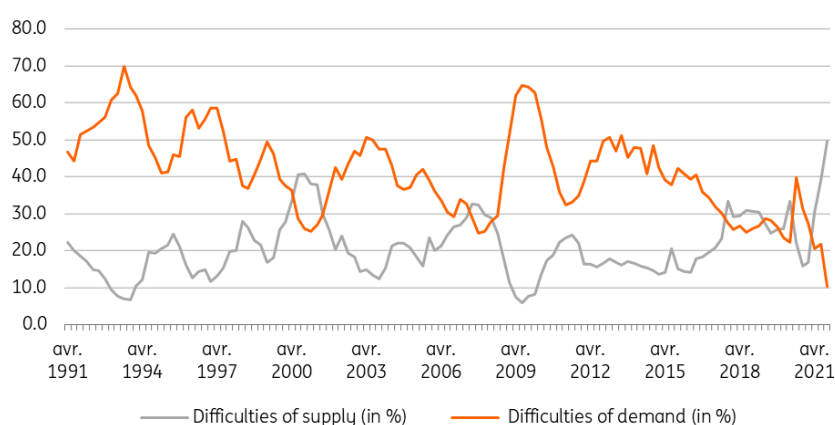
The improvement is mainly due to the service sector, where companies are more optimistic about the general business outlook, expected demand and planned activity. In the retail sector, the business climate has improved slightly. On the other hand, despite the evidence of some strong order books in the industrial sector, the business climate there is only managing to hold stable, hampered by less optimism about future production levels.

## Not enough supply, lots of demand

The details of the survey, perfectly illustrate how unusual the current situation is for French businesses. Never before in the history of the data (the series started in 1991) have so few companies been confronted with demand difficulties (only 10% of the companies surveyed), and never before have so many companies been confronted with supply difficulties (49% of companies). This is, of course, due to the global supply constraints which are weighing heavily on industry and preventing companies from meeting demand, thereby severely limiting the momentum of the economic recovery.

## Few companies confronted with demand difficulties, many companies confronted with supply difficulties

(% of companies, industrial sector)



Source: INSEE, ING Economic Research

As well as input supply problems holding back production, companies are also constrained in their output by a lack of staff; recruitment difficulties are at levels that have not been seen for 20 years or more. 57% of industrial companies say they are experiencing these difficulties, the highest level since 2001. In the services sector, 51% of companies are facing these difficulties, the highest level ever. In construction, 77% of companies are also having difficulty finding the necessary workers.

Overall, the rise in the business climate indicator is very good news, as it implies that the French economy is starting the 4th quarter on a more positive footing than previously expected. Despite the increasing difficulties, the economic recovery is still underway. Economic growth will probably be strong in the third quarter and dynamic at the beginning of the fourth quarter. Nevertheless, the peak has probably passed and we expect the business climate to deteriorate from November onwards.

## Energy crisis as an additional challenge

The accumulation of difficulties leads us to expect that growth will be weaker in the fourth quarter than in the third and that 2022 growth will probably be less dynamic than previously anticipated. Indeed, in addition to the supply and recruitment problems that will not be solved in the coming quarters, there is now also the energy issue, which risks undermining the morale and production of

French companies.

Indeed, the rise in energy prices will impact companies in two ways:

Firstly, because it is pushing costs up sharply, in a context where many other cost increases are also being felt. This puts pressure on company margins, as they seek to pass on higher costs into higher selling prices, but are not always fully and directly able to do so.

Secondly, because rising energy costs directly impact the consumer and reduce the portion of their income that is available for non-energy expenditures. The rise in energy prices, therefore, implies a reduction in the growth in demand that French companies face. The current shock from higher energy prices can be considered as having the same effect as a tax on the whole French economy.

The effect is therefore very clearly negative for economic activity and the outlook for this winter and early 2022. We estimate that growth in 2022 is likely to be lower than the government's target of 4%. A figure closer to 3.5% seems more realistic.

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