France: GDP growth slammed by drop in inventories

GDP growth unexpectedly contracted in the fourth quarter, hit by a surprise drop in inventories. And while domestic demand accelerated in 2019 from a year earlier, the latest figures show that this positive trend has been weakening recently

Source: iStock

Domestic demand growth remains positive

A drop in inventories unexpectedly sent French growth into negative territory in the fourth quarter. The 0.1 contraction was way below the consensus expectation of 0.2% growth. This brings 2019 GDP growth down to 1.2% instead of the expected 1.3%, after 1.7% growth in 2018.

Domestic demand growth slowed in the final quarter of the year to 0.3% QoQ from 0.7% in the third quarter after a very strong year: domestic demand expanded by 1.8% in 2019 after 1.3% in 2018.

We also saw an expected slowdown in private consumption in the fourth quarter (to 0.25% from 0.4%) after a rebound in the previous three months. It looks as though the protests around the pension reform had only a limited impact on both consumer spending (it went down moderately in December after two months of growth) and confidence. However, despite all the fiscal measures taken to boost household purchasing power, the recovery in private consumption was limited last year, with growth accelerating to just 1.2% from 0.9% in 2018. We believe that the current levels of consumer confidence will allow for a further acceleration in spending this year, although this will be limited to 1.4% as the job market recovery is likely to slow in the second half of the year.

Business investment was less supportive in 4Q19

Business investment was the main engine of domestic demand in 2019 although this weakened in the fourth quarter to 0.3% QoQ from 1.6%, the lowest level since the first quarter of 2018. However, growth over the full year was still very strong (4.2% after 3.9% in 2018).

Public investment also recovered last year (but came to a standstill in 4Q19), to 3.9% in 2019 from 2.4% in 2018, while household investment remained subdued: 4Q19 growth was limited to 0.5% QoQ, which is half of what one could expect when mortgage interest rates are at zero, although the building sector appears to be facing capacity constraints.

Overall, the picture for investment in 2020 remains positive. Business climate indicators remain strong, especially outside the manufacturing industry, and credit growth is very supportive. We nevertheless expect a small deceleration to 3.4% in 2020 from 3.6% last year.

We maintain our 2020 forecast of 1% GDP growth

The deceleration in GDP growth this year is likely to come from a deteriorating outlook for external trade. The contribution of net exports to growth was mildly negative in 2019 (-0.2 percentage points) but should worsen in 2020 (-0.4ppt) on the back of higher domestic demand (increasing imports), lower world trade growth, weaker intra-eurozone trade and a slightly stronger euro.

As in other eurozone countries, 2020 is likely to show a slowdown in GDP growth. We maintain our forecast of 1% for the French economy after 1.2% in 2019. The first half of the year should remain positive, but the recent slowdown in eurozone growth should take a toll on hiring and investment intentions, which is why we expect a more sluggish second half of 2020. However, this should be temporary and pave the way for a stronger outlook in 2021.