France: Looking for a breath of fresh air

Now that French economic restrictions are easing, President Macron is looking for a second wind to take him to the next Presidential elections which are due in 2022. At first glance, the recovery announcements made up to now won't get him there

French President Emmanuel Macron

Source: Shutterstock

The French economy is currently paying the price of one of the harshest lockdowns in the Eurozone.

After a record -21.4% quarter on quarter annualised contraction of GDP in the first quarter, we expect the contraction to reach 65% in 2Q20. Indeed, activity surveys have shown that the French economy was running at only 65% and 75% of capacity in April and May, while the Google mobility data for June shows, there is plenty of catching up to do.

On average, 2Q20 GDP is likely to be 20% lower than what we saw in 4Q19, which explains why the current growth forecast for France in 2020 is one of the worst among Eurozone economies (-9.5%).

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If we still believe that the first part of the recovery will be V-shaped, disruptions in supply chains and the labour market should put a brake on growth in 2021. Despite an expected 6.5% rebound next year, the French economy is unlikely to catch-up to its 4Q19 GDP level before the end of 2022.

External trade is likely to weigh on the recovery

On one side, a domestic demand recovery will take place, but at a stunted pace because of widespread corporate caution about future investments and higher unemployment.

On the other side, external trade should also weigh on growth. French exports will take time to recover as we expect weak growth in the Eurozone, the potential threat of a no-deal Brexit on New Year's eve, more trade war pressures and a subdued Asian recovery, while imports will be fueled by the recovery of domestic demand.

Domestic demand will see two brakes

More than half of private-sector employees - 25 million in 4Q19 - are on the French temporary unemployment scheme, which, in terms of direct public spending, is by far the main measure taken so far to safeguard the French economy.

Despite this, the number of unemployed (on top of those nearly 13 million workers) has jumped from 3.2 to 4.3 million between February and April 2020 as interim and short-term contract workers lost their jobs.

We expect that in 4Q20, the unemployed population will have increased by more than half a million people on the year, taking the unemployment rate towards 10.5% (compared to 7.9% in 4Q19). As the weakest workers with the highest propensity to consume will be disproportionately hit (as they are overrepresented in the worst-hit sectors like tourism), we believe it will weigh on the private consumption recovery throughout 2021.

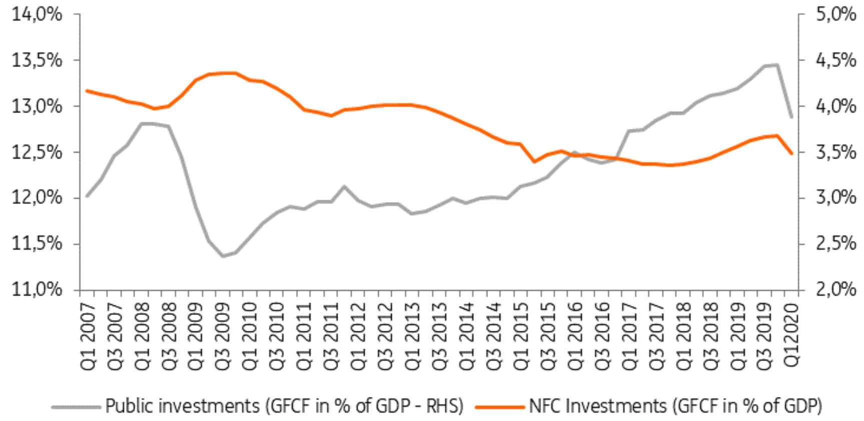
Public v Corporate investments

As far as investments are concerned, public investments will probably substitute corporate investment for a few quarters.

The figure below shows that corporate investments grew faster than GDP in the post-financial crisis recovery, thanks to a mix of supply-side policies. At the same time, public investments remained subdued until 2017. Calls for ambitious public investment plans for 2021 and beyond still have to be designed.

The EU Commission proposal for a Recovery and Resilience facility of EUR 560 bn could bring a framework to these investments together with an incentive to act. If the proposition is approved, each country would have to build an investment plan for the coming years that could potentially go well beyond EU funding intentions.

Can public investments catch-up in coming years?

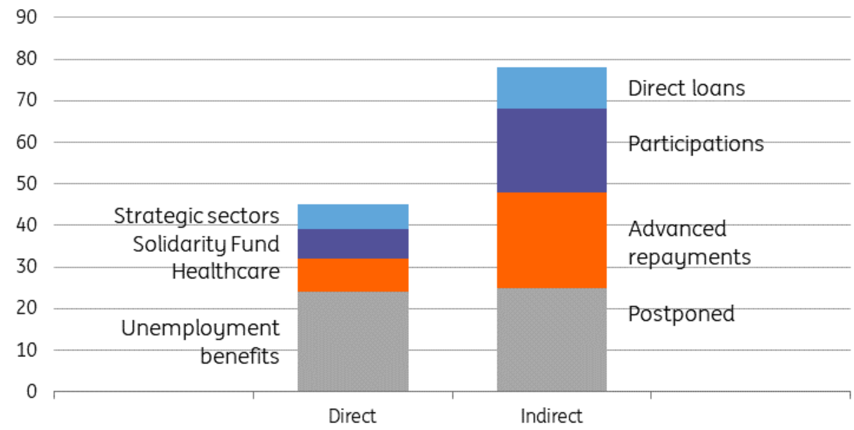


Source: INSEE, ING

Pre-announced economic safeguarding measures are now in place

It is not as if nothing has been done though. The French government has already come up with some recovery plans for three strategic sectors: aeronautics, automobile and tourism industries.

But only part of the measures contained in these plans are actually new: they rely heavily on the instruments put in place earlier in the Covid-19 crisis.
1) Direct spending (at least 2% of GDP) which include an extra healthcare budget (8 €Bn), a solidarity fund for SMEs (7 €Bn) and various adjustments (3 €Bn). The main direct spending is the temporary unemployment scheme which has a direct cost estimated at 24 €Bn in the adjusted 2020 budget. But since this estimate, the number of potential beneficiaries has increased by 50% and the program has been lengthened so that the costs could be 15 €Bn more elevated. On top of these, we estimate that around 6 €Bn will be spent directly in strategic sectors (see below).
2) Tax measures and participations (70 €Bn or 3.1% of GDP): the Treasury has advanced due payments (23 €Bn) and postponed taxes it should have received (25 €Bn). It is likely that part of this amount will end up in the direct spending category, but it is too soon to say in which proportion. The French State will also take participations in "strategic" industries, for an amount that is currently 20 €Bn. "Strategic loans" are also scheduled for 3 specific sectors (see below), so far for around 10 Bn€.
3) Guarantees (315 €Bn or 13.9% of GDP) for various corporate loans issued through the banking sector.



Source: ING

But the last plans for strategic sectors do not go much further

On top of these, specific plans have been decided for three strategic sectors, which largely (for around 90%) rely on the above mentioned measures.

1) Tourism (18 €Bn): tax rebates (for 2 €Bn, part of the 25 €Bn mentioned above that could ultimately end up in direct spending) and higher limits for meal cheques (given by employers as part of a salary package). The headline figure (18 €Bn) is actually relying much on the above mentioned instruments: tourism will specifically use 6.2 €Bn of guarantees for SMEs, 3 €Bn of temporary unemployment benefits, a share of the Solidarity fund and of the participation plan (1.3 €Bn for an investment fund that is supposed to drive a total of 5.4 €Bn investments from the private sector on top of the 1.3 €Bn capital).

2) Aeronautics (15 €Bn): the national airline AirFrance will benefit from a 7 €Bn plan (4€ Bn of credit guarantees and 3 €Bn of direct loans). These are part of previously announced instruments. Apart from military orders for the aeronautic industry (which should reach 0.6 €Bn) and direct R&D investments (1.7 €Bn), the rest of the plan is made of temporary unemployment benefits and guarantees for corporate credits.

3) Car industry (8 Bn€): around 1 €Bn for cleaner car purchases by the general public (up to 200k units) and 0.75 €Bn of investments in the sector together with Renault and PSA (which will add 100 € million each). The rest of the plan (around 6 €Bn) is essentially made of credit guarantees and temporary unemployment benefits.

The lack of fiscal room for maneuver will shadow the two last years of Macron's presidency

The impact on public finances will be sizeable as the deficit is likely to reach 12% of GDP this year (with a hypothesis of 65 €Bn of direct spending, which is 20 €Bn more - than in the April budget estimate).

Public debt should therefore temporarily reach 118% of GDP before coming down to 115% in 2021. This is likely to weigh on President Macron's ability to deliver in the last two years of his mandate which therefore will have to focus on structural reforms, in particular ending the pre-Covid debates on pension reforms. He may need a second breath to achieve this, which is why a government reshuffling is not unlikely this summer.

However, despite the current rumours, we still find it hard to see a replacement for Mr Philippe as the prime minister at the current juncture.

The French economy in a nutshell

	2019	2020F	2021F	2022F
GDP (%YoY)	1.3	-9.5	6.5	2.4
Headline CPI (%)	1.1	0.4	1.3	1.7
Unemployment rate (eop, %)	7.9	10.5	9.2	8.5
Budget balance as % of GDP	-3.0	-12.0	-4.0	-2.0
Government debt as % of GDP	98.1	118	115	111

Source: ING forecasts