

France: Moment of truth for Macron's reform ambitions

One year after France was paralysed by the “yellow vest” crisis, social unrest is once again taking centre stage, this time as a result of protests on pension reform. It is still too soon to say if the government will succeed in buying its way out of the crisis again, but the early 2020 outlook must certainly be considered with caution



1%

Our estimate for French GDP growth in 2020

Lower than expected

Another rocky end of year for Macron

On 5 December, France saw the largest industrial action since railway strikes paralysed the country in the second quarter of 2018 (when the government decided to reform the national rail operator SNCF). Most unions joined the movement in December but mainly in the public sector

(public transport and hospitals, justice, schools). Unrest is expected to continue until the end-of-year holiday period.

Pension reform is another politically symbolic move that President Macron pledged to enact during his campaign and is opposed by the same people involved in the yellow vest protests, reflecting a divided France. Public support for the reform (or at least what they know about it) is fading overall (29% supporting it in early November, against 33% in October in an Elabe poll) and is very weak among extreme right and left voters (where 79% and 72% oppose it, respectively). However, support remains strong among La Republique En Marche voters (80%) and The Republicans (43%).

The biggest question, therefore, is whether this will revive the grass roots yellow vest movement which paralysed the country in the final quarter of 2018 and first quarter of this year (without being backed or organised by unions and which went well beyond the public sector). There is a high risk that the 800,000 people marching across France on 5 December will do so again: a recent poll by Elabe showed that two thirds of the French public are expecting more social unrest. However, it seems that the yellow vest movement has faded after a long period of national debate gave way to new public spending (estimated at €17 billion or 0.7% of GDP). Can the Government buy its way out of the current tensions. It is possible.

The impossible reform

The aim of the pension reform is to merge – as of 2025 - the 42 different French pension regimes into one, based on the number of years each worker has contributed throughout his or her career, rather than a given retirement age. The official age (62 years old, but 67 years old with full pension rights) should not be challenged, the aim being to increase the actual age of departure (currently closer to 61 if the OECD is to be believed, having been below 60 during the period 1993-2015). Another survey by Elabe in early December showed that 67% of French people are in favour of a single common pension system, 57% think that workers will need to work longer and 55% agree that the current system is not financially sustainable (the last official report showed a likely deficit of 0.5% of GDP in 2025). Put simply, there is a consensus on the need for action, little clarity about what is actually in the reform and little willingness to pay for it. That is why we think that the government could again buy its way out.

This is what Prime Minister Édouard Philippe tried to do on 11 December when detailing the government's proposal. By leaving out all those born before 1975, ensuring a minimum pension allowance (at 85% of the minimum wage), ensuring higher allowances for women and parents of large families and offering extra guarantees to school teachers, Philippe has tried to minimise opposition to the reform. The financial trajectory of the new system is still to be determined and lies largely in the hands of social partners in forthcoming negotiations. The amount of the bill is yet to be known but is certainly lower than the cost of leaving things unchanged, unless the final reform does exactly that.

Nevertheless, uncertainty around social stability will remain high in the months to come at a time when the French economy is set to face external risks. We are therefore very cautious about GDP growth at the beginning of next year.

Current growth rates rest on consumers

The second half of 2019 should still see higher GDP growth rates than in the rest of the eurozone. So far this year, France has been the main contributor to eurozone GDP for the first time since the

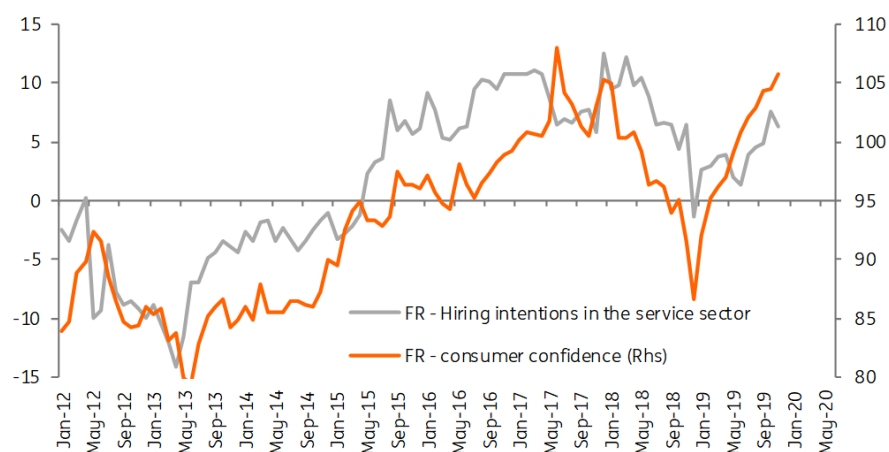
financial crisis. GDP growth was 0.3% quarter-on-quarter, slightly weaker than in 2Q19 (0.35%), confirming that a 1.3% GDP growth rate is reachable for 2019 as a whole. In the second half of 2019, it was mainly a domestic demand story. In particular, GDP numbers for the third quarter continued to show the strength of the private consumption engine.

Private consumption growth reached 0.4% QoQ in 3Q19 and the fourth quarter has also started on the right note: consumer expenditures on goods were up by 0.1% month-on-month in October. The spike was especially strong in food and transport equipment. Given that household purchasing power has increased by 0.6% in 3Q19 (thanks to higher wage growth and higher social benefits), we expect this trend to remain positive.

Consumer confidence surveys, in particular, indicate that purchasing intentions remained very high in November: at -4, the index has not been higher since March 2018. Consumer confidence as a whole even increased in November on the back of stronger confidence in the economic environment and employment prospects. Fear of unemployment has reached its lowest level since 2008. In this regard, we did not see any strong correction in the large drops seen in the unemployed population registered in August and September: unemployment was broadly stable in October and hiring intentions remain elevated in the service sector. This should lead to further declines in the household saving ratio, which peaked at 15% in 1Q19 and was down to 14.2% in 3Q19, supporting consumer spending. Over a year, private consumption rose by 1.4% in 3Q19, which should lead to 1.2% growth in 2019 after the 0.9% achieved in 2018.

In addition, household investment in new construction experienced a rebound in 2Q19 (+1.7% QoQ) and 3Q19 (+0.7% QoQ). It should be noted that the fall in mortgage interest rates after 2014, even if it took time to have an impact, has allowed investments to rebound from 2016 onwards: growth since then has averaged 3.6% per year. We expect the catch-up to continue in the first half of 2020.

French consumer confidence is high but for how long?



Source: Refinitiv Datastream

Business investment remains strong despite global downturn

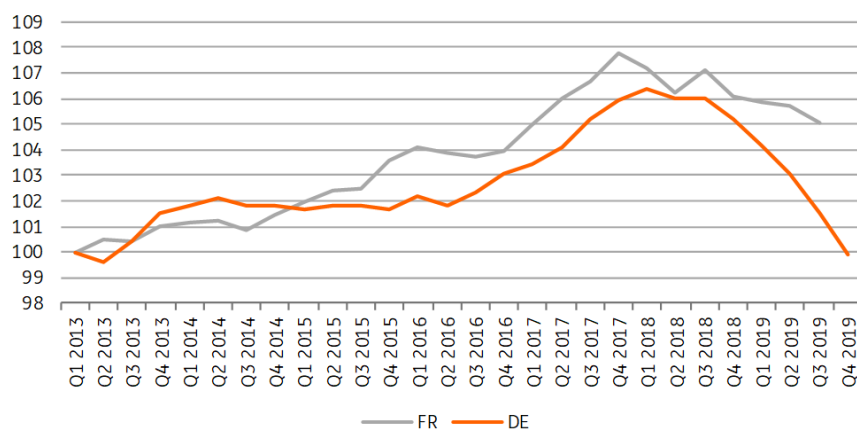
Despite the drop in sentiment seen throughout Europe and especially in neighbouring Italy and Germany, French indicators remained robust throughout the second half. PMI indicators have rarely fallen below 50.0 and industrial production has slowed less steeply than in other countries (it

was slightly lower than a year ago at the beginning of 4Q19). Capacity utilisation has remained high in comparison with Germany. However, confidence indicators suggest the stagnation in activity is likely to continue with a toxic mix of rising inventories and declining order books.

Thanks mainly to the service sector and very supportive credit growth, business investment continued to perform well in the third quarter. With growth of 1.2% QoQ, this was above expectations. Even if we see a slowdown in the last quarter of the year, business investment growth should still reach 4.1% in 2019 after 3.9% in 2018.

It should also be noted that public investment growth continues to contribute positively to GDP. After several years of negative contributions (2013-2016), public investment boosted growth by 0.3% in 2018, a figure that is expected to double this year. Thus, after growth of 2.4% year-on-year in 2018, this should grow by nearly 4% in 2019. Even if it's still 4% below the 2008 level, this is certainly a welcome comeback.

Capacity utilisation in industry (1Q13 = 100)



Source: Refinitiv Datastream

External demand is becoming less supportive

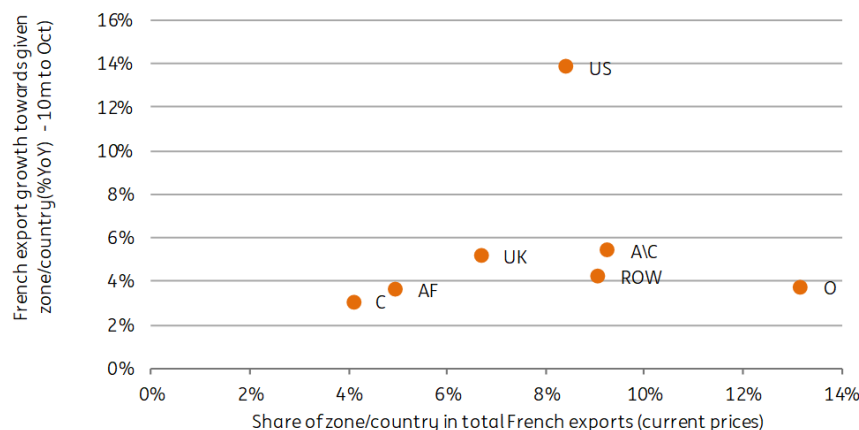
Despite the trade war and the slowdown in global export growth, French exports have benefited from the euro weakness. In the first 10 months of 2019, export growth to the eurozone slowed to 2.2% (compared to 5.1% over the same period last year), all other regions posted higher growth rates (Figure 3).

The trade balance with the US has strongly improved since the beginning of 2018 and is balanced for the first time in 15 years. President Trump has recently pledged new taxes on €2.4 billion on exports of wines and luxury bags, but these items are not the main factors behind the improvement. Aircraft exports (€12.2 billion) represent more than 25% of French exports to the US and increased by 49% in 2019. So while tariffs on champagne and luxury bags are likely to hurt French exports, the main shock will come from the new 10% tariff increase that the US will impose on Airbus exports. This new phase of the trade war should affect French exports in 2020.

While net exports had a particularly high contribution to growth in 2018 (0.6% was the highest since 2012), we do not think it can be repeated in 2019 and 2020. For this year, we expect a slightly negative effect on growth from foreign trade. On one side, the slowdown in world trade and eurozone growth had an impact on French external demand. On the other, the recovery in

domestic demand should continue to support imports. This outlook should deteriorate further in 2020 where we expect a 0.4% negative contribution from net exports on the back of the new tariffs and a stronger euro.

French exports to the US have outperformed



O (EU28 excl EZ and UK); AIC (Asia excl China); C (China); AF (Africa); US (USA); UK (United Kingdom); ROW (Rest of the World)

Source: Refinitiv Datastream

Accident prone

The hard data is still encouraging for the last quarter of the year, but the beginning of 2020 looks far from accident prone. Business investment growth will abate with the manufacturing slowdown and a renewed period of uncertainty triggered by social unrest. The labour market- which is still the main factor supporting current growth- could also slow down earlier than expected because of this instability, sending consumer confidence back down. At this stage, we do not expect the impact to be as large as during the yellow vest crisis of 2018, but the unrest around the pension reform will negatively affect 1Q20 growth: larger episodes of strikes and a prolonged manufacturing slowdown could lead to temporary hiring freezes and hit consumer sentiment, which is why we expect a slow start to the year, limiting GDP growth to 1% in 2020 after 1.3% this year.

The French economy in a nutshell (%YoY)

	2018	2019F	2020F	2021F
GDP (%)	1.7	1.3	1.0	1.2
Private consumption (%)	0.9	1.2	1.3	1.4
Investment (%)	2.8	3.6	3.3	2.7
Government consumption (%)	0.8	1.3	1.5	1.1
Net trade contribution (%)	0.7	-0.2	-0.4	-0.2
Headline CPI (%)	1.9	1.1	1.0	1.4
Unemployment rate	9	8.6	8.5	8.9
Budget balance as % of GDP	-2.5	-3.3	-2.4	-2.1
Government debt as % of GDP	98.4	99	98.8	98.6

Source: Refinitiv Datastream. All forecasts ING estimates. Unemployment rates according to ILO definition

Author

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross
Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com