France: Public spending will not prevent recession

In France, the first half of 2022 has been difficult, and the second half does not look any better, despite significant support from government spending

French President Emmanuel Macron

A difficult start to the year

After a year marked by strong GDP growth (+6.8% over the year) and a return to pre-pandemic levels of activity, 2022 has proven to be more difficult for the French economy. GDP contracted by 0.2% in the first quarter, weighed down by a sharp drop in household consumption (-1.5% over the quarter) and lacklustre exports. Weakened by the disruption to supply chains and the unfavourable specialisation of the French economy in the current context (particularly in the manufacture of transport equipment and in tourism), exports in volume terms have still not returned to their pre-pandemic level. Consumption has contracted due to the sharp fall in consumer confidence amid the war in Ukraine, and also because of high inflation which weighs heavily on household purchasing power and sentiment. France is one of the only European countries (with Denmark and Sweden) to have seen its GDP contract in the first quarter of the year, even though inflation is lower in France than in other European countries, and therefore purchasing power is less degraded. Indeed, the government has spent billions of euros to limit the impact of rising energy prices on inflation and households in France, via the so-called "tariff shield" which has drastically limited increases in gas and electricity prices, and via a rebate on fuel. Combined, these measures have reduced inflation by 1.5 to 2 points according to INSEE estimates and largely explain the inflation gap between France and the rest of the eurozone (in June, harmonised inflation stood at 6.5% against 8.6% in the eurozone as a whole).

GDP is unlikely to have recovered strongly in the second quarter of 2022. The inflationary environment has continued to weigh on household consumption and consumer confidence has deteriorated significantly. Supply chains remained disrupted, and although manufacturing output picked up in May, it is unlikely to be up for the quarter as a whole. The only positive element, which could prevent a second consecutive quarter of contraction in France, is the end of health restrictions, which should give a short-lived boost to the services sector, and in particular, to tourism-related activities which benefit from the return of international tourists. This reopening effect could continue to have a small effect on economic growth in the third quarter.

Labour market and public spending offer support

For the rest of the year, the good performance of the labour market should continue to limit the contraction in consumption. At 7.3%, the unemployment rate is close to its historic low, thanks to the very strong employment growth observed in 2021. Surveys still point to strong recruitment difficulties and thus to the potential for future job creation, but the first signs of a slowdown are beginning to emerge. We believe that the unemployment rate will remain historically low in 2022, although we expect a small increase, which should help preserve the purchasing power of French households.

Household purchasing power will also be supported by fiscal policy, which in France can currently be characterised as very expansionary. Indeed, after having already spent 23 billion euros to support households and companies in the face of inflation, the government intends to spend 20 billion more. It has just unveiled new measures that it wants to put in place, notably an extension of the tariff shield on gas and electricity, indexation of civil servants' salaries, faster indexation of pensions and social benefits, food aid for low-income households, a permanent reduction in contributions for the self-employed, a limitation on rent increases, fuel vouchers for workers and a reduction in certain taxes for all. The government's objective is therefore no longer only to limit price increases, but also to support activity (which, all things being equal, should have the effect of supporting inflation, at a time when the European Central Bank is trying to reduce it...).

A significant cost to public finances

All these measures would cost 43 billion in one year, which is much higher than what is implemented in neighbouring countries. The government has set itself the target of maintaining the deficit at 5% this year, which would be difficult to achieve in the context of the economic slowdown, and 3% in 2027, also ambitious. Moreover, all this is taking place in an unprecedented political context in France, where the government does not have a majority in parliament. This means that the measures will have to be discussed in the National Assembly. In order to reach a compromise, other costly measures could be added to the package proposed by the government.

Avoiding recession will be difficult

Although expansionary fiscal policy and a strong labour market are supporting purchasing power somewhat, we expect economic activity in France to slow down significantly in the coming quarters. Inflation, which is expected to remain between 6% and 7% until the end of the year, will continue to weigh on consumption. The global economic slowdown will have an unfavourable effect on exports, while possible interruptions in gas supplies will have a negative impact on industrial activity. Taking all these factors into account, we expect GDP to contract in the fourth quarter of 2022, as well as in the first quarter of 2023, before a very gradual recovery. This implies that, after expected GDP growth of around 2.1% on average for the year 2022, growth for 2023 could be close to 0% (we currently expect 0.3%).

The French economy in a nutshell

(% YoY)	2020	2021	2022F	2023F	2024F
Demand and output					
GDP	-7.9	6.8	2.1	0.3	1.4
Private consumption	-6.8	5.3	1.9	-0.1	1.7
Investment	-8.4	11.4	1.3	1.2	1.8
Government spending	-4.1	6.3	2.1	0.5	1.2
Net trade contribution (% points of contribution to GDP)	-1.1	-0.1	0.2	0.0	-0.1
Labour market					
Unemployment rate (%, Eurostat)	8.1	7.9	7.4	7.7	7.9
Government finances					
Budget balance as a % of GDP	-9.1	-6.5	-5.0	-4.4	-4.0
Government debt as a % of GDP	115	114	114	113	112
Prices					
Inflation (HCPI)	0.5	2.1	5.9	3.3	1.8

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