France Q4: A different country?

President Macron is sticking to his plans and implementing his first reforms. With more to come, France should be a reform leader not a laggard

Neither Left nor Right

In the past six months, the first president of the Fifth Republic, not aligned to the traditional Left or Right, has proved that it is possible to govern from the centre. He can not only govern, but also reform as it seems he has been everywhere, leaving the Prime Minister, Edouard Philippe, in the shadows.

It started with a French return to the international diplomatic front in June and July, it continued with the reform of the National Assembly, (intended to limit scandals such as those which engulphed the former PM, Francois Fillon during the presidential campaign), labour market reform in September and the 2018 budget in October. The President has not been absent from the industrial sphere either - the Government supported the union of the Alstom and Siemens train building units, preferring "to build European giants", and reached a deal with Italy's Fincantieri on the St Nazaire naval shipyards.

The labour market reform should support hiring intentions

The new Labour Law goes much further than the El Komri reform voted under President Hollande, and which succeeded in concentrating all the frustrations with his administration in street marches. The current law faced very limited opposition. The milestone was to set a maximum for dismissal compensation which we believe is a real positive for permanent contract creation; the bulk of employment growth is currently coming from short-term contracts.

> *The 2018 budget was also an occasion for President Macron to deliver on his campaign promise for productive investments*

This investment plan is a package of €56.3bn over five years, of which €15bn will finance new professional training programmes aimed at one million younger people (16-24 years old) and 1 million long-term unemployed (of all ages). This will be added to the previous state-aided contract system. Although it will be reduced strongly in 2018, to 200-thousand contracts, it should support the current recovery in employment growth.

Although all these have not yet made Mr Macron more popular than he was when elected, is core support is holding up strongly. We doubt his approval rating (now back at 49%) can fall below where it was after the summer (40%). On the contrary, it should be supported by the ongoing recovery. GDP growth has reached 2.0% (QoQ annualized) for three quarters in a row and domestic demand remains strong. External trade has contributed positively to growth in the first semester but a stronger euro should diminish this effect in the coming months.

€56.3bn

Skills based investment package

Split over 5 years

Monsieur Popular?

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GDP reaches higher plateau, boosting President's popularity

Confidence indicators show that French GDP has reached another growth level, more consistent with the current Eurozone recovery. After having grown on average by 1.0% per annum in 2013-16, growth rates should now be consistently above 1.7%. Investments are growing strongly, especially business investment which should grow by 4.1% in 2017 after 3.4% in 2016, given the strong order book backlog.

Household investment has also contributed positively to the recovery for the last six quarters, thanks to low-interest rates and a stabilising housing market. On that front, some of the 2018 budget measures could dampen growth in 2018. The weakest investment growth spot remains the public sector which should see investments contract by around 1% in 2017. However, the plan unveiled by President Macron should help these recover.

4.1%

Business Investment Growth 2017 projection

Up from 3.4% in 2016

Private consumption growth set to jump in 2H17

Private consumption growth remained relatively subdued during the first half of the year and should be much lower than the 2.1% reached in 2016 (we expect 1.1%). Reasons for this include the negative base effect from the 4Q16 rebound and the unemployment rate remaining close to 10%. With employment growth on the right track, we expect private consumption to accelerate in the second half of the year, backed by higher consumer confidence.

1.9% growth looking likely through 2018-19

All in all, domestic demand is therefore on the right track. This growth outlook is however darkened by the negative contribution of external trade expected in the second half of the year, together with a stronger euro.

However, while external trade shaved off almost a full percentage point of growth in 2016, this effect should be much less in 2017 and GDP growth could still reach 1.7% this year. As we expect the recovery to be supported by the current reforms, we expect France to end its upward cycle only somewhere in 2019 - this is why we think that growth of 1.9% is achievable both in 2018 and 2019.

Finally, one should note that the 2018 budget will bring the French budget deficit below 3% for the first time since 2008. This will probably not be enough to allow France out of the EDP procedure as the structural effort (0.2ppt of GDP) remains well below what is required from France (0.5ppt), but should be sufficient to start bringing down the debt - currently at 97.5% of GDP, we expect it to decline by 5ppt over the next five years.