

How would a 'hard' Brexit hurt France?

In France, the trade deficit decreased in February to 4.0 billion euros. Trade is nevertheless expected to be a less important support for growth in 2019 than in 2018. Brexit continues to weigh as a risk. The impact of a 'hard' Brexit on French growth would be similar to that of the 'yellow vest' crisis but would affect different sectors



The French President, Emmanuel Macron and the British Prime Minister, Theresa May, at a meeting in November 2018

€4.0 Bn

Lower than expected

French trade deficit

Declined in February

Trade will be less supportive in 2019

For most of the years since 2004, the trade deficit contributed negatively to growth in France. In this respect, 2018 was an exception as net exports (exports less imports) contributed a positive 0.6pp to GDP growth, offsetting weak domestic demand, especially at the end of the year. In fact, the performance of net exports was partly due to this weakness: the sluggish growth in consumption weakened imports last year. In fact, imports grew in real terms by only 1.3% in 2018

compared with 4.1% in 2017. Thus, even though exports saw their growth fall by 4.7% to 3.3%. % between 2017 and 2018, the contribution of net exports was still positive.

The current context does not seem as supportive for 2019. Indeed, business investment remains high, while a recovery in private consumption is expected, which should favour domestic demand and therefore imports. Meanwhile, global trade is still slowing on US-China trade crisis fears; the WTO has recently revised down its global merchandise trade growth forecast to 3% in 2019 after 3.9%. % in 2018.

In France, the trade deficit data published this morning shows a deficit of 4.0 billion euros, lower than it was in January. It is likely that the first quarter deficit will, therefore, only be slightly higher than the 4.2 billion reached in the last quarter of 2018, probably offsetting very slightly GDP growth in the first quarter of 2019.

The UK is an important partner

Looking at geographies, Eurozone demand for French exports has seen lower dynamics recently, with a growth of only 1.4% in 4Q18. The US, and Asia (excluding China), which respectively represent 8% and 9% of total French exports, were much more dynamic (with growth of respectively 7.6% and 14.8%).

The United Kingdom is an important partner for France, with 6.6% of exports in 2018, more than China (4.2%) and almost as much as the USA (7.8%). The growth of French exports to the United Kingdom in 2018 was 5%, after a slight decrease recorded in 2017. In 4Q18, their progression was again superior to that of French exports towards the rest of Europe.

We are just days away from a milestone in the Brexit process

We are just days away from a milestone in the Brexit process. Indeed, if the British Parliament has not voted in favour of the agreement negotiated in December 2018 or in favour of the organisation of European elections before 12 April, there's no guarantee the European Council will agree a time extension. The United Kingdom would then, from 13 April, be considered a third country. If that probability is still low, it is also possible that we could be back here again by 2021, which should mark the end of the hypothetical transition period. However, the impact of a 'hard' Brexit on the French economy depends on two factors:

1. the importance of British demand in the activity (in the value added) of each sector of the economy and
2. the importance of each sector in the French economy.

The impact of a potential 20% drop in trade with the UK

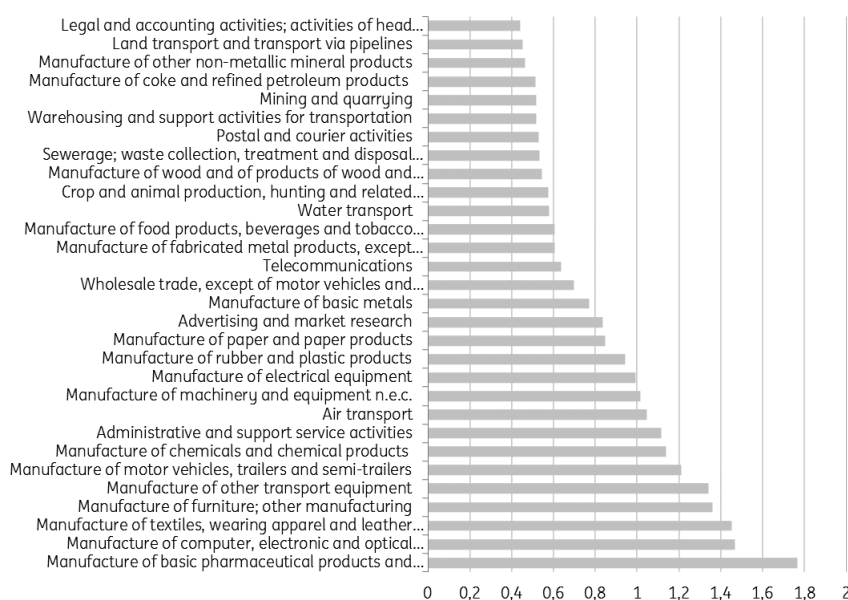
If the British demand represents 6.6% of French exports (6.9% in 2016), it is actually at the origin of 8.2% (2016 figure) of the added value due to the exchange of goods in the French economy. Trade actually creates more value than the face value of exports. As a result, British demand is also responsible for 1.6% of the total value added created in France by all sectors. In other words, assuming that a 'hard' Brexit causes a 20% drop in trade between France and the United Kingdom

in 2019, GDP for this year would be cut by 0.2pp, which would yield a GDP growth of 1.1% in 2019 in the case of 'hard' Brexit (as our current forecast is 1.3%). At the euro area level as a whole, ING currently estimates the effect at 0.3pp, so France would be slightly less affected.

Most sectors would not suffer much: in the scenario described above, 16 major sectors (representing 60% of French GDP) would have an impact less than or equal to the 0.2pp shock suffered on average by the French economy. Actually, only 11 sectors have more than 5% of their value added which directly depends on UK demand.

For the 30 sectors shown in the graph below, the effect would be greater or equal to 0.5pp of their total value added. A 'hard' Brexit would cost up to 1.8pp of value added in the pharmaceutical manufacturing industry. Of these 30 sectors, the loss of value added would, therefore, involve about 60,000 jobs (which however does not mean that they would necessarily disappear). It should be noted that most of the exposed sectors are in the manufacturing sector, but also that half of the jobs are in only three labour-intensive service sectors (administrative support, accounting or legal services, and wholesale trade).

Sectors most impacted by a 'hard' Brexit



Source: World Input Output Database (WIOD) by Timmer et al, University of Groningen - ING computations

An impact similar in size to the 'yellow vest' crisis

To conclude, we can say that the economic impact of a 20% decrease in trade with the United Kingdom would be absorbed by the French economy as a whole in 2019, but it would nevertheless be significant; growth would be cut by 0.2pp, an effect similar to that already endured by the economy following the 'yellow vest' crisis. However, it should be emphasised that the impact would be concentrated in certain sectors, particularly high value-added manufacturing sectors and employment-intensive service sectors which differ to those affected by the 'yellow vest' crisis at the turn of the year. The risk cannot, therefore, be ignored.

The full report in French is [here](#):