Does France have the fiscal space to counter the economic slowdown?

The French 2020 budget is off limits once again, but it is unlikely to be a problem at a time when the economy needs a push. However, Mario Draghi insisted this week that countries like France, with high debt levels, should keep some powder dry

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The ritual exchange of letters

This week, the European Commission sent a letter to France and Italy, expressing concern about their 2020 budget plans. In the case of France, the spending evolution scheduled for 2020 fails to comply with the structural effort promised (0.6pp of GDP vs 0.0pp scheduled) and with the debt reduction path previously settled. France was invited to react by giving more information on why it is the case before deciding on a qualification of this breach of the rules. France answered today that it is still determined to reach a budget balance (something which has not happen in any of the last 40 years), though just not right now...

Although there is a strong sense of “déjà vu” in the mail exchange between Bercy and Brussels, we think that a strong answer from Brussels is unlikely for the time being. Not only because the new European Commission is still to be confirmed, but also because the economic slowdown in the

Eurozone has pushed the European Central Bank to call for countries which "have fiscal space" to use it and help avoid a prolonged slowdown of the Eurozone economy.

But what does fiscal space look like for France?

Looking at 2020 projected deficits throughout Europe, eight countries will have a budget surplus, including the Netherlands and Germany (+0.8% of GDP each). Taken together, if all Eurozone countries were to post a deficit of 2.5% in 2020, it would free almost €200 billion to support the economy compared to current plans. However, with the current plans, the fiscal thrust for the Eurozone should be very limited: a boost of 0.1pp or 0.2pp to GDP growth at the most.

With a forecasted deficit of 2.2% of GDP, France is – together with Spain (2%) and Italy (-3.5%) – in the bottom three. At least, these countries cannot be accused of not doing more to support growth. But should we expect more? In France, expenditures are already planned to grow by 2.6% in 2020, well above the recommended 1.2%, with public debt remaining just below the 100% threshold. This is a consequence of the "yellow vest" crisis which gave way to more supporting measures for households. It was made possible by lower interest rates: with the 10-year bond yield in negative territory, extra spending was made possible without derailing Emmanuel Macron's debt reduction pledges completely. But there is a sense that some powder should be kept dry for the next downturn: doing that means that there is no fiscal space left.

Be ready for the next downturn

In his last press conference at the ECB this week, Mario Draghi suggested that "countries where public debt is high, governments need to pursue prudent policies and meet structural balance targets, which will create the conditions for automatic stabilisers to operate freely". In other words, the weather could turn rough, and some countries would be better leaving some fiscal space to automatic stabilizers. With the next economic downturn now at France's doors, it seems that there is just enough space for the stabilizers. Getting the pension reform done without giving up too much in short-term compensation will therefore be critical for the French Government to limit social unrest in the next two years.

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