

Snap | 23 February 2022

FRANCE

France: Business climate points to solid recovery, but Ukraine conflict and inflation could spell trouble

The French business climate indicator rebounded strongly in February. But it does not yet take into account the recent geopolitical tensions



There is renewed optimism about the business outlook in France, thanks to the decline in Covid cases and the gradual abandonment of restriction measures

The French economy with all sails set?

The French business climate indicator rebounded strongly in February, after two months of decline, to 112, compared to 107 in January. The rebound is mainly due to the services sector, where business leaders are showing renewed optimism about the business outlook, thanks to the observed decline in the Omicron wave and the gradual abandonment of restriction measures. This is particularly the case in the restaurant and accommodation sub-sector and in the administrative and support services sub-sector. The business climate is also recovering slightly in the retail trade and construction. In contrast, there is a small decline in industry, but this relates to the level of past production, not to future prospects.

Overall, these indicators paint a very favourable picture of the French economic situation: after two more difficult months due to the pandemic, the economy is rebounding in all sectors. The Purchasing Managers' Index (PMI) published at the beginning of the week were no different: activity is on the rise, due to renewed optimism and an influx of new orders, particularly from

abroad. This is leading companies to increase their workforce and to plan to increase it further. The employment climate reached 113 in February, its highest level since 2008. This good shape of the labour market bodes well for household consumption in the coming months and thus for economic activity as a whole. Nevertheless, the February business climate does not take into account the increased uncertainty of the last few days related to the situation in Ukraine. The conflict is likely to have a negative effect on business sentiment and will therefore weigh on business climate from March onwards, and could, if prolonged, have a negative impact on economic activity. The usual forward-looking nature of the business climate indicator is therefore significantly diminished this month.

Inflationary pressures are rising and will increase further

Furthermore, data from the business climate indicator also suggest that inflationary pressures are far from abating in France and are in fact increasing. The expected trend for sales prices in the manufacturing sector rebounds very strongly in February, after having fallen slightly in January. In the services sector, the expected price indicator continues to rise and is at its highest level ever. Before the publication of the February inflation figures scheduled for Friday, these indicators suggest that inflation will continue to rise in France and will probably pass the 3% mark (after 2.9% in January). The recent deterioration of the situation in Ukraine is likely to keep energy prices elevated, putting further upward pressure on inflation in Europe and France. As a result, inflation will remain higher than expected for longer and probably above the 2% mark throughout the year. This is likely to weigh on business and household costs and thus on economic activity in the coming months. The growth outlook may therefore have to be revised downwards, despite today's upbeat business sentiment figure.

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