France: Political uncertainty increasingly weighs on business climate and outlook

The French economic outlook continues to worsen as a result of political uncertainty, with business sentiment falling again in December

France's parliament this week approved a bill to roll over the budget to prevent a government shutdown

Third consecutive fall in the business climate

Business sentiment in France deteriorated again in December, falling by two points. This is the third consecutive month of decline. It deteriorated in all sectors except industry, where it was stable but weak. The decline is very visible in the forward-looking components, with business leaders taking a much less positive view of demand and production in the months ahead. The rise in pessimism for the months ahead is particularly noticeable in the services sector. The French economy's former growth engine is no longer in operation, apparently held back by political uncertainty and the resulting deterioration in the economic environment. In industry, the perceived uncertainty is rising sharply, leading business leaders to predict a deterioration in the production outlook, despite a rise in orders. Inventories are rising again. The rise in perceived uncertainty is also strong in the retail sector, where managers are also reporting a fall in past sales.

At the same time, the employment climate continues to deteriorate, signalling a future weakening of the labour market and a likely rise in unemployment.

Possible contraction in 4Q GDP

Taken together, the data points to a clear weakening in the French economic outlook. While the third quarter was buoyant, thanks in particular to the Olympic Games, the confidence indicators point to a much weaker fourth quarter. While INSEE and the Banque de France are still expecting economic growth to stabilise at the end of 2024, today's data, together with the downward revision to November's business climate figures, indicate that a contraction in activity is possible. We are expecting GDP to fall by 0.1% quarter-on-quarter in 4Q.

A dark cloud over the 2025 outlook

Looking ahead, the political situation will continue to influence the outlook. Until a government is formed, the appointment of François Bayrou as Prime Minister will not be enough to reduce political uncertainty. The unresolved issue of the 2025 budget continues to put businesses and households in a wait-and-see situation, which is clearly putting the brakes on activity. At this stage, the only thing that is certain is that the 2024 budget will be extended into 2025, as the special law allowing this has been passed. This means that the budget deficit will remain far too high, after having been close to 6.3% in 2024. The latest estimates, surrounded by considerable uncertainty, point to a deficit in excess of 6% in 2025 as things stand, i.e. as long as the 2024 budget is extended to next year. It seems unlikely that a budget will be voted on in the next few weeks, which will make the subsequent effort to restore public finances even more difficult. The previous government had promised to return to a deficit of 5% of GDP by 2025 and 3% by 2029, but these targets are becoming less and less credible as time goes by. Meanwhile, all the economic players are well aware that a restrictive budget will have to be put in place at some point, and are postponing their decisions until they see what tax increases will be implemented. As a result, business investment and household consumption have stalled. A further rise in the household savings rate is likely.

Added to these questions is the attention of the financial markets, with Moody's downgrade of France's debt the clearest sign of this. As a result of this downgrade, the ratings of seven French banks have been downgraded, which could lead to an increase in their financing costs and ultimately to a rise in the cost of credit in France. This is not good news in an environment where business investment is still very depressed.

Finally, the international context, with weak growth in our European neighbours, strong competition from Chinese products, and the threat of tariff hikes, is not favourable for French exports in the coming months.

All these factors suggest that the French economy is in for a difficult winter, with economic activity likely to stagnate and a recession not out of the question. While we can hope for a slight recovery when - and if - the political situation becomes clearer, this will not be enough to give a significant boost to French activity in 2025. We are therefore still expecting GDP to grow by 0.6% in 2025, compared with 1.1% in 2024 - a lower figure than most official institute forecasts. The difference is explained by the fact that the latest political developments are already factored into our forecast, as is the likely increase in tariff barriers next year. Against this backdrop, we can only hope that the Christmas spirit, and the political decision-makers, will soon dispel the clouds hanging over the French economy and help us revise our forecasts upwards. However, this will require a real Christmas miracle, as the risks are currently on the downside.

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