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Snap

French business climate decline shows warning signals ahead

France's business climate has deteriorated to its lowest level in over two years, signalling a clear turning point and an expected slowdown in the second quarter. Inflationary pressures are moderating substantially

Signs of a worsening outlook have been accumulating for several months, but until now, they haven't overshadowed the outlook

Signs of a worsening outlook emerge

The business climate in France deteriorated in May, falling by two points to 100 – its lowest level in over two years. The decline is notable in the services sector, as well as in industry, retail and wholesale trade. Both the assessment of the current situation and the assessment of business prospects are falling everywhere.

Signs of a worsening outlook have been accumulating for several months, but until now, they haven't overshadowed the outlook. With PMI indices published yesterday, the May data are now very clear: a slowdown in French economic activity is to be expected in all sectors, starting in the second quarter. And this slowdown is beginning to have an impact on the labour market, which means that it's likely to continue for several quarters. The employment climate fell sharply in May to 106 – its lowest level since September 2021 – due to a more negative assessment of employment developments in the services sector.

Given these early signs of labour market weakness, a weaker outlook according to business leaders, persisting high inflation, expected weak global growth and the impact of monetary tightening being felt in a more meaningful way, we expect GDP growth to be weak in the coming quarters. This should bring 2023 growth to 0.6%

and 2024 growth to 0.7%, with risks tilted to the downside. While France escaped recession last winter, today's indicators are a reminder that a recession in the coming months cannot be ruled out.

Divergence in Europe

With this generalised weakening, France is an exception from its neighbouring countries. In other European countries, the divergence between the manufacturing and service sectors increased in May as the global economic slowdown weighed down industry, while services benefited from the gains in purchasing power linked to lower energy prices and higher negotiated wages. In France, this divergence is not quite as significant – and more importantly, the slowdown is visible everywhere, including the services sector.

The difference between France and its neighbouring countries is likely due to differences in the inflation context; French inflation increased again in April, while it continues to decrease elsewhere. The biggest inflation shock on purchasing power occurred in 2023 in France but took place in many other European countries last year.

From an inflation perspective, the report brings good news, with business price expectations falling in all sectors. The decline is particularly pronounced in the industrial sector, where the expected trend in sales prices has fallen back below its long-term average. This is a clear sign that inflationary pressures have diminished significantly. In services, the decrease is less pronounced, but expected selling prices have returned to their November 2021 level.

Forecast prices are also down in trade and construction. This good news should be greeted with relief by the European Central Bank, as it indicates that inflation in France should begin a fairly clear descent in the coming months.

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