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FRANCE

French business confidence confirms weakness in domestic demand

Business climate indicators signal that industry has cushioned the shock in April, while domestic demand saw a significant weakening

Business confidence has dropped sharply in France, with expected demand declining and order intentions contracting

Deteriorating growth outlook

As expected, business confidence in France deteriorated sharply in April, down three points over the month. The decline is particularly pronounced in retail trade, where the indicator fell by six points, as well as in services. In both sectors, the overall outlook has darkened significantly: expected demand is declining, and order intentions have contracted sharply.

By contrast, business confidence remained stable in construction and improved slightly in industry. In this sector, overall order books are recovering, as are firms' own production expectations. A similar pattern is observed in the PMI indicators, with the services PMI deteriorating sharply, while the manufacturing PMI improved.

The increased vulnerability of Asian industrial competitors to the current energy crisis (due to their heavy reliance on supplies transiting through the Strait of Hormuz) appears to be supporting the competitiveness of French firms. In addition, the risk of shortages and price rises seems to be prompting industrial clients to bring forward their orders. This is a clearly positive signal for French industrial conditions. However, its durability remains uncertain and is closely tied to developments in the geopolitical situation in the Strait of Hormuz.

This support for industry will help the French economy limit the immediate risk of slipping into recession. However, it will not be sufficient to offset the deterioration in domestic demand, which is very visible in the April data. Rising energy prices appear to be weighing heavily on household purchasing behaviour. They are curbing consumption, and this is directly weakening activity in retail trade and services. This weakness in domestic demand will significantly constrain economic growth this year. We now forecast growth of 0.7% in France in 2026, compared with 1% expected before the outbreak of the conflict. This forecast could be revised further downwards if the conflict were to drag on even more.

Inflation set to rise in the coming months

Business confidence indicators also point to a recovery in firms' price expectations across all sectors. The rebound is particularly visible in industry and construction. Nevertheless, expected prices remain well below their 2022 levels, once again illustrating the difference in impact of this energy crisis compared with the previous one. Domestic demand simply appears too weak to trigger price increases similar to those observed at the time.

Moreover, the risk of an inflationary spiral remains more contained in France than in the rest of the euro area. The starting point for inflation is lower than in most European countries. The French economy is characterised by a large share of administered or centrally negotiated prices, which slows the pass-through of cost increases to consumer prices. In addition, the labour market remains fragile. Hiring intentions are weak, and net job creation has been negative for several quarters. Ongoing wage negotiations do not fully incorporate this new inflationary shock. In this context, wage growth is likely to remain more moderate than elsewhere in the euro area, limiting inflationary pressures, especially in services.

This does not, however, imply that inflation will remain under control. Rising energy prices, higher costs for certain key inputs (such as fertilisers or metals), and the rebound in firms' pricing intentions suggest that French inflation should continue to rise and exceed 2% for several months this year. At this stage, we expect average HICP inflation of 2.1% in 2026, compared with 1.3% in our pre-conflict forecast.

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