

Prospects

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FRANCE – 2016-2017 macroeconomic scenario

Growth resilient but sluggish

- For Q1 2016 we are forecasting growth of 0.3% compared with Q1 2015. This corresponds to the average rate observed last year. Q1 Business climate surveys and activity indicators are somewhat mixed.
- In 2016-2017, the recovery in activity will mainly be stimulated by external factors such as low interest rates, a weak euro and cheap energy, but also by specific economic policy measures such as the CICE research tax credit, the government's Responsibility Pact and the accelerated depreciation mechanism for industrial investment. Growth is nevertheless hampered by structural factors and economic slowdown in the emerging countries.
- In view of this, consumption is likely to remain the mainstay of growth, with investment gradually taking up the slack to support domestic demand. Foreign trade seems likely to make a slightly negative contribution given the sluggish pace of global growth.
- In a highly uncertain environment, French growth is likely to be resilient, but a bit sluggish. After annual growth of 1.2% in 2015, we are forecasting 1.2% in 2016 and 1.4% in 2017, below the forecast eurozone average of 1.6% in 2016 and 2017.

No acceleration in Q1 2016

Modest recovery in 2015 confirmed

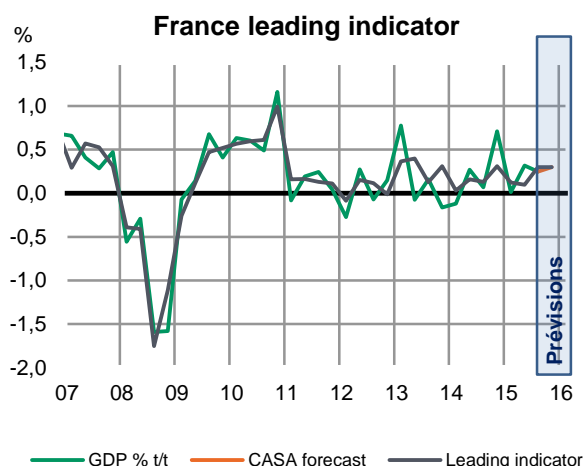
In Q4 2015, volume GDP rose by 0.3% relative to Q3, in line with our forecast and the consensus. While net foreign demand had an adverse impact on growth, domestic demand, and inventories in particular, propped it up. Although household consumption contracted in the wake of the November 2015 terror attacks, business

investment has been fairly dynamic. Overall, in 2015 as a whole, growth came out at 1.2%, or 0.1 of a point higher than our last forecast, after the figure was revised by Insee.

Moving on, no acceleration in Q1

The Q1 business climate surveys and activity indicators are somewhat mixed. The rebound in household consumption in particular has been confirmed in Q1. This offsets the negative shock from the November 2015 terror attacks. There is a significant growth overhang in consumption in Q1 of 1.7% over the quarter. Conversely the Q1 growth overhang is negative both in the manufacturing sector (-0.2% over the quarter) and in industry (-0.4%).

Looked at overall, the cyclical indicators testify to the fragility of the current recovery. Our Q1 growth forecast is unchanged at 0.3% over the quarter. The figure corresponds to the average growth figure observed in France in 2015. This forecast is also consistent with our leading indicator for growth, which is based on available survey data and hard data. Household consumption is forecast to return to trend after the negative impact of the attacks. Investment is forecast to rise, but the increase should be less marked than that observed at end-2015. On the other hand, the contribution from foreign demand is likely to be virtually zero, with exports rising slightly faster than imports. Inventories, which had strongly supported growth in the second half of 2015, would appear to have made a negative contribution.



Source : Crédit Agricole S.A.

Leading growth indicator, Crédit Agricole				
% Change q/q	Q2 15	Q3 15	Q4 15	Q1 2016
GDP	0,0	0,3	0,3	
CA leading growth indicator				0,3
CA forecast				0,3

Sources: INSEE, Crédit Agricole SA estimates

2016-2017: resilience in an uncertain environment

The global environment is likely to remain generally conducive to an improvement in French growth in 2016 and 2017, but only very gradually. Consumption seems likely to again be the main pillar. Investment should also take up some of the slack in supporting domestic demand. However, the contributions from foreign trade and inventories are likely to be less favourable in 2016 and 2017.

All in all, after growth of 1.2% in 2015, we are opting for a very slight improvement at 1.2% in 2016 and 1.4% in 2017. The external environment, featuring a weak euro, ultra-low interest rates, and low oil prices, underpins our forecast for a modest acceleration, but the lack of momentum compared with the rest of the eurozone, where growth is forecast to come in at 1.6% in 2016 and 2017, can be explained by structural constraints.

Household consumption still the mainstay of the recovery

Household consumption is still the main engine of the ongoing recovery. After rising 1.4% in 2015, it is forecast to increase by 1.2% in 2016, and then by 1.6% in 2017. Several positive factors are supporting consumption, chief among which are a slight rise in purchasing power due to very low inflation, and a slight drop in taxation on low-income households. The effect of the low inflation is likely to fade, however, in the wake of a rise in oil prices. Consumption is nevertheless constrained by high unemployment and the fiscal adjustment process.

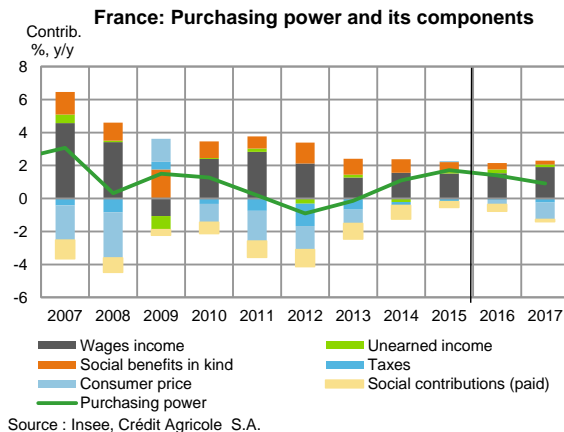
The purchasing power of disposable income is forecast to increase fairly markedly, by 1.4% in 2016, then by 0.9% in 2017, compared with 1.7% in 2015, thanks to limited inflation and slightly higher disposable incomes. Low inflation has a positive effect on purchasing power. This effect, which was extremely significant in 2015, is likely to gradually erode in 2016 and 2017 as inflation starts to rise once more as a result of the improving economic climate, rising energy prices, and the effects of ECB policies. With zero inflation in 2015, our inflation scenario is based on an annual 0.2% in 2016, then 1.0% in 2017.

By 2017, our scenario includes the assumption that primary incomes will be supported by growth in total wages in the wake of a timid recovery in employment, of 0.4% in 2016 and 0.5% in 2017, and an increase in per capita wages of around 1.4% on average. But that per capita wage growth nevertheless looks set to remain below trend level, suggesting that the labour market is still fragile, with an unemployment rate (using the International Labour Organisation's definition) forecast to stand at 9.7% at end-2017 in continental France, down from 9.9% in 2016 and 10.0% in 2015 (see p.6, "Slow improvement in employment").

Moreover, the rate of increase in welfare benefits paid to households is likely to ease off gradually, for the fourth consecutive year. After 1.7% in 2015, the rate should fall to 1.1% in 2016 and 1.0% in 2017 in view of the counter-cyclical nature of these benefits and the constraints of fiscal adjustment. In particular, in 2016, a certain number of benefits (ie, the RSA and Agirc-Arrco pensions) will be revalued later than previously.

Our scenario is based around the assumption that tax rises will have topped out but that taxes are likely to fall very little in the short term. The tax cuts enshrined in the government's Solidarity Pact are having a positive impact on the income of the lowest-earning households. In 2016, the negative contribution of tax paid should therefore be slightly lower than in 2015, given the revision of the income tax scale for low-earning households (€5bn in tax cuts). Some 3 billion euros were allocated in 2015 and the remaining 2 billion will be allocated in 2016. These tax cuts will help drive consumption by low-income households, whose marginal propensity to consume is the highest. Conversely, we may take note of a slight increase in pension contributions.

Furthermore, against a backdrop of considerable uncertainty, the savings ratio is likely to remain high in 2016, close to its current level of 15.9%. It would only decrease very gradually as the improvement in the economic climate helps to restore household confidence and slightly reduces their propensity to adopt precautionary saving behaviour.

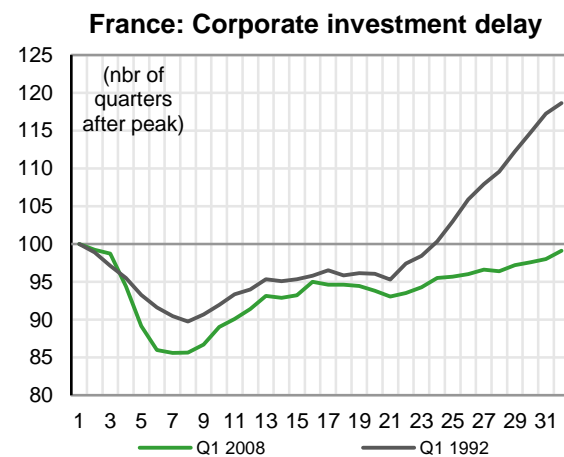


Investment to continue modest recovery

After two years of falls and a drop of 1.2% in 2014, investment stabilised in 2015. Looking forward, in 2016 and 2017, investment is forecast to pick up gradually, by 1.5% in 2016 and 2.2% in 2017. The changes are contrasted, however. Business investment is forecast to rise by 2.9% in 2016 while public sector investment is due to decline by 1.8%. Household investment is forecast to rise slightly, by 0.1% in 2016, after falling for four years in a row. The recovery should be sustained by improved confidence and firms' better financial situation, linked largely to measures to cut payroll taxes, and as accelerated depreciation for industrial investment kicks in.

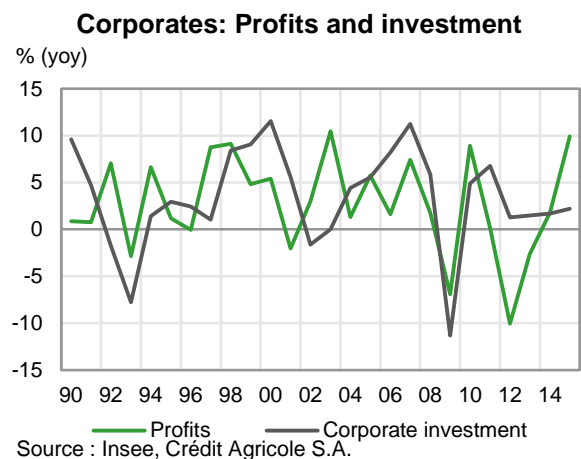
Business investment to recover gradually

Business investment has been increasing for nine quarters. After rising by 1.9% in 2015, it is forecast to accelerate by a modest 2.9% in 2016 and by 3.3% in 2017. The increase is modest if we compare it to past business cycles where the recovery was more vigorous and not so late in arriving. In terms of its level, business investment has only just returned to its 2008 level (see graph).



The scale of the recovery in investment is currently uncertain. Some factors favour a pick-up in investment, namely the fiscal support measures (the Responsibility Pact, the CICE, and the accelerated depreciation measure, amounting to a total 33 billion euros in 2015 and 2016), the drop in energy prices and the very low cost of bank or money market finance. However, compared with the sharp rise in profits of around 15% in 2015, the recovery in investment is timid, some companies opting to use this "breathing space" for other ends by channelling the gains from these measures towards wages or paying down debt.

In addition, the investment recovery is limited by a modestly optimistic business climate, a below-trend industrial capacity utilisation rate, continued modest forecast domestic and foreign demand levels, and high taxes.



The investment trend will also be especially sensitive to the roll-out of measures planned in the framework of the Responsibility Pact, which we believe will be deployed. In April 2016, the second phase of the Pact came into force, after a 3-month delay to find funding for the accelerated depreciation measure, deemed a priority. This second phase consists of a 1.8 point cut in employer child benefit contributions on all salaries between 1.6 and 3.5 times the Smic minimum wage. This represents an additional full-year cost for the public finances of 4.2 billion euros. Looking forward, in 2017, and for the record, the vote on the third phase of the Pact includes tax measures, namely the definitive abolition of the C3S¹ company solidarity levy, and a 1% cut in company income tax, costing 3.5 and 1.5 billion euros respectively.

In the immediate future, survey data signal expectations of a rise in business investment in the manufacturing industries. Surveyed in October 2015, manufacturers were forecasting a 3.0% rise in their investment by value in 2016. In January

¹ C3S: Contribution Sociale de Solidarité des Sociétés.

2016, this forecast was revised upwards by 4 points, to 7%. The change is also linked to the windfall effect in connection with the accelerated depreciation measure, which is valid until December 2016. Finally, one may also note that industrialists are above all forecasting upgrade investment, while investments to increase productive capacity are still running below trend.

Household investment forecast to return to growth after a prolonged correction

Following a sharp fall of 5.3% in 2014, household investment (ie, the purchase of new homes and the cost of renovations) continued to deteriorate in 2015 for the fourth year in a row (-3.0%). In 2016, however, it is forecast to gradually pick up due to the recovery in the sale of new-build homes. The real estate market as a whole (new-build and pre-owned) experienced a rebound in 2015 as sales jumped by 15% and house prices stabilised. The market should remain relatively sustained in 2016 thanks to a series of new-build housing support measures (eg, the Pinel buy-to-let scheme and the widening of the interest free housing loan) and to the very low level of mortgage lending rates.

In view of the time lags habitually observed between a recovery in new-build house sales and that of household investment, investment is due to gradually recover in 2016-2017. However, a number of dampers are adversely affecting household investment. For one thing, household confidence levels are running below trend, and for another, real estate prices, while they do not seem over-valued, are still too high for many first-time buyers. In addition, lending rates could rise gradually of the coming quarters.

External contribution again negative in 2016

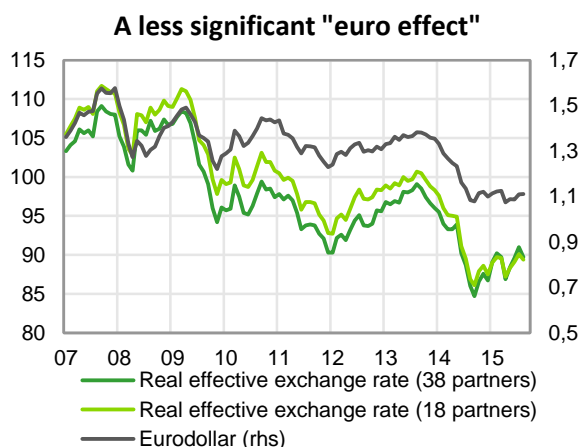
After making a negative contribution to growth in 2014 (-0.5 of a point) and in 2015 (-0.3 of a point), the contribution from foreign trade looks set to continue slightly negative in 2016 at -0.3 of a point, after which it should be virtually neutral in 2017. Exports are forecast to rise by 4.5 % in 2016, and then by 5.4 % in 2017, compared with an average 5.0% growth in imports over the same period.

In 2015, the strong momentum of imports (up 6.7% compared with 3.9% in 2014) eclipsed the improvement in exports (up 6.1%, compared with 4.5% in 2014). The rate of increase in imports was especially dynamic in the second half of 2015 due to sustained imports of manufactured goods. Looking ahead, imports are forecast to remain strong but grow at a more measured pace, following a modest improvement in domestic demand. Imports are forecast to grow by 5.0% in

2016 and 2017, a rate close to their trend level in 1985-2010.

On the exports front, the euro exchange rate environment is fairly favourable and is helping French exports, but the “euro effect” should be less significant than in 2015. The euro’s real effective exchange rate² has shown a degree of resilience over the past year, linked to the decline in some emerging currencies (the rouble, Brazilian real and Turkish pound in particular), while the euro/dollar exchange rate was fairly stable in 2015. The differentiation between the Fed’s monetary policy and that of the ECB implies that the euro’s exchange rate against the dollar may remain low for the duration. However, the ECB seems to prefer supporting lending in the eurozone through its new TLTROs and CSPP³, rather than weakening the euro exchange rate. These factors are built into our projections, which predicate a drop in the euro/dollar exchange rate to 1.08 at end-2016 and end-2017, compared to 1.13 at end-March 2016.

However, the exchange rate effect will be unable to remove the dampers on French exports and the vigour of world trade. For the industrialised countries, which take 80% of French exports, the auspices are generally good in 2016 as they continue to benefit from low energy prices. But French addressed demand is constrained by the difficulties experienced by a large number of big emerging countries. Brazil is increasingly mired in a political crisis and a severe recession. Russia is also seeing large-scale difficulties in the wake of the drop in oil prices and international sanctions. In China, growth is still relatively buoyant, but is seeing a gradual slowdown in trend terms.

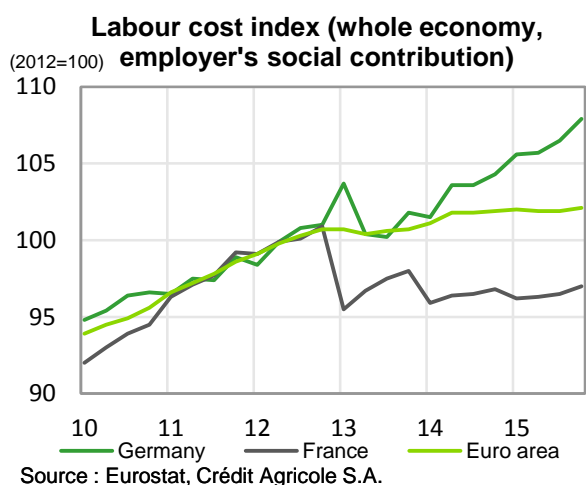


² The effective exchange rate is the exchange rate of a monetary area measured as a sum weighted by the exchange rates with the area’s various trading partners and competitors.

³ CSPP: Corporate Sector Purchase Programme.

Moreover, the French economy's structural competitiveness gap (costs and non-costs) is still a brake even if an improvement in cost-competitiveness is perceptible over the recent period. The underlying trend of a gradual decline in French export market share within the eurozone testifies to the existence of this competitiveness gap. Since 2012, though, that market share has stabilised.

While the effects of a policy of lower payroll costs under the CICE and the Responsibility Pact has yet to translate into an improvement in eurozone market share, they can nevertheless be seen in changes in the cost of labour. Since 2012, the labour cost index calculated by Eurostat has been increasing faster in Germany than in France. This difference can be explained by the drop in the non-wage component (employer payroll taxes) of the labour cost index, which has fallen by 3 points since 2012 across the whole economy in France, while it has advanced 7 points in Germany. Consequently, the differential in the cost of labour between France and Germany is narrowing (which can also be partly explained by the introduction of a minimum wage in Germany). Whereas in 2012 the cost of one hour's labour stood at 30.5 euros in Germany compared with 34.3 euros in France, in 2015, the cost stood at 32.2 euros in Germany vs 35.1 euros in France, according to Eurostat. The gap between France and Germany can largely be explained by the differences in non-wage costs, which in 2015 accounted for 33% of labour costs in France as against 22.3% in Germany. One may also note that, in the industry sector, the labour cost calculated by Eurostat is now slightly lower in France than in Germany, at 37.6 euros compared with 38 euros. However, above and beyond these changes, France's catch-up in terms of eurozone market share will remain contingent on firms' use of this room for manoeuvre to invest or lower their prices.



Inventories likely to be run down

The forecast contribution to growth from inventories is likely to be lower in 2016 (0.1 of a point, vs 0.3 of a point in 2015), and is forecast to be slightly negative in 2017. This follows on from three consecutive years of positive contributions from inventories.

During 2015 inventories helped sustain growth with a contribution of 0.3 of a point, although with fairly erratic variations from one quarter to another. Following a negative 0.4 of a point contribution in Q2, inventories rebounded sharply in Q3 (+0.7 of a point) and Q4 (+0.6%). The inventory building trend in the second half was fairly unusual and is likely to correct itself gradually in 2016. In the business climate survey, there are almost as many industrialists who reckon that their finished product inventories are lower than normal as there are who see them as higher than normal. The balance of opinion on inventories, which was running close to trend in Q4, is now running below trend, suggesting a running down of inventories in Q1. Overall, the level of firms' changes in inventories has reached a record high of 21 billion euros in 2015, up since 2011, and this will slowly see a correction.

Slow improvement in employment

Our scenario includes a slight drop in the unemployment rate from end-2016, carrying over into 2017, as a result of improving growth prospects and the effects of economic policy measures.

The forecast recovery in the traditionally job-rich construction sector may bolster the positive effect of an improving economic climate. The measures enshrined in the 2016 budget are designed to support employment in micro-enterprises and SMEs. They include a harmonisation to eleven employees for tax thresholds that previously kicked in at nine or ten employees. It is also planned that by end-2018, in firms employing fewer than 50 staff, crossing a threshold does not trigger a loss of benefits or the application of new levies. Recent announcements in early 2016 may also have an impact. These concern vocational training (a target of training for 500,000 job-seekers has been announced) and a temporary mechanism – a one-off 2,000-euro hiring premium – designed to encourage hiring by SMEs. All these measures point to a possible slight drop in the unemployment rate, but the overall improvement in labour market conditions seems to be more delayed as shown by our aggregate labour market condition indicator⁴. Last, with growth remaining modest, the recovery in employment seems likely to be slow and gradual. Recent labour market reforms in the 2013 Act guaranteeing employment, and the future draft

Labour Act currently being debated, could have a positive impact and boost jobs growth, but the impact would be measured and perceptible above all in the medium term. ■



France	Yearly average (YoY, %)				Quarterly growth (QoQ, %)											
	2014	2015	2016	2017	2015				2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
GDP	0,2	1,2	1,2	1,4	0,6	0,0	0,4	0,3	0,3	0,3	0,3	0,3	0,4	0,4	0,4	0,4
Households consumption	0,7	1,4	1,2	1,6	0,6	0,0	0,4	-0,1	0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,4
Investment	-1,2	-0,0	1,5	2,2	0,4	-0,1	0,1	0,7	0,3	0,4	0,4	0,5	0,6	0,6	0,6	0,6
Change in inventories*	0,2	0,3	0,1	-0,1	0,3	-0,3	0,7	0,6	-0,2	-0,2	-0,2	-0,2	0,1	0,1	0,1	0,1
Net exports*	-0,5	-0,3	-0,3	-0,0	-0,2	0,3	-0,6	-0,4	0,1	0,1	0,1	0,1	-0,1	-0,1	-0,1	-0,1
Unemployment	10,3	10,4	10,3	10,1	10,3	10,4	10,5	10,3	10,3	10,3	10,3	10,1	10,1	10,1	10,1	10,0
CPI (yoy)	0,6	0,1	0,2	1,0	-0,2	0,3	0,1	0,1	-0,0	-0,0	0,3	0,6	1,1	0,9	1,0	1,1
Government net lending	-3,9	-3,5	-3,3	-3,0												

* Contributions to GDP growth

Source : Crédit Agricole SA, estimates

⁴ This indicator is calculated using a range of labour market data on which we perform a principal component analysis to provide an aggregate view of changes in the labour market.

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