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Economic Insight

France – An economy at a dead end

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Table of contents

France is facing a new vote of no confidence against its government. Regardless of the outcome, the country is facing an economic and fiscal deadlock. This is because economic growth has recently been largely driven by rising public spending, but the increasing interest payments on its debt force the government to implement significant savings in the coming years. Unemployment could rise in the coming months and the long-term outlook for France's economy is also rather bleak.

Confidence in the French economy is waning

Since the parliamentary elections in July 2024, French politics has been paralyzed. No political camp has an absolute majority in parliament, the constitution rules out snap elections for a year and lasting coalitions are not being formed.

Partly due to this political uncertainty, the mood among companies and investors in the EU's second-largest economy has fallen to an alarmingly low level. For example, the business climate of the French statistics authority Insee, a highly regarded economic indicator, has fallen continuously since its peak in summer 2021 and is now well below the average of the last seven years (Chart 1). This is worrying because entrepreneurs and investors are not only assessing the current situation, but are also forming expectations for the future and the outlook for the French economy is clearly very bleak.

Chart 1 - Confidence in the French economy is waning

Level of Insee business climate and the stock index of companies with small market capitalization adjusted for the national CPI, normalized by the average and standard deviation from 2017-2024

Source: Insee, Bloomberg, Commerzbank-Research

Economic growth depends on public spending, …

The outlook for the economy is also clouded by the fact that its growth in recent quarters has depended to a considerable extent on rising government spending. While the contribution of government consumption to quarterly growth in the years from 2010 to 2019 was only 0.07 percentage points, it was around twice as high last year (Chart 2). Without the stimulus from government spending, the economy would have almost stagnated in the first two quarters of last year and would have contracted even more strongly in the fourth quarter.

Chart 2 - Puplic spending has gained importance

Contributions to France' quarter-on-quarter GDP growth, seasonally adjusted, in percentage points

Source: Eurostat, Commerzbank-Research

... but the government must implement drastic savings

Government spending, however, will not be able to increase any further in the coming years. This is because the deficit was already more than 6% of GDP last year. Against the backdrop of debt amounting to 111% of GDP, this has already caused turmoil on the financial markets. In addition, the EU's recovery fund (NGEU) will cease to be a source of financing in the foreseeable future. In order to curb the rise in debt, the government will have no choice but to cut spending and increase taxes. The aim of Prime Minister Bayrou's new government is to reduce the deficit to 5.4% this year and return it to the upper limit of 3% set by European debt rules by 2029.

Risen interest rates on French debt make this effort more difficult. While a ten-year government bond demanded 1% p.a. in interest before the pandemic, 3% interest was due last year. As these higher interest rates are not only required for new government debt, but also when refinancing “old” debt, interest payments on France's government debt are likely to rise from just under 2% of GDP at present to 3% in 2029 according to our calculations (Chart 3)[1].

In order to reduce the deficit to 3% by 2029 as announced, the government would therefore have to balance the national budget without interest payments (primary balance) by that year. This would require savings or tax increases of more than EUR 120 billion (around 4% of GDP), which would certainly put a noticeable brake on public and private demand.

Chart 3 - France has to reduce its primary balance dramatically

Interest balance, primary balance and budget balance overall as share of GDP

Source: Bloomberg, Commerzbank-Research

Will Paris get a short-term boost from stronger growth?

One alternative on the road to sustainable government debt, besides budget savings, would be higher economic growth and the associated increase in tax revenues. Indeed, the ECB's falling key interest rates should also support the French economy in the coming quarters. The country could benefit from this quickly, as the French economy has a lot of spare capacity. Companies in the manufacturing and services sectors are currently operating at around 80% of their capacity, which is significantly lower than in previous years (Chart 4).

However, this low capacity utilization could also pose a threat to the economy: An economic downturn – triggered by government austerity measures, for example – could lead to capacity being reduced. Companies would invest less and cut staff. The increase in the proportion of the population employed in the private sector from 34% in 2016 to 37% in 2024 could be partially reversed. Hence, there is a risk of negative feedback from rising unemployment and falling consumer confidence. We therefore expect France to grow only moderately in the coming quarters.

Chart 4 - Built up capacity remains unused

Survey results on capacity utilization in manufacturing and the services sector, number of people employed in the private sector as a share of the population overall, in percent

Source: Bloomberg, Commerzbank-Research

Growth remains limited in the long term

The expansion of the French economy could also be limited in the long term. This is because the working-age population (25 to 64 years) in France is likely to decline slightly (Chart 5). In contrast, the population of people over 65 will increase by 20% over the next ten years. This means that the demographic trend in France is still better than in Germany, where the working-age population is actually shrinking noticeably. Nevertheless, the demographic trend in France is unlikely to provide any positive impetus for the economy. Whether technological progress or greater use of capital goods such as automated production systems can compensate for this is more than questionable. This follows the fact that investment activity in France has also been very subdued over the past two years due to higher real interest rates.

Chart 5 - Population dynamics in France and Germany

Population by age group, 2024 = 100

Source: UN, World Population Prospects (2024)

Bleak outlook for France overall

This means that the outlook for the French economy will remain very bleak for the coming years. We assume that medium-term growth in the EU's second-largest economy could be below 1% per year. In addition to demographics, this is also due to the overdue budget consolidation. Paris is therefore likely to insist all the more strongly that the EU takes on more debt at the European level. This would reduce the pressure on the French government to save somewhat, but contributions to the budget of EU institutions would also increase in the future – for both France and Germany.

[1] We use the Fiscal Monitor from Bloomberg Economics for forecasting the development of interest payments, which simulates the refinancing of maturing government bonds. Our assumptions include medium-term French GDP growth of around 1% per year and yields on French 10-year government bonds of 3.4%. The reduction in the deficit targeted by Prime Minister Bayrou for 2025 has already been taken into account. (back)

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