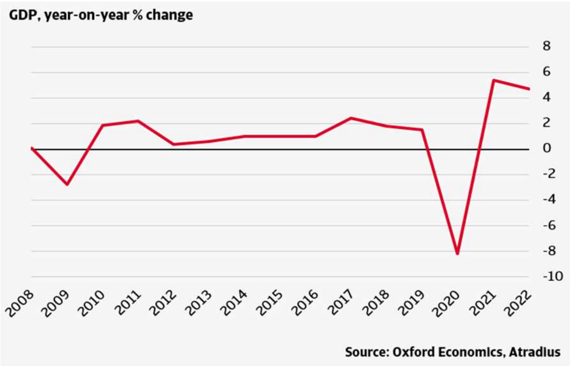
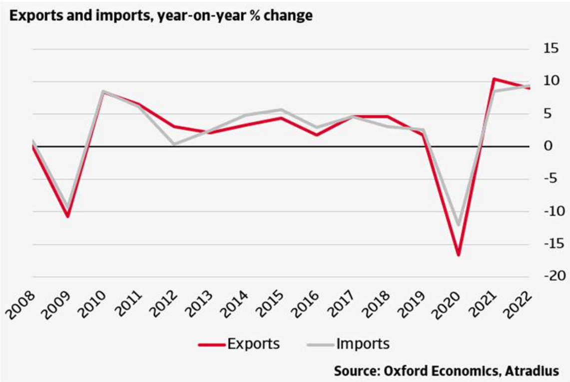
France Country Report

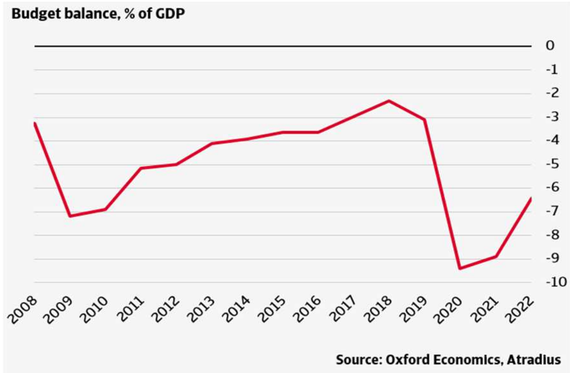
June 2021

Massive stimulus measures will drive economic recovery

Economic Situation







In the first quarter of this year, French GDP contracted only 0.1% quarter-on-quarter, after a 1.5% decrease in Q4 of 2020. The economic activity was sustained by a modest rebound in investment spending and private consumption.

While the growth rate in Q2 will be affected by the comprehensive lockdown measures imposed in April, the gradual easing of those restrictions in May and June will, together with the vaccination rollout, lead to a rebound in the second half of the year. According to Oxford Economics, the French economy is forecast to grow 5.4% in 2021, after a steep 8.2% contraction in 2020. The economic rebound will be mainly driven by domestic demand. Both household consumption and investment will increase 3% and 10.5% respectively, with business investments benefitting from ongoing large stimulus measures (see below). While real government consumption will grow 4.7%, exports are forecast to rebound 11%, after a contraction of more than 16% last year. Inflation will increase 1.5% this year, due to the recovery and higher energy prices.

In 2022 the French economy is expected to grow 5.3%, with further rising investments and exports (up 4.5% and 9%, respectively). Private consumption is forecast to grow by 6.7%. As in H2 of 2021, household purchasing power will be supported by the government's furlough scheme and savings accumulated during the lockdowns. However, rising unemployment (expected to increase to 9.2% in 2022, from 8.3% in 2021 and 7.8% in 2020) could hamper private consumption.

Massive stimulus measures have driven up government debt

Since the outbreak of the pandemic in France, the French government has launched massive stimulus measures to support consumers and enterprises alike. In order to support businesses affected by the pandemic, the government launched several measures, e.g. a furlough scheme, a Solidarity Fund to help small businesses and micro-entrepreneurs, a large state-guaranteed loan program (prêt garanti par l'État, PGE), and measures facilitating the establishment of debt and rent payment moratoria.

Due to those stimulus measures and to the negative impact of the pandemic on tax revenues, the French fiscal deficit increased to 9.4% of GDP in 2020. With additional public spending to sustain the economy in 2021 and into 2022, another deficit of almost 9% of GDP is expected this year, followed by a 6.5% of GDP shortfall next year. Currently, the government's economic policy agenda focuses on implementing a EUR 100 billion supply-side recovery plan (of which EUR 40 billion is to come from the EU's EUR 750 billion recovery fund, subject to final approval by the EU Commission and the European Council). The recovery plan mainly aims to boost the industrial sector by increasing competitiveness and investments in digitalisation and ecology (green businesses), while another pillar is the strengthening of social and territorial cohesion (including job creation/minimising the rise in unemployment).

Public debt will increase to almost 120% in 2021, the third highest debt/GDP ratio in the Eurozone after Greece and Italy. Nevertheless, in the short-term, the government will prioritize economic growth over fiscal consolidation. This is helped by the fact that the European Central Bank (ECB) indirectly supports France's government finances with its extraordinarily loose monetary policy. The ECB has committed to purchasing assets under the Pandemic Asset Purchase Programme (PEPP), and it has increased and extended the PEPP in December 2020. The ECB will purchase up to EUR 1.85 trillion of bonds until March 2022, and it will reinvest principal payments until the end of 2023. This will keep financing costs down for the time being and provide Eurozone governments with some space to increase their debt issuance.

Performance forecast upgrades for some industries

Due to the improved economic outlook, the credit risk/business performance outlook of some key industries has been recently upgraded, albeit from a very low level in most cases.

Automotive/Transport: automotive sector output is forecast to increase by about 22% this year, after decreasing 28% in 2020. However, despite the strong rebound, the credit risk situation of many businesses remains strained, as the 2020 downturn has led to severe liquidity strains and cash shortfalls. Despite comprehensive stimulus measures (e.g. direct spending and tax break measures), many Tier I and Tier II subcontractors, and even some medium-sized businesses, are facing increased credit risk. French aerospace industry production will rebound by about 13%, but it recorded a contraction of more than 30% in 2020. Subcontractors will continue to suffer from subdued activity, with no real recovery expected before 2024-2025. As the segment needs to consolidate, many players will disappear in the short- and mid-term. Due to all those adverse factors, the sector performance outlook remains "Bleak" for the time being.

Construction/Construction Materials: the sector performance outlook has been upgraded by one notch, but it remains "Poor" for the time being. The industry was performing poorly before the coronavirus outbreak, with increased cash issues for businesses due to difficulties funding their working capital requirements. Construction output contracted 14% in 2020. While residential and non-residential building activity continued to decline in early 2021, the renovation work subsectors have remained resilient so far. Construction output is expected to rebound by about 12% in 2021, but material shortages, volatile input pricing and postponement of projects are weighing on businesses with tighter margins. Thanks to government support measures, construction insolvencies remained low again in 2020 and Q1 2021, but a rise of business failures is expected towards the end of this year.

Electronics/ICT: sales have deteriorated due to the closure of businesses because of the lockdowns, and some retail businesses face a reduced level of incoming cash flow. However, spending from businesses and employees on digital goods and services has increased due to the sharp rise of remote working, and ICT output is set to grow 5% this year. Therefore, the sector performance outlook has been upgraded by one notch, from "Poor" to "Fair".

Machines/Engineering: machinery output is set to rebound 13% in 2021 after a contraction by the same figure in 2020. After a difficult time due to the freeze in investments by many industries, a rebound has started since late 2020. The outlook remains positive for H2 of 2021 and for 2022, as previously postponed capital investments will finally be realised. Engineering output is forecast to grow 11% this year and 4.5% in 2022. Therefore, the sector performance outlook has been upgraded by two notches, from “Bleak” to “Fair”.

Metals and Steel: both industries will see a recovery in orders and sales this year, as demand from some key buyer industries (automotive, construction and machines/engineering) is rebounding. French iron and steel output is forecast to increase 14.5%, after an 18.5% contraction in 2020. While producers currently benefit from higher sales prices due to increasing demand and shortages of steel and metals products, higher input prices due to a lack of raw materials are an issue. Both metals and steel sectors have been updated by one notch, from “Bleak” to “Poor”.

Services: Due to the comprehensive lockdown measures and the ongoing pandemic, many segments have suffered heavily, especially hotels and catering, restaurants, bars, entertainment and cultural events, travel agencies and tour operators. After a 10% contraction in 2020, service output is expected to rebound by about 4% this year. The recovery of the tourism sector back to past levels will take some time. Tourism flows will not fully recover in 2021, as some people will refrain from travelling to limit health risks. As restrictions are eased, the severely hit hotel and catering segment will rebound, but by only about 8% in 2021, after a 29% contraction last year. The services sector performance forecast remains “Bleak” for the time being.

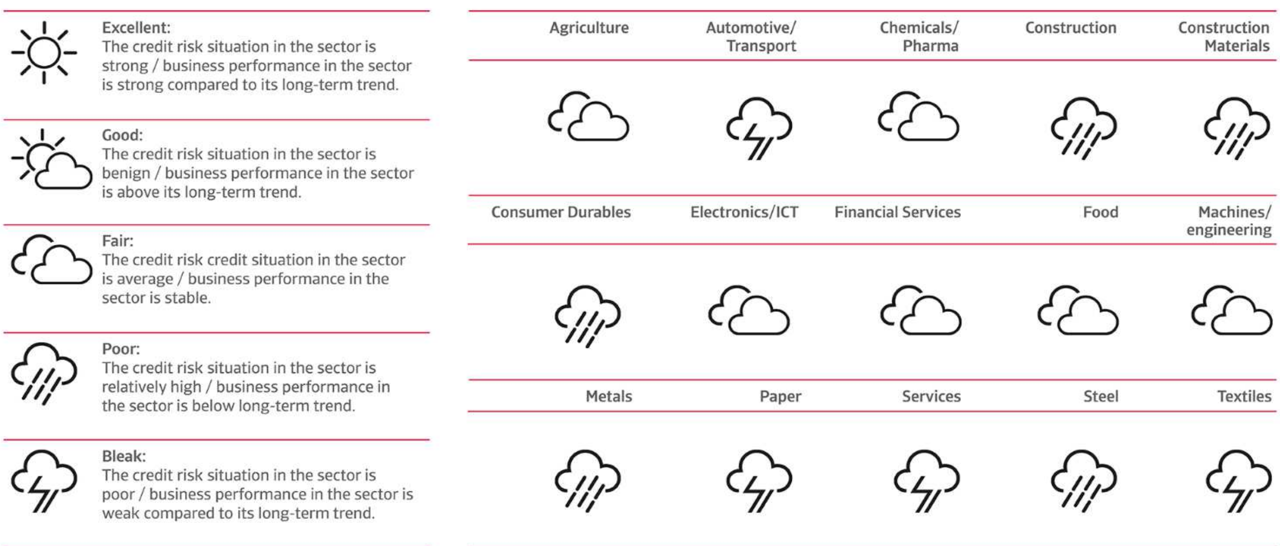
Rising insolvencies expected as of H2 of 2021

Despite the sharp economic contraction in 2020, French business insolvencies decreased 39% year-on-year, to 31,200 cases. According to the Bank of France, business failures declined 35% in the April 2020 - April 2021 period.

The decline was mainly due to a temporary bankruptcy moratorium and extensive fiscal support. While a moratorium on the requirement to file for insolvency expired at the end of August 2020, the massive stimulus measures to support businesses have kept insolvency figures low. With the expiry or abatement of fiscal support, it is expected that business failures will increase again towards the end of 2021. Looking at the cumulative insolvency growth between 2019 and 2021, French business failures are forecast to increase 8%, with further rising insolvencies expected in 2022.

France industries performance forecast

June 2021



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