

Economy

Focus France

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France: implications of the “yellow vests” movement

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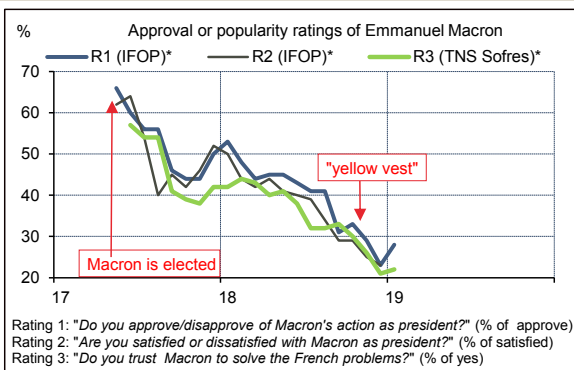
In a few short months, the “yellow vests” movement (gilets jaunes) has changed the way France is viewed in the economic and political spheres. The negative impact on the pace of activity seems modest, transient, limited to some sectors. On the contrary, the impact on the business climate and household confidence is extremely brutal. It does not square with the hard data from the real economy. As the strength of the movement has eased, a correction is likely. The budget impact is moderately expansionary. At this stage, what is most aggressively questioned is Emmanuel Macron’s ability to carry out structural reforms.

The week’s focus

For the past three months, it has been impossible to look at the French economy without referring to the “yellow vests” (*gilets jaunes*). This spontaneous movement has flourished thanks to social networks that offer a decentralised, anonymous and free mode of expression. Every Saturday, since 17 November, there has been a national day of protest - the ninth episode has just occurred - in the form of roadblocks, peaceful demonstrations but also, in some instances, destruction of property and violence against the police, elected officials and reporters. The images of chaos in highly symbolic places in Paris during the third episode, on **1 December**, have gone around the world. Some foreign leaders have not missed an opportunity since then to express, through hints (Trump, Putin) or explicit references (Salvini, Di Maio), their satisfaction with a social crisis that is undermining France.

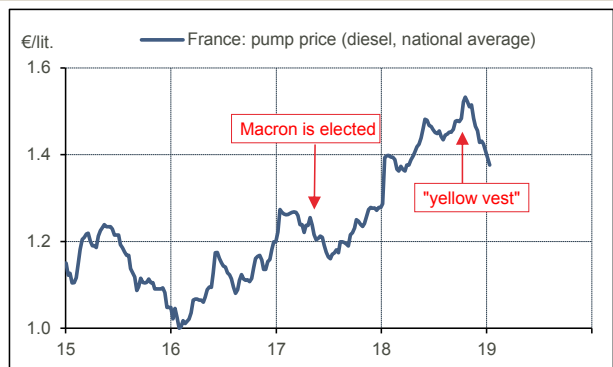
The “yellow vests” have no organisation or clearly identified representatives. They reject the “elites”, the “system”, the “rich” and Paris - in other words everything that Macron supposedly embodies. His popularity had declined last summer and has continued to fall since then (chart lhs). Helped by the viral nature of social networks, the movement readily stokes conspiracy theories and victimisation. It has developed outside trade unions and political parties, but all opposition leaders are seeking, to varying degrees and fairly cynically, to capitalise on it in view of the upcoming European elections. Originally, the protest targeted certain government decisions restricting car use, in particular the lowering of speed limits on secondary roads and the energy transition. At the beginning of Macron’s mandate, the price of diesel was less than € 1.2 per litre; it has increased by more than 30% in eighteen months under the double effect of higher oil prices, by far the main cause, and higher fuel taxes (chart rhs). The demands of the “yellow jackets” now cover much broader areas, taxation, purchasing power and political representation. There are different aspects to consider.

Emmanuel Macron's popularity ratings



Sources: Polling institutes, Thomson Reuters, Oddo BHF Securities

Average price per litre of diesel in France



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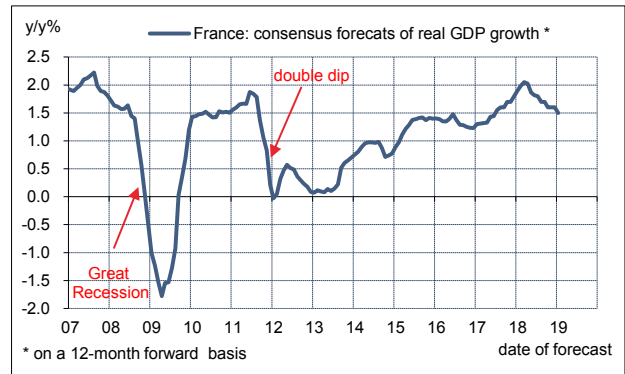
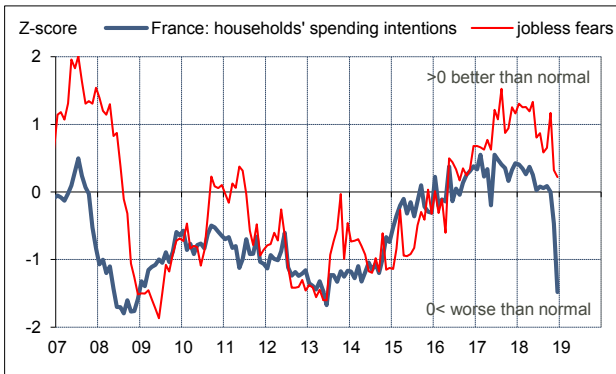
➤ **Economic repercussions** – The start of the "yellow vests" movement involved protestors blocking roads and warehouses, primarily disrupting the logistics of the industrial sector and sales in the retail sector. The Banque de France surveys published on **10 December** showed a negative impact in most industrial sectors (food, electrical equipment, transport equipment, printing) as well as certain services (hotels & catering, transport & warehousing, automotive repairs). The same survey published one month later, on **11 January**, showed a recovery in manufacturing activity but confirmed that the negative shock has continued for hotels & restaurants and automotive repairs. The latest PMI surveys, mostly carried out from **5 to 13 December**, just after the most violent demonstrations, showed a collapse in confidence in services (-6.1 points to 49.0) and a further erosion in industry (-1.1 points to 49.7). By comparison, the INSEE surveys were generally slightly more reassuring. The INSEE synthetic index fell 2.3 points to 102.5 in **December**, the decline being almost entirely due to the blow to the retail and hotel sectors.

In a social crisis on this scale, which seemed to come out of nowhere, household confidence naturally plummeted. The INSEE index shed 8 points in **November and December**, accentuating the decline seen since the start of 2018. The last time the index fell so strongly in such a short period was back in 1995, another period of major social unrest. It goes without saying that the constant media coverage of the unrest, combined with the government's relative apathy in the face of the disorder, largely explains the fall. It does not reflect fundamentals. Some details in the survey, such as household big item spending intentions, are at their lowest point since 2008. Yet the economic situation in France is in no way comparable to that in the Great Recession (chart lhs).

All told, the disruption to activity may be estimated at first sight as a negative shock of around 0.2 points on growth in Q4 2018. The Banque de France and INSEE now expect real GDP growth of just 0.2% q-o-q, instead of 0.4% in the forecasts compiled before the "yellow vests" protests began. The phase of downward revisions to growth forecasts for France continues (chart rhs).

France: spending intentions and unemployment concerns

France: real GDP growth forecasts by the consensus



Sources: INSEE, Consensus Inc, Oddo BHF Securities

➤ **Political consequences** – this is the area where the "yellow vest" effect is the most significant, and also where it is likely to be the most sustained. Distrust of the president, his ministers, his party and, at the end of the day, his political direction, is deeply entrenched. To some extent, this movement effectively completes the deconstruction of the traditional system, which was already disrupted by Emmanuel Macron in the 2017 presidential election campaign. The disruptive approach by Macron in the political arena has been repeated by the "yellow vests" in the social domain. In the past, the president's response would have been to dump his prime minister to start afresh. But this old way of doing things is losing its appeal in the short term. A broad-based ministerial reshuffle after the European elections is still an option, though.

The rancour towards Emmanuel Macron shown in public opinion is probably in line with the hopes that had arisen in the wake of his election, after three five-year terms that had left a bitter taste (Chirac 2002, Sarkozy 2007, Hollande 2012). In this context, it is natural that all the parties which Mr Macron beat or steamrollered in the 2017 elections, are benefiting from his weaker position, with calls for his resignation, the dissolution of the Assembly and early elections, or the complete reversal of his economic policy. These are very unrealistic expectations, in our view.

In view of the recent polls, Marine Le Pen seems to be the main beneficiary of the social unrest. Her party, the Rassemblement National (former FN), gathers around 24% of voting intentions in the European elections on **26 May**. This puts her in first place in France, ahead of Macron's party on 19%. Note that in the European elections of 2014, the FN was already the leading French party (24.8% of votes) ahead of the right (20.8%). The far left (Jean-Luc Mélenchon) is having more trouble capitalising on the social unrest as it is partly held responsible for the violent outbursts of some "yellow vests". As for the



socialists, they have completely disappeared from the French political radar screen. The conservative right is suffering from the lack of charisma shown by its leader (Laurent Wauquiez) and his ambiguous attitude towards Macron (in synch with his economic choices) and the “yellow vests” (a portion of his natural electorate in rural areas).

➤ **Government's response (economic)** – On **4 December**, the French Prime Minister initially proposed a six-month freeze on the energy taxes due to be levied as of 1 January. This measure was found to be sorely lacking given the scale of the demands. As a result, there was an announcement the following day that these taxes would be scrapped for all of 2019. The shortfall in tax revenues as a result is evaluated at € 4bn, or 0.2% of GDP. Then, in a televised speech on **10 December**, Mr. Macron announced measures to boost the purchasing power of households: 1) cancellation of the means-tested increase in social charges on pensions that had been voted through in 2018; 2) an increase in the activity bonus for employees paid the minimum wage (also means-tested); 3) exceptional year-end bonuses to be tax exempt; and 4) income from overtime to be tax exempt. The initial estimate for this raft of measures is around € 8bn-10bn, i.e. 0.4% of GDP.

One of the demands frequently voiced by the “yellow vests” is the re-introduction of the wealth tax (ISF) which was scrapped in 2018 and replaced by a tax based on property assets (IFI). Some MPs in the majority party seemed prepared to go back on this symbolic decision - politicians rarely hesitate to penalise 1% of tax-payers to please the other 99%. Mr Macron rejected this option along with any calls to reverse the cuts to social charges paid by companies.

➤ **Government's response (political)** – To counter the accusations that it has lost touch with reality, the government has launched a nationwide “grand debate”. On **13 January**, the president sent a *Letter to the nation* outlining four areas of discussion. They are: 1) the role of the state (tax and spending); 2) the organisation of the state and its administrative bodies; 3) the ecological transition; and 4) democracy and citizenship (types of vote, number of MPs, role of the Senate, referendums and the introduction of immigration quotas). Until **15 March**, registries will be available at all town halls so that people can list their grievances. An ad hoc commission will then be tasked with analysing all of the demands. We wish it luck in summarising the requests in a coherent manner. Emmanuel Macron is to give his own conclusions towards **mid-April**. It is said that some proposals might be put to the vote in a referendum in parallel with the European elections.

The regaining of control by the forces of law and order during the recent demonstrations as well as measures in favour of purchasing power (above) are, at first glance, a means to partially restore lost consumer and business confidence. The population is growing increasingly tired of a movement that is calling for demands which are incompatible with one another (lower taxes, more public spending) and rejects its violence against the police. According to IFOP, a majority of public opinion considers favourably the “yellow vest” movement although the degree of support has fallen sharply. The “support-opposition” balance of opinion, which stood at +60 points at the beginning of November had fallen to +26 points by the beginning of January.

➤ **Budget impact** – In 2019, the transformation of tax credits for business to lower social contributions is weighing on budget balance to the tune of 0.9 points of GDP. The impact should be reversed by the same proportion in 2020. Initially, the government deficit was expected at 2.8% of GDP in 2019 vs 2.6% in 2018. With the newly introduced tax measures, a spiralling above 3% is possible. Given the transitory nature of this slippage, the Commission is likely to take a conciliatory view. For its part, the government is looking to make savings. Some have not ruled out the possibility that higher earners (the 8th, 9th and 10th deciles) will be subject to a tax hike. It is also anticipated that the reduction to the corporate tax rate (from 33.3% to 31% in 2019) will be postponed by one year. The target of 25% in 2022 is not called into question.

➤ **Agenda for reforms** – Officially, this has not been amended. However, it is unlikely that much progress will be made on ongoing dossiers - PACTE bill for the businesses, harmonisation of pension regimes - before the European elections.

Forthcoming events

- The forthcoming business climate surveys (INSEE on **23 January**, PMI on **24**, Bank of France on **11 February**) and consumer confidence (**29 January**) should help to shed some light on the permanence of the “yellow vests” shock. The initial real GDP growth estimate for Q4 2018 is due for publication on **30 January**.

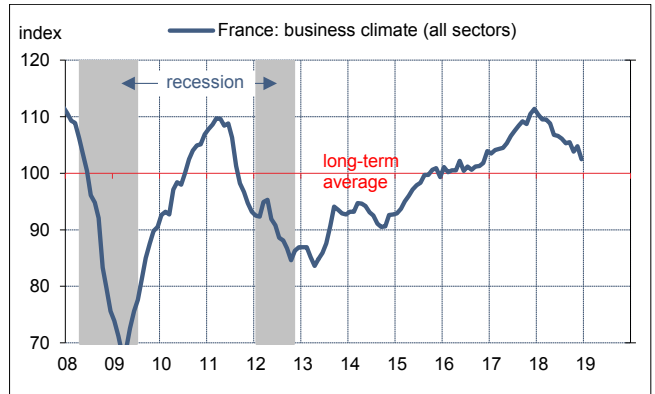


Confidence indicators

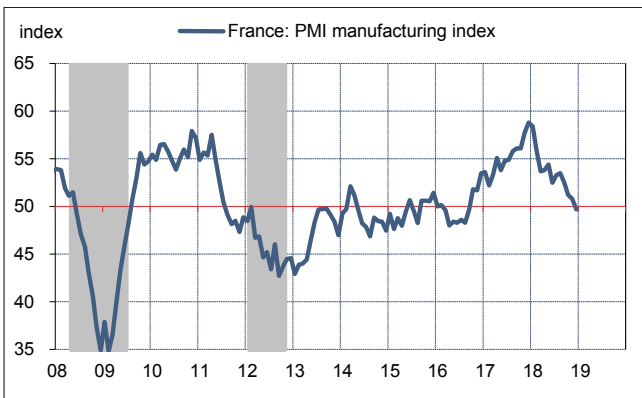
France: survey data and the business cycle						
Index	Current			Expansion	Recession*	
	Dec	Nov	Oct		2008-09	1992-93
PMI manufacturing	49.7	50.8	51.2	52.0	42.6	-
PMI services (output)	49.0	55.1	55.3	55.2	46.8	-
PMI composite (output)	48.7	54.2	54.1	54.5	44.9	-
INSEE manufacturing	104	106	104	102	84	81
INSEE services	104	104	103	101	84	84
INSEE construction	109	109	108	103	103	85
INSEE retail sector	100	108	105	101	86	86
INSEE wholesale sector	-	104	104	101	85	87
INSEE consumer conf.	87	91	94	101	84	101
BdF manufacturing	103	101	102	103	79	85
BdF services	102	102	102	101	91	83

*from Q2 2008 to Q2 2009; and from Q2 1992 to Q2 1993

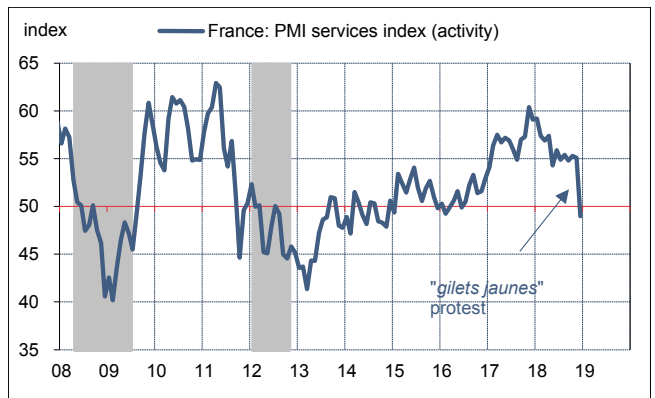
Business climate



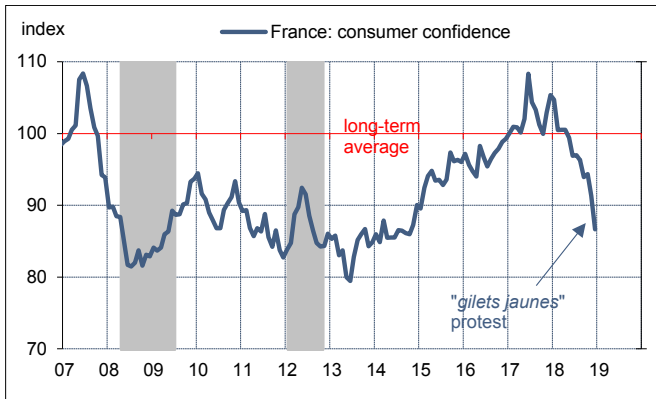
PMI-manufacturing survey



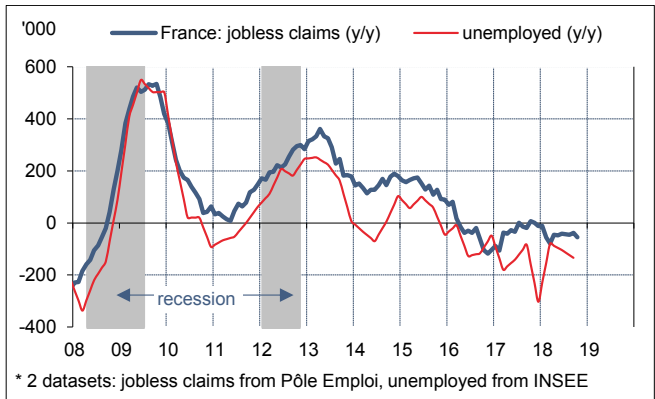
PMI services survey



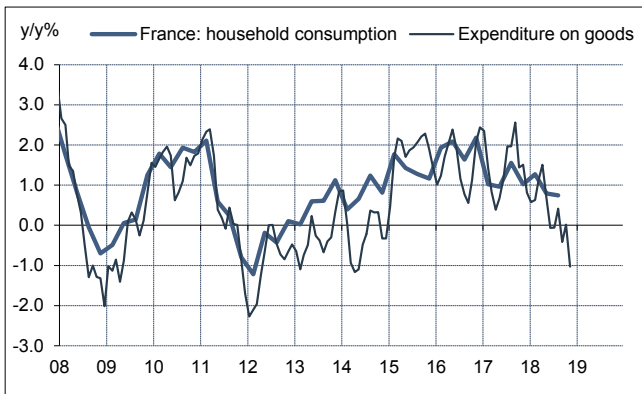
Consumer confidence



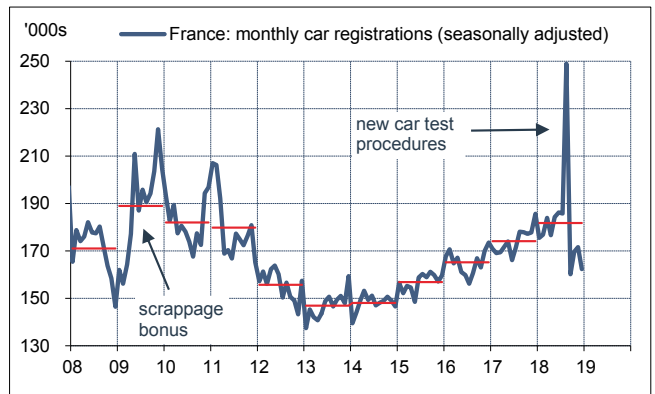
Jobless claims



Household spending



Vehicle sales

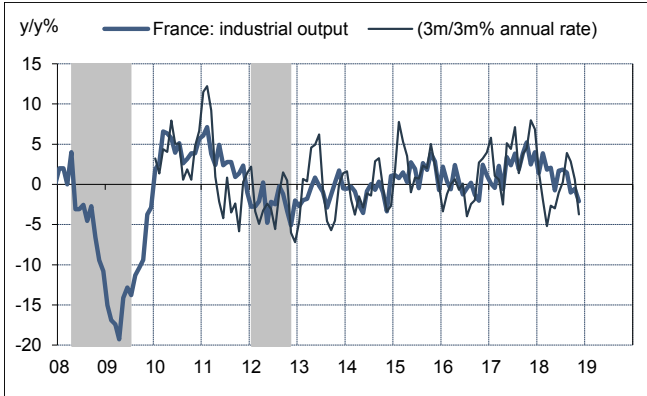


Sources: Thomson Reuters, Markit, Odoo BHF Securities

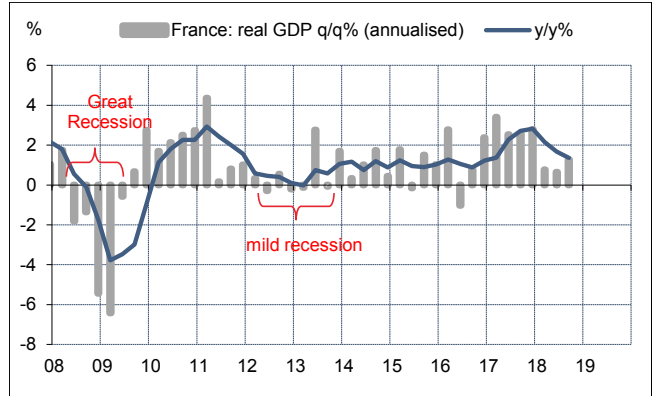


Appendix chart: activity, inflation, credit, finances

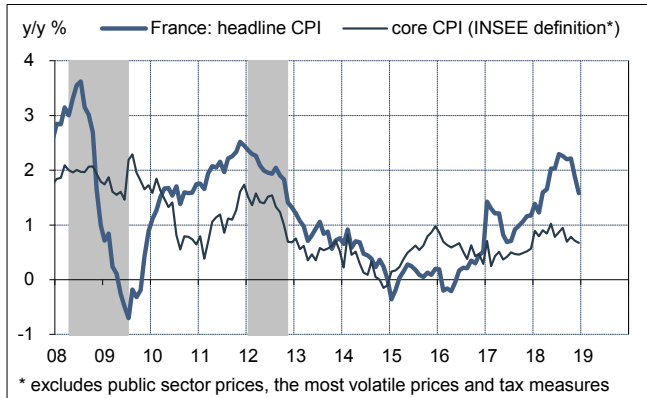
Industrial output



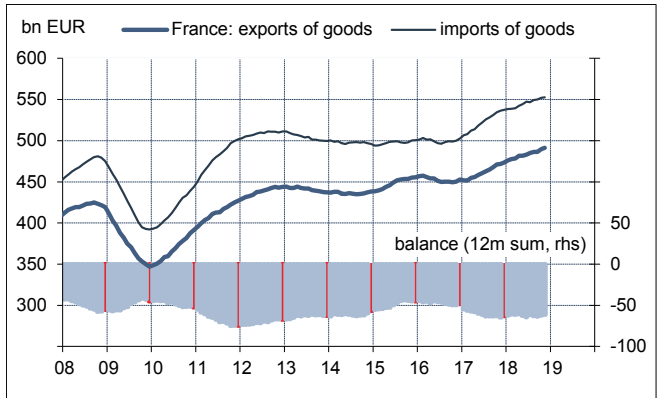
Real GDP



Headline and core inflation



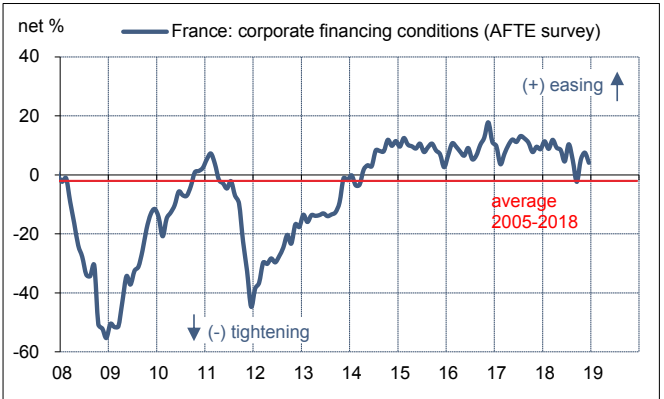
Trade in goods



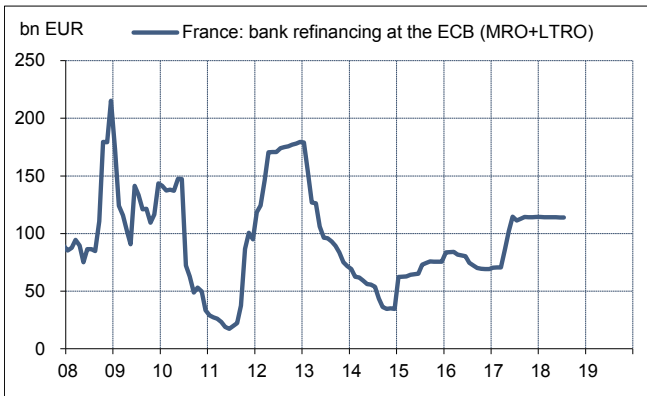
Private sector credit



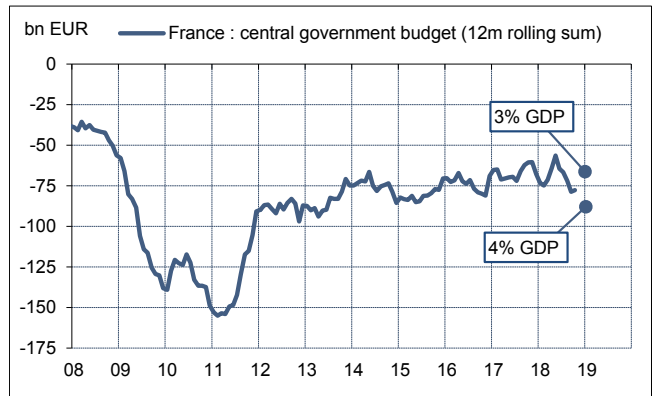
Credit conditions for businesses



Bank refinancing at the ECB



Government budget



Sources: Thomson Reuters, AFTE, Odfo BHF Securities



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