FRANCE – How will Brexit impact the French economy?

- Like the rest of the EU, France will be affected by the United Kingdom’s exit from the Union.
- The impact will, however be modest. In the short term there will be some market turbulence and a deterioration in the business climate.
- In the medium term, growth will be impacted by a slowdown in exports and foreign investment.
- In all, the negative impact on French growth should be fairly measured and spread over time, estimated at around a cumulative 0.4% of GDP in 2016-2019 if the exit is accompanied by a free trade agreement (FTA), and around 0.6% with no FTA.
- The main lines of our forecast are more or less unchanged, therefore. We are forecasting that the steady, gradual recovery will continue, with resilient private consumption and a slight slowdown in investment.

It is very difficult to know about the arrangements for the UK’s exit from the EU. In our scenario, a process of negotiation between the UK and the EU will begin in September, after the election of a new leader of the Conservative party. But the length of negotiations (two years, if not more) and the contours of the agreement (free movement of goods, but doubts about the free movement of people and services, etc.) are very uncertain and other scenarios are obviously possible.

The UK economy will obviously be affected by Brexit, via a number of channels, such as a sharp fall in sterling, which may improve the competitiveness of UK exports, but will also markedly increase the cost of imports and worsen an already large trade deficit; a drop in consumption due to import inflation; in the longer term, a fall-off in UK exports to the EU, the scale of which will depend on the agreement negotiated with the EU; and a drop in foreign direct investment.

And the fallout for France?

Negative, but modest immediate impacts

Initially, Brexit will push sterling markedly lower, stock markets will fall and there will be significant shifts in bond rates. The financial markets will see considerable volatility over the coming months. In addition, Brexit has raised a whole series of questions, namely a risk of contagion spreading to other EU countries that might consider withdrawal, a risk of an acceleration in the rise in populism and euroscepticism, and significant uncertainty around the negotiation process, its duration, and final impact.

All these factors will bolster wait-and-see behaviour among economic agents in Europe, especially in France. Our country is experiencing a period of recovery that is so far gradual and fragile. Growth is being penalised by a number of obstacles, including the structural competitiveness deficit, which will be absorbed only progressively, the high unemployment rate, further budgetary consolidation, and uncertainties about emerging countries.

Brexit and its indirect effects are, therefore, additional negative factors that should not be given too much weight, although they will bolster cautious, wait-and-see behaviour among French firms. Investment spending and inventories, which were just beginning to see a more lasting recovery, could slow once more over the coming quarters. In light of this, investment growth is likely to remain fairly modest despite the improvement in profits, partly driven by the CICE tax credit and the Responsibility Pact, together with the accelerated depreciation measure for industrial investment, which is currently generating a windfall effect.
Corporate investment is thus forecast to increase by 4.9% in 2016, and then by 3.6% in 2017.

More marginally, turbulence on the financial markets could trigger negative wealth effects and act as a brake on household consumption. Note also that the purchasing power of British retiree households living in France will be curbed by the fall in sterling, which will have an impact on consumption, especially in particular regions, such as the Dordogne and the Côte d’Azur.

As a result, we have revised our growth forecast for 2016-2017 down, but only modestly. The cost of Brexit for growth in France should be limited, at around 0.1-0.2% over this period. We have retained our gradual, modest recovery scenario with GDP forecast to rise by 1.5% in 2016 and 1.4% in 2017, compared with 1.2% in 2015.

Despite a gloomy global business climate, growth in France is benefiting from support measures for business and from the conjunction of external factors such as the slow recovery in oil prices, very low interest rates, and exchange rates that tend to favour the euro. In Q1 2016, the pace of growth, at 0.6% q/q, came as a pleasant surprise. Going forward, growth is likely to be more modest, at 0.3% per quarter. Household consumption will continue sustained, at 1.9% in 2016 and 1.6% in 2017. It is benefitting from the very low level of inflation, which is forecast to rise only very gradually, by 0.2% in 2016 and 0.8% in 2017, helping to bolster purchasing power. Investment should slow somewhat in 2017 (see above). The contribution from foreign trade is forecast to be negative in 2016 and then neutral in 2017. The exchange rate environment should remain upbeat and support French exports, but the “euro effect” looks set to be less significant than in 2015. We are forecasting that the euro will continue to depreciate slightly in connection with the ECB’s accommodative monetary policy in 2016 and 2017 (euro/dollar at 1.09 by end-2017). In addition, global growth looks set to slow in 2016, before picking up again slightly in 2017. Note also that job creation will remain moderate and that the unemployment rate will decline only slowly; we are forecasting 10% in 2016 and 9.8% in 2017, compared with 10.4% in 2015 for France, including its overseas territories.

Mid-term effects

Over the next few years French growth will be affected by Brexit via several channels and in particular its trade in goods and services and foreign investment.

Trade in goods and services

In 2017-2018, the UK’s imports of goods will slow fairly markedly due to the slowdown in UK growth and the weaker pound. When Brexit is effective, possibly in 2019, this effect could be amplified, moderately if a free trade agreement (FTA) is signed between the UK and the EU, substantially if no FTA is signed, meaning, in particular, additional customs tariffs. French exports will, as a result, be impacted, but less than those of Germany and the Benelux countries. The UK is France’s fifth largest trading partner and takes 7% of French goods exports, worth 32 billion euros, and 11% of its exports of services. Car, machinery, aerospace, chemicals, pharmaceuticals, and agri-food exports are likely to be the most severely affected.

In terms of trade in services, some financial players operating in the City could relocate their businesses to countries under EU jurisdiction to preserve their access to the single market and cut additional administrative costs. That would benefit other financial centres, including Paris. On the other hand, flows from UK tourist spending in France would decline.
Foreign investment

In the wake of Brexit, French companies are less likely to want to invest in the UK. Similarly, UK firms will invest less in Europe and France. The net balance of UK investment is positive vis-à-vis France. In terms of incoming FDI for France, the UK was the second largest investor in 2013-2014, after Luxembourg, with close to 10 billion euros over the two years. The effects are likely to be gradual and spread over time but some French sectors will be penalised by a reduction in FDI from the UK (financial services, chemicals, retail, etc.).

![French inward FDI (average 2013-2014)](chart.png)

Source: INSEE, Crédit Agricole S.A.

Overall, the negative impact of all these factors on French growth will be fairly measured and spread over time, coming in at around a cumulative 0.4% in 2016-2019 if the UK exits with an FTA, and at 0.6% without an FTA.

Impacts on interest rates and real estate

Interest rates

Eurozone short-term interest rates will stay slightly negative in 2016-2019, as a result of the ECB’s highly accommodative monetary policy, but Brexit is unlikely to seriously modify forecast short-term interest rate trends.

Conversely, long-term interest rate forecasts look set to be revised downwards. This is partly because Brexit-related uncertainties have triggered a flight to risk-free assets, as we saw on Friday 24 June, with a fall in German and French long-term rates and higher risk premiums on peripheral Eurozone countries. In addition, the ECB could accelerate its purchases of sovereign bonds if there were marked tension on the sovereign debt market in the Eurozone. French long-term rates, subjected to conflicting pressures, with some upside factors, such as economic recovery in the eurozone and the forecast uptick in inflation, and some downside factors, including the ECB’s highly accommodative policy (and in particular the effects of QE), worries about the emerging countries, and the safe haven value of core Eurozone countries. In this balance of risks Brexit strengthens the downside factors. French 10-year OATs are likely, therefore, to see a very slight increase by end-2017.

Real Estate

Paradoxically, the housing market could benefit from Brexit via the lending rates channel. The real estate market has seen a fairly marked rebound since early 2015 partly due to the sharp drop in lending rates, which triggered a windfall effect and stimulated sales. The new-build sector stimulus plan has also played a role. But some negative factors persist. The real estate market has not been genuinely “cleaned up”. Prices are no longer over-valued, but have not fallen far and remain very high. The economic environment is still patchy, with an unemployment rate that will fall only a little. The ongoing recovery is highly dependent, therefore on the level of long-term rates and lending rates. If these remain very low over the coming quarters, the windfall effect will persist, sales of homes will remain very high, and prices will continue to edge up.

Conversely, Brexit could have a negative impact on the market via home purchases by British nationals. According to French notary statistics, 5.1% of transactions in the pre-owned home sector in 2015 were by foreign buyers. If we look just at non-resident foreigners, the figure falls to 1%. It is therefore quite low. But British buyers account for 33% of foreign, non-resident buyers, well ahead of the Italians, at 15%, and the Belgians, at 11%. They tend to buy in the South West particularly (Dordogne, Charente, Lot), the Alps and the Côte d’Azur. With Brexit, house purchases by British buyers are likely to decline.

In high-end real estate, however, Brexit could lead to an increase in transactions as some of the people now working in the City could be transferred to Paris. These people would buy homes in Paris fairly rapidly. They would benefit from substantial capital gains on the sale of their London homes, whose prices have risen sharply, by 38%, over the past three years, and would borrow at very low rates before the pound falls too sharply.

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France 2014 2015 2016 2017

| GDP | 0.7 | 1.2 | 1.5 | 1.4 |
| Houses of consumption | 0.7 | 1.5 | 1.7 | 1.5 |
| Investment | -0.4 | 0.9 | 3.1 | 2.3 |
| Change in inventories* | 0.5 | 0.1 | 0.1 | -0.1 |
| Net exports* | -0.5 | -0.3 | -0.7 | -0.0 |
| Unemployment | 10.3 | 10.4 | 10.0 | 9.8 |
| CPI (yoy) | 0.6 | 0.1 | 0.2 | 0.8 |
| Government net lending | -4.0 | -3.5 | -3.3 | -3.0 |

* Contributions to GDP growth
Source: Crédit Agricole SA, estimates

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