

## FRANCE: ECONOMIC ACTIVITY

## YELLOW VEST PROTESTS CAST CLOUD OVER MACRON'S REFORM PLANS

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## SUMMARY

- French protests began on November 17 over hikes in fuel taxes, but have progressively broadened out into an expression of general anger with the French government about the cost of living and high taxes.
- To calm the situation, the government has dropped the planned fuel tax hike from next year's budget.
- Whether or not retreat from the fuel tax will be enough to satisfy the so-called 'yellow vest' protesters is unclear at this stage. The protesters' ambitions now go far beyond fuel taxes to include demands for higher pensions, the repeal of other taxes and the restoration of the wealth tax abolished just last year.
- The recent protests are likely to impact the growth trajectory, putting our French GDP forecasts for 2018 and 2019 at risk of downward revision.
- 2019 French budget will be impacted as well. The suspension of the planned fuel tax hike is likely to cost EUR4bn (~0.2% of GDP) in lost revenues in 2019. With France already at risk of "significant deviation" from the required improvement in its deficit according to the European Commission, the pressure is likely to rise on the administration.
- All in all, how the yellow vests respond to the government's latest fuel concessions and promises to review tax policy and how the government responds to increasing disillusion in French society in general will be key variables for our French economic outlook.

## What triggered the protests?

The protest movement known as *gilets jaunes* (yellow vests) began around November 17, when French drivers sporting yellow vests demonstrated across the country to push back against rising taxes on petrol and diesel, part of a broader government plan to minimise France's reliance on fossil fuels. The plan was to increase taxes by 2.9 cents per litre on petrol and 6.5 cents per litre on diesel on January 1, 2019. Initially, the protesters were mainly people on modest incomes living predominantly in rural or semi-rural areas who drive long distances to work and are thus especially sensitive to fuel tax hikes.

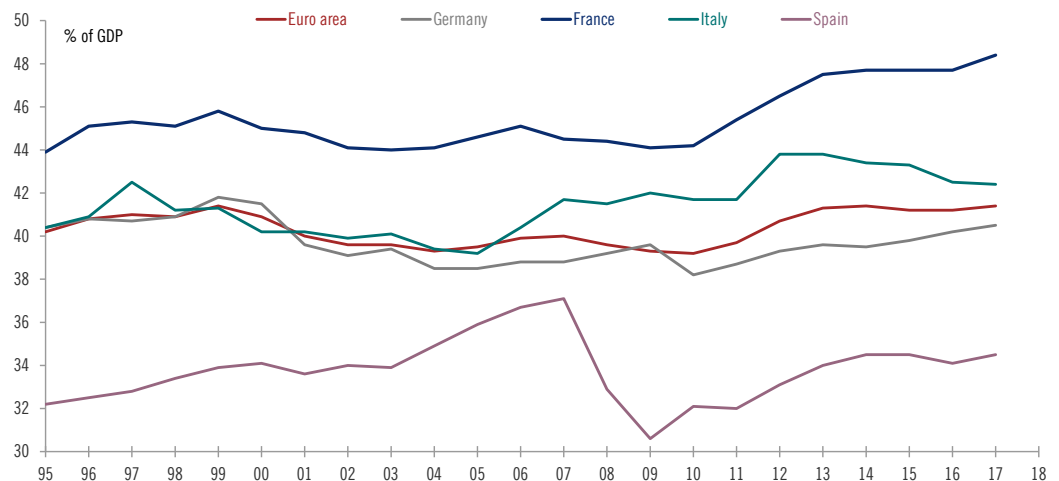
Progressively, **the movement has broadened into an expression of general anger with the French government about the cost of living and high taxes.** Protesters conceive of themselves as an embattled middle class struggling to pay their bills, whose incomes are too high for welfare benefits but too low to feel financially comfortable. **They denounce the erosion of their purchasing power through taxes** and perceive the tax reforms<sup>1</sup> that the government of Emmanuel Macron pushed through at the beginning of his five-year term as mainly benefiting the "wealthy elite". **The proposed rise in fuel taxes was perceived as the last straw, reinforcing the image of Macron as "president of the rich".** Taxes and social contributions in France are indeed the highest of any large country in Europe (*see Chart 1*) as a percentage of GDP, adding currency to the protesters' grievances.

<sup>1</sup> Notably, Macron's government reformed the *impôt de solidarité sur la fortune* (ISF), a wealth tax, last year so that it covered only property assets and excluded investments.

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CHART 1: GENERAL GOVERNMENT TOTAL RECEIPTS FROM TAXES AND SOCIAL CONTRIBUTIONS



Source: PWM - AA&amp;MR, Eurostat

**What makes this movement different?**

The yellow vest movement is very different from other protest movements France has seen. Launched spontaneously via social networks, it is independent of existing associations, organisations, trade unions and political parties and has resisted attempts to hijack it. Yellow vest protesters reportedly come from across the political spectrum and have a wide range of expectations. **The absence of attachment to existing structures and the lack of clearly identified leaders make the yellow vest movement difficult to apprehend for the government.**

Protests were mostly peaceful at the beginning, but the past two weekends have seen outpourings of violence and rioting in Paris and elsewhere. While the number of those protesting declined between the two weekends, the wide popular support for the yellow vests has increased the pressure on Macron. According to the latest polls, **72% of the French sympathise with the protest movement.**

**Macron's concessions**

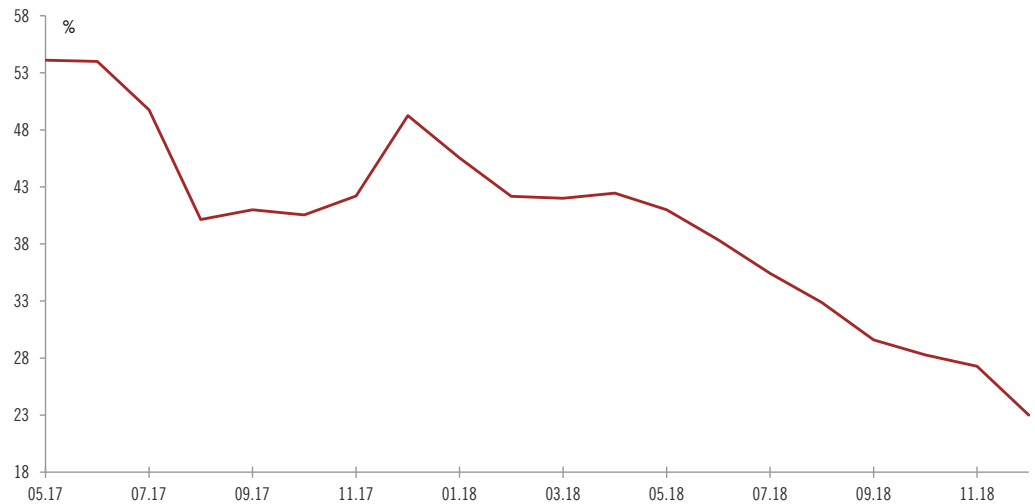
In response to pressure from the yellow vests, **the French government first suspended and then announced a complete abandonment of the planned fuel tax hike.** These concessions mark a setback for president Macron, who has repeatedly vowed not to surrender to street rule. The political context also makes the situation complicated, especially as Macron's approval ratings fell to new lows of around 23% in late November (see Chart 2). Ahead of the European Parliamentary elections in May 2019, Macron can hardly afford to let frustration rise further, given the risk of boosting anti-establishment parties.

**Whether or not a temporary retreat from the fuel tax will be enough to satisfy protesters is unclear.** The yellow vests' ambitions now go much further to include demands for higher pensions, the repeal of other taxes, the restoration of the wealth tax abolished a year ago, new parliamentary elections, and even Macron's resignation.

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CHART 2: MACRON'S APPROVAL RATING



Source: PWM - AA&amp;MR, various polls

**What could be the economic impact?**

As in other euro area countries, French GDP growth decelerated in the first half of 2018. GDP growth bounced back somewhat to 0.4% q-o-q in Q3. With similar rates of growth projected for the coming quarters, annual GDP growth of 1.6% in 2018 and 2019 (see Chart 3) looked on the cards, according to our baseline scenario. **But the recent protests are likely to impact the growth trajectory, putting our French GDP forecasts at risk of downward revision.** Given the size of the French economy, this could also influence our forecast for the euro area economy at large.

But quantifying the precise impact of protests and strikes on economic activity is rather complicated. On the one hand, the blockages of traffic, warehouses, oil depots and shopping centres are naturally not good for economic activity. On the other hand, the repair work needed after riots and protest marches actually add to economic activity. Yet, whereas some spending may simply be postponed or migrate online, the losses caused to the retail or tourism sectors are more definitive.

If we look at the past, protests and strikes against pension reform over 22 days in late 1995 cut 0.2pp from French quarterly growth, but this was largely recovered in the following quarter. In Q2 2018, strikes cut 0.1pp according to French statistical office.

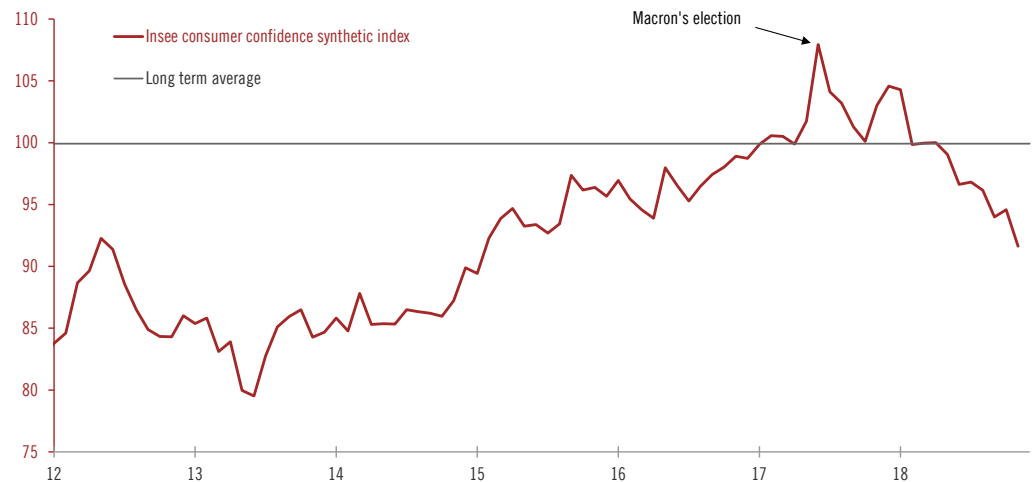
Consumer spending figures for November will not be reported until late December, but **there was a sharp decline in consumer sentiment last month** (from 95 in October to 92, its lowest level since January 2015, see Chart 3). The INSEE survey seems to echo the concerns of yellow vest protesters: falling standards of living are making French consumers more gloomy. Furthermore, the November manufacturing purchasing managers' index (PMI) survey revealed that "recent *gilets jaunes* protests have adversely affected the supply side of the sector, with some panellists blaming demonstrations for lengthened delivery times", according to PMI compiler Markit.

On balance, **the impact of the recent protests could be marginally negative**, lowering our GDP growth forecast for France in Q4. This would leave **our annual forecast at 1.5%**

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in 2018 (versus 1.6% previously). But the longer the protests lasts, the bigger the economic impact will be, impacting growth figures for 2019 as well as the end of 2018.

CHART 3: INSEE CONSUMER CONFIDENCE INDEX



Source: PWM - AA&MR, INSEE

**Macron's public finance dilemma**

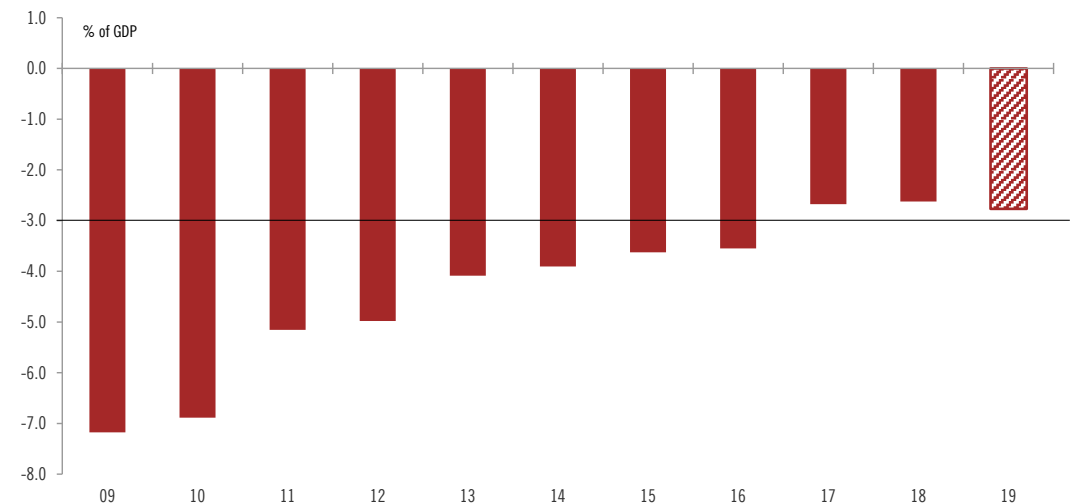
The recent protests also show the dilemma of trying to maintain fiscal rectitude, as Macron promised to financial markets, and launching unpopular structural reforms at the same time. This dilemma becomes more acute when growth turns down (as seems to be the case in France). France is already skating close to the EU limit in terms of deficit spending. It is estimate the public deficit will be 2.6% in 2018 and the government has targeted a deficit of 2.8% for 2019. The French government expects the public debt-to-GDP ratio to remain broadly stable in 2018 and 2019, at 98.7% and 98.6%, respectively.

Nevertheless, the recent protests will also have some impact on the 2019 French budget plans. The suspension of the planned fuel tax hike is likely to cost EUR4bn (~0.2% of GDP) in lost revenues. With France already at risk of "significant deviation" from the required improvement in its deficit according to the European Commission (see [here](#)), the pressure is likely to rise on the administration to trim spending to stay within 3% EU deficit limit (which in itself could lower GDP growth). Moreover, **lower GDP growth prospects compared to government projections** (in its draft budget plan, the French government expects real GDP growth of 1.7% in 2018 and 1.7% in 2019, see [here](#)) will add to the pressure, increasing the risk of deviation.

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CHART 4: FRENCH GENERAL GOVERNMENT BUDGET BALANCE (% OF GDP)



Source: PWM - AA&MR, European Commission

### Macron is being pushed to rethink his economic programme

Emmanuel Macron was elected in 2017 on a platform of economic reform. However, regardless of what happens in the next few days and weeks, it is clear that the crisis is going to change the course of Macron's presidency. For the first time in his presidency, he has been forced to abandon an important reform by protestors. He didn't back down against *cheminots*. While he has vowed not to back track on other reforms, frustration is growing at Macron's abolition of the wealth tax (now exclusively concentrated on real estate) and the flat tax on capital gains, reforms that are seen by many as favouring the rich. **The wide popular support for the yellow vests increases the pressure on Macron to rethink his government's economic programme** and tackle the increasing dissatisfaction of the French society. Ahead of the European Parliament elections next May, Macron can hardly afford to allow popular frustration rise further given the risk of boosting anti-establishment parties. **Macron's weakened domestic position also challenges his push for European reforms.**

All in all, how long the yellow vest protests last and how the government responds to the increasing general disillusion in French society will be key variables for our French economic outlook.

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