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FRANCE

French inflation surges, adding to the economy's mounting pressures

French inflation jumped to 3.0% in September, significantly more than expected, mainly driven by energy. Higher inflation will weigh on purchasing power again at a time when consumption is weakening and rising interest rates are exacerbating France's fiscal difficulties



Inflation surprises sharply to the upside

French inflation, as measured by the consumer price index, rose more than expected to 3.0% year-on-year in September, up from 2.4% in August. The acceleration was even more pronounced for the harmonised index, which increased from 2.6% to 3.4%. The figure was also higher than Insee's latest forecast, which only two weeks ago projected HICP inflation of 2.9% in September.

The increase was primarily driven by energy prices, which rose by 21.2% year-on-year, following a 16.7% increase in August. Unlike some other European countries, France has not introduced broad-based reductions in fuel taxes or prices. The government has instead opted for targeted support measures, which support the incomes of certain households and sectors but do not directly reduce measured inflation. The rise in global oil prices has therefore passed through more directly to French inflation. However, the increase in market gas prices observed in September has not yet been fully passed on to the prices paid by households and should continue to fuel energy inflation in the coming months.

The acceleration was also visible across several other components. Services inflation rose from 1.9% to 2.2%, as the seasonal decline in accommodation and transport prices was less pronounced than a year earlier. Food inflation increased from 1.1% to 1.5%, driven by a sharp rise in fresh food prices, which jumped by 9.9% year-on-year compared with 5.9% in August. Inflation in other food products remained stable at 0.4%. The decline in manufactured goods prices eased slightly, to -0.3% from -0.4% year-on-year.

Today's figures suggest that inflation is likely to remain above 3% for the rest of 2026 before gradually declining in 2027. Nevertheless, the rise in French headline inflation masks underlying price pressures that remain relatively weak and should stay below 2%. Excluding energy, inflation should therefore remain more contained in France than in the rest of the eurozone. Weak demand and a soft labour market are limiting wage pressures and companies' ability to raise prices, particularly in services. At this stage, a broad-based increase in inflationary pressures in France appears rather unlikely.

Consumption disappoints, increasing the risk of stagnation

Weak demand was confirmed once again this morning by disappointing household consumption data. In August, household spending on goods fell by 0.5% in volume terms, more than reversing the increase recorded in July. The July figure was also revised slightly lower, to +0.4% from an initial estimate of +0.5%.

The decline in August was mainly due to a 2.3% fall in energy consumption and a 0.4% decrease in food consumption. Purchases of manufactured goods held up better, rising by 0.3%. Compared with a year earlier, household consumption of goods increased by only 0.8%.

Consumption therefore remains subdued and is unlikely to provide more than limited support to third-quarter growth. The renewed rise in inflation will also weigh on purchasing power again and delay the expected recovery in household spending. After GDP contracted by 0.2% in the first quarter and stagnated in the second, the risk of another quarter of stagnation has increased significantly. Against this backdrop, the government's recently revised forecast of 0.5% growth for 2026 already appears too optimistic. The inflation shock is arriving precisely when the French economy can least afford it.

Rising debt and interest rates add to the pressure

The latest public finance data have further darkened the picture. French public debt increased by almost €60bn in the second quarter, reaching €3,595.5bn, or 119% of GDP, up from 117.5% three months earlier. The government's forecast of 119.3% of GDP for the end of the year has therefore already almost been reached. According to government projections, debt would continue to rise to 121.7% of GDP in 2027.

This deterioration has been accompanied by a sharp increase in financing costs. The yield on

the 10-year French government bond recently reached around 4.8%, while the spread over the German Bund widened to around 120 basis points, compared with 62 at the beginning of June. The rise in yields has been much faster than anticipated in the budget, which was still based in the spring on a 10-year rate of 3.9% at the end of 2026.

As a result, the government now expects interest expenditure to increase from €79bn this year to €91bn in 2027. Compared with forecasts made a year ago, interest expenditure is now expected to be €5bn higher in 2026 and €7bn higher in 2027. The relatively long maturity of French public debt slows the transmission of higher interest rates to the overall debt stock, but the burden will gradually increase as the debt is refinanced. That said, the French Treasury said that France will have to borrow €340bn in 2027, driven by a record €189bn of maturing debt. Persistent inflation also raises the cost of inflation-linked bonds. Higher interest rates are therefore becoming a source of fiscal deterioration, making it even more difficult to stabilise public debt.

For now, it is difficult to identify an obvious catalyst for a sustained tightening of French spreads. The adoption of a credible budget for 2027, which seems difficult at this stage, could provide temporary relief, but it would not resolve the structural problems facing French public finances. Attention is therefore increasingly turning to the presidential election and the likely legislative elections in 2027. The problem is that, for now, none of the presidential candidates has presented a sufficiently detailed and credible plan to stabilise the public finances. There is also a significant risk that the next president will once again be left without a clear parliamentary majority. Markets need a reason to turn more positive on France, and for now there is none.

Against this backdrop, France's risk premium is likely to remain elevated in the coming months. An improvement in the situation in the Middle East and a decline in energy prices could bring European interest rates down. But in the absence of a political or fiscal improvement in France, the potential for a meaningful tightening of the spread appears limited. High borrowing costs will therefore continue to hold back an economy that is likely to remain subdued in the coming months. Higher rates are not only reflecting France's fiscal problems; they are now making them worse.

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