Overview

The year 2005 saw the world economy showing firm resistance in the face of the oil shock. World activity continued to progress at a half-yearly rate of more than 2 %, so that on an annual average basis the slowdown was only slight compared with 2004 (growth down from 4.8 % to 4.2 %). Although producer and consumer prices both accelerated in mid-year, the *"second-round"* effects via a transmission to wage growth were circumscribed. In the absence of major inflationary pressures, the expansionary momentum was maintained. Against a background of a string of interest-rate hikes, activity in the United States levelled off (a rise of 3.5 %, compared with 4.2 %) but still rose at close to its potential rate. Growth in the emerging Asian countries, the world economy's other locomotive, was as vigorous as ever, led by China, where it stabilised at around 10 %. In Japan, the spectre of deflation faded with the confirmation of the reactivation of domestic driving-forces for growth.

Growth in world trade, although slower than in a very dynamic 2004, remained firm from Q2 on, with an acceleration in H2 2005. The repeated rises in the Federal Reserve's key rates, intended to kill off inflationary germs and curb the surge in real estate prices, had only a small impact on United States and European long rates. As a consequence, growth in the United States, backed up by China, was able to spread to the rest of the world.

Despite a buoyant international environment, the euro zone continued to lag behind, with growth falling to 1.4 % from 1.8 % in 2004. Nevertheless, in several countries the implementation of structural reforms aimed at increasing labour market flexibility made it possible to stem the rise in the unemployment rate. Because of limited room for manoeuvre in fiscal policy, it was the maintenance of low short rates at around 2 % in Europe that underpinned demand. This gave support to corporate investment and encouraged household consumption and demand for housing through increased borrowing. Despite the strong demand at world level, European exports failed to take full advantage of the depreciation in the euro's effective exchange rate that accompanied the tightening of the United States monetary stance.

Even with the acceleration in investment, domestic demand in the euro zone remained too fragile to breathe fresh life into the recovery. While the oil shock was in general satisfactorily absorbed, the low level of job creation and the stagnation of real wages adversely affected household income, although the precise nature of the process differed from country to country. Spain and France, still riding their respective housing booms, were able to count on robust domestic demand. In Germany, while the tough wage restraint paid off in terms of exports, this was at the cost of depressed private consumption (up by 0.2 %). Italy, for its part, was a loser on all fronts, combining slack domestic demand with export market share losses due to a sectoral specialisation that puts it in direct competition with the emerging countries.

In France, following a sluggish first half-year, growth got some colour back into its cheeks in the second. Averaged over the year, GDP growth fell back to 1.2 % from 2.3 %. After having for a long time enjoyed faster growth then its European partners, France therefore returned to the pack. French activity continued to be based mainly on private domestic demand, mainly household demand. Despite *"spinning wheels"* to some extent in Q2, household consumption remained robust, with average annual growth of 2.1 %, down from 2.3 %. Moreover, French households' demand for housing, underpinned by attractive interest rates against a background of persistently rising house prices, remained as strong as ever. Growth in corporate investment levelled off (3.6 %, down from 4.7 %) as a result of the industrial gloom and the erosion of profitability due to the rise in prices of inputs, but still remained vigorous.

For a third consecutive year, foreign trade held back activity, reducing average growth by 0.8 of a percentage point. Export growth was disappointing (3.1 %, down from 3.9 %) in view of the robustness of world demand (up 5.8 %) and the recovery in competitiveness. This weak growth, especially when compared with the strength shown by German export sales, points to structural weaknesses due both to the nature of French specialisation and to microeconomic factors. At the same time, the strength shown by domestic demand was reflected in the maintenance of strong import tendencies (a rise of 6.1 %, following 6.6 %). In the final analysis, the balance on goods and services in value weakened by more than €20 billion, of which half was attributable to the rise in the oil bill, the result being a deficit of €16.3 billion.

In view of the more uncertain expectations regarding demand, firms, which had substantially rebuilt their inventories in 2004 (making a contribution to GDP growth of 0.6 of a point), adopted more cautious behaviour in 2005, the result being a negative contribution to growth of 0.1 of a point. The upturn in recruitment was also timid, total employment growing by 0.2 % on average and on a full-time equivalent basis, with the progressive build-up of the new arrangements in favour of employment. Labour productivity growth slowed down from the very high rate achieved in 2004, but remained close to its trend level. The slower productivity gains posted in the market branches, and more particularly in manufacturing industry, contributed to an acceleration in unit wage costs, whose growth exceeded that of value added, so that the margin rate for the non-financial corporations declined still further.

The rise in the consumer price index fell back to 1.8 % on an annual average basis (compared with 2.1 % in 2004) following a peak of 2.2 %, year on year, in September, under the impact of the marked rise in the crude oil price. This easing is explained by the decline in core inflation made possible by the restraint shown by manufacturing prices and the absence of any further raising of tobacco prices. On the other hand, the household consumption deflator, whose coverage is slightly different from that of the consumer price index, accelerated slightly to 2.0 % from 1.9 %.

The gradual revival in employment, combined with a decline in the labour force, led to a downturn in the unemployment rate, which ended the year at 9.6 % compared with 10 % at end-2004. The decline in unemployment and the revaluation of the hourly minimum wage in its various forms failed to prevent a slowdown in average wages per head from becoming the generator of an erosion of the total wage bill. More than the slowdown in growth of earned income, however, it was the rise in social contributions and tax recovery that was mainly responsible for the slowdown of growth in the purchasing power of disposable income (which rose by 1.1 %, compared with a revised figure of 2.2 % in 2004 and 0.9 % in 2003).

Faced with weak growth in their real income, households drew on their savings and their demand therefore remained brisk. In fact, household consumption expenditure, led by goods and services related to the new information and communication technologies, slowed down only slightly. The decline in the household saving ratio that had begun in 2003 continued, with a decline in 2005 of 0.9 of a point to 14.9 %. Household demand for housing turned out to be just as a dynamic as in 2004 (a rise of 4.1 % in volume, compared with 4.0 %), with recourse to housing loans continuing to be stimulated by the maintenance of favourable financial conditions.

Despite the less favourable economic climate, growth in general government revenue accelerated (a rise of 5.8 % compared with 4.8 %). Taxes on income and wealth were particularly dynamic (rising by 6.2 %) as a result of the broadening of the tax base and the rises in the rates of CSG (Generalised Social Contribution) following the reform of the health insurance system. VAT revenue also continued to grow strongly. Corporation tax revenue benefited from the recovery in corporate profits. In addition, the financial implications of the backing obtained from the general regime for the regimes operating in the gas and electricity industries (IEG) led to an increase in contributions to the basic and supplementary old-age insurance schemes.

In total, the incidence of taxes and compulsory contributions as a proportion of GDP rose by 0.9 of a point in 2005 to 44.0 %. Of this rise, 0.5 of a point was attributable to the spontaneous growth in compulsory contributions associated with the economic situation and 0.4 of a point to the new measures. Meanwhile, public expenditure in value rose faster than activity and its share of GDP increased to 53.8 % from 53.2 %. Central government expenditure was kept in hand, while that of local authorities was very dynamic.The rise in payments related to retirement contributed to the strong growth in old-age benefits paid out by general government, boosted by the backing provided for the IEG pension scheme. On the other hand, economies were achieved through the reform of health insurance and the easing of unemployment.

After declining during the past three years, the public deficit has returned to 2.9 % of GDP, below the 3.0 % threshold set by the Stability and Growth Pact. This improvement in the general government deficit reflects the upsurge in public revenue and the moderation applied to public current expenditure. Public debt continued to rise, reaching €1 138 billion by end-year, equivalent to 66.6 % of GDP (64.4 % in 2004). ❒

World growth standing up well

In 2005, the world economy showed firm resistance in the face of the high level of commodity prices. The Brent oil price rose by $16/barrel in the space of a year and metal prices also rose strongly. These upsurges led to an acceleration in producer and consumer prices in most countries around the middle of the year. However, by comparison with the previous oil shocks of 1973 and 1979, this tendency remained well contained. In the first place, the rise in prices was spread over a longer period, so that it was easier to make adjustments. Second, energy intensity has been reduced considerably in the past 30 years and inflation is lower. Lastly, the intensification of competition and, to some extent, the greater credibility of the central banks have been exerting strong downward pressure on prices and this has limited the risks of resurgence of inflation. Only the so-called *"first round"* effects, in other words the automatic effects of the rise in commodity prices on the energy components of the price index, have come into play. In most countries, the second-round effects related to the transmission of price rises into wages have so far been avoided.

The impact of the oil shock on world activity was also circumscribed. There was no easing of the strong growth momentum in the Asian region, where the industrial sector was still feeling little effect from the surge in commodity prices. In the United States, growth was admittedly less firm than in 2004 (3.5 % against 4.2 %), but both household demand and corporate investment remained very robust, despite successive interest-rate hikes. In Japan, the spectre of deflation gradually faded, against a background of renewed domestic dynamism, with growth in 2005 coming out at 2.7 %, the highest in five years. In Europe, by contrast, performance was more modest. The United Kingdom felt the impact of the slowdown on the housing market, which had been contrived as early as 2003 by the interventions of the Bank of England. As a result, GDP rose by only 1.8 %, compared with 3.2 % in 2004. The euro zone, for its part, continued to lag behind in terms of growth (1.4 %, down from 1.8 % the previous year). Held back by the weakness of the rise in purchasing power, euro-zone household consumption remained slack, especially in Germany (0.2 %) as a result of the wage restraint. In addition, foreign trade made a negative contribution to growth.

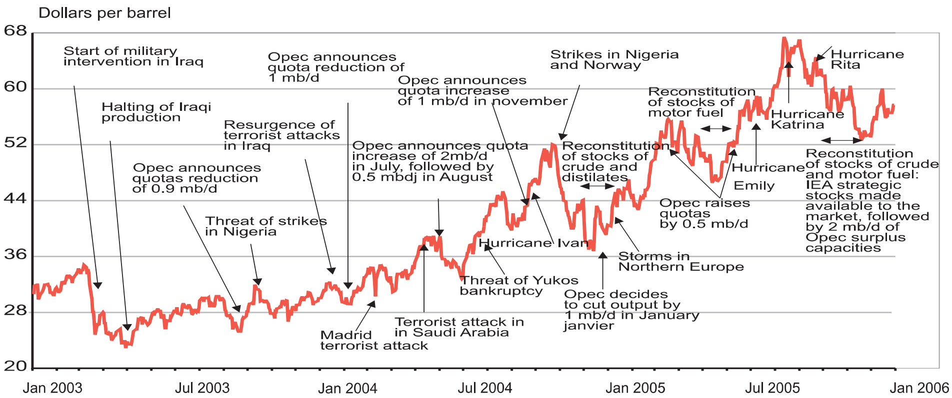
All in all, following an exceptional year in 2004, world growth weakened somewhat. However, in view of the shocks they were called on to face, economies showed great resilience, although to very different degrees in different geographic zones. Trade imbalances worsened, without currency markets showing much reaction. The widening of the American deficit continued and the higher oil bill produced a slow deterioration in the European position, while Japan, like its Asian neighbours, has been building up trade surpluses.

The oil shock cushioned

In 2005, the oil price in real terms (deflated by the French consumer price index) was situated between the level reached after the first oil shock in 1973 and that reached after the second oil shock in 1979. However, unlike the experience in previous crises, the rise in crude oil prices has resulted not so much in an interruption to the supply of petrol as in firm demand, linked to the strong growth in the world economy. Demand for oil from China, where activity was stimulated by rapid industrialisation, and from the United States has been firm. As this growth in demand has generally been under-estimated (the International Energy Agency (IEA)[1] has in fact on several occasions made upward revisions in its forecasts of world oil demand), production capacity quickly became saturated. In these circumstances, OPEC has lost part of its position as backup and swing producer, with its decisions concerning production quotas no longer enabling it to steer world oil prices. The announcement of an increase in OPEC quotas amounting to 0.5 million b/d starting 1st July (bringing them to 28 mb/d) seems to have had virtually no impact on oil prices during the summer of 2005.

Graph 1

Monthly evolution in the price of Brent crude since 2003



Sources: Financial Times, Insee.

By the end of Q3, it also seemed that the refinery bottleneck could constitute a major problem for the oil market. Prices of motor fuels soared after the destruction of a considerable amount of American refinery capacity in the wake of hurricanes Katrina and Rita. They began to ease only when the IEA decided to draw on its strategic reserves of oil and refined products, in order to avoid a motor fuel shortage in the United States.

However, compared with the two previous oil shocks in 1973 and 1979, the rise in oil prices was much less violent this time. In the first oil shock, the price of crude more than tripled between the end of 1973 and the beginning of 1974, rising from just under $5/barrel to more than $15/barrel. The second oil shock of 1979 saw prices rise just as quickly, doubling in less than one year from slightly under $20/barrel in Q1 to almost $40/barrel in Q4. The present episode is characterised, on the contrary, by the steady rise in oil prices from $30/barrel at the beginning of 2003 to more than $55/barrel at the end of 2005, a rise of more than 80 % spread over three years.

1. Created in 1974 by the oil-importing countries, the International Energy Agency has 26 member countries. Since December 1975, each member has been obliged to maintain a minimum level of stocks of petroleum products equal to 90 days' consumption, calculated on the figures for the previous calendar year. These stocks, which have a precautionary motive, are known as « *strategic stocks* ».

Under pressure from the rise in oil prices but also from a sharp increase in prices of other raw materials (amounting to around 40 % for ferrous metals and more than 15 % for non-ferrous metals), most economies saw inflation rise steeply in mid-year before falling back in Q4 as a result of the easing of the energy component. During this time, the core elements of inflation barely moved, mainly as a result of increased competition and the reduced influence on prices of mechanisms for price-indexation of wages, given that the rise in the price of crude failed to provoke any marked inflationary expectations, in contrast to the experience at the time of previous shocks. All in all, while the oil shock involved a cost for the importing countries, mainly borne by households and firms through higher energy expenditure, there were no appreciable second-round effects operating through the price-wage loop. Furthermore, central banks reacted promptly to the rise in inflation. This was particularly true of the United States, where hikes in key rates began in 2004, whereas in the euro zone monetary tightening began only at the end of 2005. Certain Asian countries also began to tighten their monetary policies in reaction to the first signs of inflationary pressures.

Growth still firm in the United States

From June 2004 on, the United States Federal Reserve (the *"Fed"*) carried out a continuous series of hikes in its key rates, bringing them to 4.25 % at end-2005, a rise of 200 basis points. This monetary tightening had only a very limited impact on the evolution of long rates, which rose merely from 4.2 % to 4.5 % in the space of one year. This fairly atypical situation, which the Fed Chairman Alan Greenspan described as a "co*nundrum"*, seems to have been partly due to the strong growth in purchases of government securities by foreign operators, notably certain Asian central banks (mainly those of Japan and China), purchases that financed the US deficit.

Throughout 2005, financing conditions therefore remained generally favourable in United States, despite the repeated interest-rate hikes. As firms had also generated substantial self-financing capacity, they continued to find it relatively easy to finance their investment projects. At the same time, demand for American firms' products barely weakened. Despite the upturn in inflation, household consumption expenditure maintained its momentum, thanks to an appreciable decline in the saving ratio and a rise in borrowing (with total indebtedness equivalent to more than 120 % of gross disposable income at the end of the year). With real estate prices continuing to climb (by more than 10 % in real terms in 2005 according to the index published by the Office of Federal Housing Enterprise Oversight), housing investment eased only very gradually.

As a consequence, American activity has remained robust, rising by 3.5 % in 2005 compared with 4.2 % the previous year *(see table 1)*. However, hurricanes Katrina and Rita temporarily threw the economy out of its stride. Motor fuel prices surged, bringing inflation to 4.7 % in September, and job creations dropped to 48 000 and 37 000 in September and October, respectively, from a monthly average of 175 000 in the first eight months of the year, leading to a loss of confidence on the part of consumers. Industrial output fell back at the beginning of Q4 and the business climate deteriorated. This *"sticky patch"* was short-lived, with both the employment and activity situations picking up again as early as November.

In this continuing buoyant environment, imports remained vigorous, although not quite

Table 1

Evolution of activity in leading industrialised countries and emerging Asia (% growth rates)

	2003	2004	2005
Leading industrialised countries	**1.9**	**3.0**	**2.6**
United States	2.7	4.2	3.5
Japan	1.8	2.3	2.7
United Kingdom	2.5	3.2	1.8
Euro zone	0.7	1.8	1.4
Germany	- 0.2	1.1	1.1
France	1.1	2.3	1.2
Spain	2.9	3.1	3.4
Italy	0.4	1.0	0.2
Emerging Asia	**8.1**	**8.6**	**8.2**
China	10.0	10.1	9.9
South Korea	3.1	4.7	4.0
Indonesia	4.8	5.1	5.6
Malaysia	5.4	7.1	5.3
Philippines	4.6	6.0	5.1
Singapore	2.9	8.7	6.4
Taiwan	3.4	6.1	4.1
Thailand	7.2	6.2	4.5

Sources: Insee and national sources.

to the same extent as the previous year, rising by 6.3 %. This growth finally outweighed that of exports, which continued to benefit from the past depreciation in the dollar. In the end, the external deficit widened again to exceed $750 billion, equivalent to 6 % of GDP. Meanwhile, only timid progress was being made with the reduction of the public deficit (more than $300 billion in FY 2005), hampered by the rise in military expenditure, with the result that the twin US deficits persisted in 2005.

Confirmation of domestic recovery in Japan

The year 2005 saw confirmation of the domestic recovery in Japan, permitting a rise in activity of 2.7 %, faster than in any year since 2000. As in the three previous years, it was external trade that underpinned activity, especially as the depreciation of the yen's effective exchange rate generated export competitiveness gains. However, the support provided by foreign trade was not as substantial as previously, because of the liveliness of imports, a revealing sign of the upturn in domestic demand. In the first place, household consumption benefited from the rise in real incomes, itself made possible by the acceleration in the average wage (a rise of 0.8 %, compared with a decline of 1.5 % the previous year). Job creations remained on a modest scale, but the situation on the labour market steadily improved, with the number of job vacancies exceeding the number of jobseekers at the end of the year, a phenomenon not seen since September 1992. The response to this stronger demand was a re-launch of the investment cycle. Increased pressures on productive capacity and, at a more structural level, the obsolete nature of the capital stock, stimulated corporate expenditure, which rose by 7.9 %.

Even so, this did not mean that the challenge posed by the need to end deflation was entirely met. Although its end seems near, the flatness of consumer prices (0 %, year on year, in December 2005) and of house prices continues to inspire caution. Moreover, the Bank of Japan has not deviated from the line of conduct it adopted in 2001, continuing its massive injection of liquidity into the banking system. On the side of public finances, the improvement remained marginal in 2005, with the public deficit remaining high at around 6 % of GDP and the public debt concomitantly exceeding 160 % of GDP.

Emerging Asia little affected by the oil shock

The Chinese economy again turned out to be very robust in 2005, posting growth of 9.9 %, compared with 10.1 % in 2004. Domestic demand gradually took up the running from exports in underpinning activity, while the price rise remained well in hand (inflation standing at 1.6 % in December). Over the whole of the year, investment by both firms and households was again particularly sustained, with the latter benefiting from easier access to credit. This uninterrupted momentum helped to fuel pressures on commodity prices, but it also had a hand in the positive tendency in world trade. Chinese exports benefited temporarily from the lifting of textile quotas that took place on 1st January as the result of the abrogation of the Agreement on Textiles and Clothing. The Chinese trade surplus finally passed the hundred-billion-dollar mark in 2005 (equivalent to roughly 5 % of GDP). In this supportive environment, the Chinese central bank decided in July to abandon the fixed parity of the yuan against the dollar in favour of pegging it to a basket of currencies. This announcement was immediately accompanied by a 2.1 % revaluation of the Chinese currency versus the United States dollar.

The other emerging Asian countries naturally benefited from the sound health of the Chinese economy and so maintained their robust growth *(see table 1)*. The oil shock was nevertheless felt to differing extents in different countries. South Korea and Taiwan remained sheltered from any upward drift in inflation, with the core inflation indices showing no sign of accelerating. As a result, intervention by the monetary authorities in these countries was very measured and was motivated essentially by the rise in American key rates. By contrast, inflationary pressures were much stronger in countries with higher energy intensity like Thailand and Indonesia. In each of these countries, the consumer price index rose sharply as a result of their governments' progressive withdrawal from the management of the oil crisis.

The United Kingdom economy hit by the downturn on the housing market

In 2005, the United Kingdom experienced a slowdown, with growth of 1.8 % compared with 3.2 % the previous year. This downturn in the rate of activity was a direct consequence of the decline on the housing market. It has to be remembered that house prices had been rising constantly since 1996 to historic peak levels, with prices tripling during this period. In these circumstances, the Bank of England decided to tighten its monetary policy as of end-2003.

The ensuing interest-rate rises added considerably to the interest burden of households, most of whose debt was at variable rate. The resulting slower rise in house prices gradually reduced the influence of the mortgage refinancing mechanisms that households had been using to finance their expenditure. Furthermore, this soft landing of the housing market automatically reduced wealth effects and hence consumption. Investment in new housing also felt the backlash of this reversal of tendency.

This sudden curb on household demand then adversely affected business expectations. The confidence climate deteriorated sharply, especially in the first half of the year. This fairly gloomy environment, especially in industry, held back investment decisions.

The slowdown in the economy was nevertheless moderate and short-lived, with growth returning to its trend rate as early as Q2. Reasons for this included the powerful nature of the channels for the transmission of monetary policy and the fact that its implementation was sufficiently fine-tuned. Moreover, the authorities had no hesitation in cutting key rates in August and the housing market then finally stabilised. Fiscal performance was more mixed, however. In particular, the public deficit widened more than expected (reaching 3.6 % of GDP, 0.3 of a point more than in 2004) and the debt level increased further to 42.8% of GDP.

The euro zone still lagging behind, handicapped by flabby domestic demand

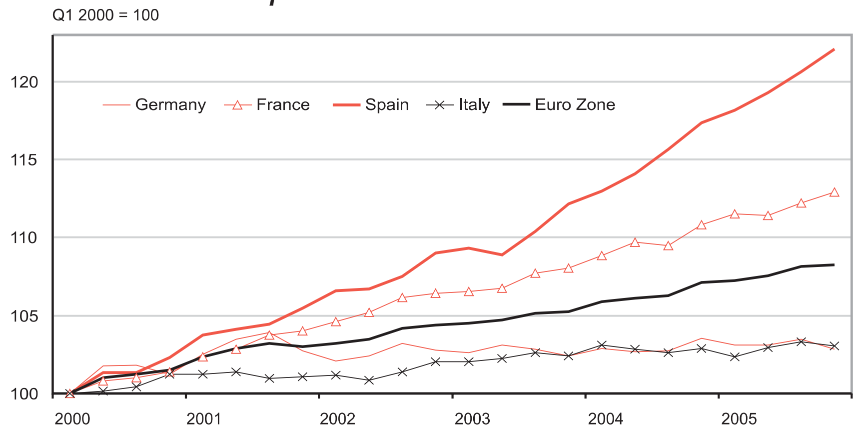
Like the rest of the world, the euro zone suffered in 2005 from the rise in industrial commodity prices. Inflation climbed to 2.6 % in September, before falling back to 2 % by the end of the year. In order to counter the price rise, the European Central Bank raised its key rates by 25 basis points to 2.25 % in December 2005. Other motives prompting this decision were the steep rises in the money supply and in borrowing. Despite the interest-rate hike, monetary conditions remained very accommodating. Throughout the whole of the year, short and long interest rates remained confined at very low levels and the euro appreciated slightly compared with the previous year, notably vis-à-vis the dollar.

In a supportive international environment, demand in the euro zone's export markets remained relatively robust in 2005. Nevertheless, foreign trade imposed a greater curb on growth than in the previous year, because of the maintenance of a high level of imports. Even so, seen from the point of view of foreign trade, inter-country disparities were very substantial within the zone. As in 2004, Germany continued to benefit from cost-competitiveness gains as well as from its favourable positioning, both in geographic terms (on the Central and Eastern European Countries and Asia, in particular) and in sectoral terms (on capital goods). German exports accordingly rose by 6.6 % in 2005, compared with 8.3 % in 2004. Italy, by contrast, continued to lose market share in the traditional consumer goods sectors in which it found itself competing with the European and Southeast Asian emerging countries. Spanish foreign trade continued to be hampered by its cyclical disparity with the rest of the euro zone : the strength of Spanish consumption fuelled import growth (+ 7.1 %), whereas exports (+ 1.0 %) were held back by the lacklustre state of domestic demand in its principal European partner countries and by the reduced competitiveness of Spanish exports.

The heterogeneous situation of the euro zone could also be seen in the differentiated evolutions in household demand *(see graph 2)*. Overall, consumption ran up against the weakness of the purchasing power of incomes (+ 0.6 % during the year) stemming from the decline in real wages (by 0.2 %) and the modest extent of the rise in employment (+ 0.6 %). But the slackness was particularly marked in Germany, where consumption rose by only 0.2 %, held back by wage restraint. By contrast, in Spain household expenditure remained extremely firm (+ 4.4 %), having as its counterpart net borrowing equivalent to 1 % of GDP and indebtedness of more than 110 % of gross disposable income. In an intermediate position, French households showed considerable constancy in their consumer behaviour (+ 2.1 % in 2005). In Italy, finally, consumption remained hampered by the low growth in real wages.

Graph 2

Growth in household consumption in the euro zone



Sources: Eurostat, Newcronos.

At the same time, public consumption was lacklustre throughout the zone, notably in the three largest countries, all of which were anxious to keep spending under control in order to meet the criteria of the Stability and Growth Pact. In the end, however, only France brought its public deficit below the 3 % threshold. Germany exceeded it slightly (3.3 %), while Italy posted a distinct deterioration in public finances, with a deficit of 4.1 % compared with 3.4 % the previous year. In Spain, by contrast, there was a budget surplus of over 1.1 % of GDP, giving it greater room for manoeuvre in public spending.

Firms meanwhile re-launched their investment spending mainly in the second half of the year, once they had been reassured regarding the short-term outlook. They not only benefited from the continuing attractive financial conditions but also from rebuilt margins that enabled them to envisage new self-financed investment (their margin rates exceeded the historically high level seen in 1998). In these circumstances, year-on-year growth in investment rose from less than 2 % at the end of 2004 to practically 3 % at the end of 2005.

In total, growth in euro zone amounted to 1.4 % in 2005, compared with 1.8 % in 2004. There remained glaring differences between countries, however. Germany ended the year with average growth of 1.1 %, Italy with 0.2 % and Spain with 3.4 %.

Upturn in the French economy in the course of 2005

The French economy marked time in 2005, with annual average growth down to 1.2 % from 2.3 % in 2004. The upturn in activity had from mid-2004 run up against a deterioration in the world economic situation, marked by a distinct increase in energy prices, but fresh impetus emerged in the second half of 2005. French performance was down on the previous year but was now also slightly below the EU average. Over the past 10 years, however, French growth has been 0.8 of a point faster than those of Germany and Italy.

Household demand yet again turned out to be the main driving force for growth. The deceleration in real household disposable income, due to slower growth in earned income and to tax rises, certainly had a somewhat adverse effect on household consumption (+ 2.1 %, following + 2.3 % in 2004), but this effect was cushioned by a decline of almost one point in the household saving ratio. In particular, the continuing low level of interest rates strengthened the disincentive to save. Moreover, households' appetite for investing in housing, which will soon have lasted for eight years, had by no means been satisfied (+ 4.1 %) and was sharpened by a fresh expansion of housing loans and a lengthening of their duration.

For the third consecutive year, foreign trade made a distinctly negative contribution to growth (0.8 of a point, following 0.6 of a point in each of the two previous years). Despite a recovery in H2 helped by the restoration of French competitiveness and the recovery in demand in French overseas markets, growth in exports of goods and services was down to 3.1 % from 3.9 %. At the same time, imports continued to grow briskly, boosted by the leap in energy purchases and the firmness of domestic demand.

Growth in investment by non-financial corporations and unincorporated enterprises, while still dynamic, slowed down to 3.6 % from 4.7 %. With financial conditions remaining highly favourable, investment was held back by the uncertain sales prospects linked to the weakness of industrial activity and by the erosion of profits as a result of soaring commodity prices. In addition, firms adopted more cautious inventory behaviour following the substantial rebuilding that had taken place in 2004.

In line with the traditional productivity cycle, the upturn in activity was not yet reflected in 2004 by additional recruitment in the market sector, with firms preferring to wait for confirmation of a revival of demand. The year 2005 saw the beginnings of an upturn in employment in the non-farm market branches, with 43 000 full-time jobs created between Q4 2004 and Q4 2005. The easing of productivity gains, combined with a slight slowdown in the average wage per head, led to a further erosion of the non-financial corporations' margin rate in 2005.

The rise in oil prices failed to dent the decline in inflation, which fell back to an average of 1.8 % in 2005 from 2.1 % in 2004. This tendency is explained both by the easing of core inflation due to the moderation shown by prices of manufactures and to the absence of any further rise in tobacco prices. However, the household consumption deflator accelerated very slightly to 2.0 % from 1.9 % because of increased rents (an item carrying a higher weight in the deflator than in the price index).

Marked deterioration in the external balance

Despite the greater liveliness of exports in H2, the deterioration in the foreign trade balance that began in 2003 was amplified in 2005. The deficit on trade in goods and services amounted to €16.3 billion in value, compared with a surplus of €4.1 billion in 2004. As a result, the contribution of foreign trade to French growth was sharply negative in 2005 (0.8 of a point of GDP, compared with 0.6 of a point in both 2004 and 2005).

The merchandise deficit widened by more than €18 billion to €24.2 billion, while the erosion of the surplus on services that had begun in 2003 continued. Roughly half the deterioration in the merchandise balance stemmed from the increase in the oil bill, which now stands at €37.4 billion. The other half was related to the deterioration in the balance on manufactures, which moved from a surplus in 2004 to a deficit of €4.4 billion in 2005. Furthermore, the surplus on agricultural and food products fell again, reaching €1.6 billion.

In 2003 and 2004, the erosion of the French external accounts had stemmed mainly from the deterioration in the export/import ratio in volume as a result of a cyclical lag between France and its main European partners, notably Germany. The more rapid growth in activity seen in France led to an increase in imports while at the same time weak domestic demand in the other euro-zone countries was holding back French sales. In 2005, two thirds of the deterioration of the external balance in value was explained by volume effects and one third by a deterioration in the terms of trade. Despite the ending of the cyclical lag vis-à-vis the rest of the euro zone, the growth in French imports of goods and services in volume (6.1 %) was twice as fast as for exports (3.1 %). In contrast to the two previous years, when the terms of trade had been beneficial to the French trade balance, in 2005 they deteriorated sharply as a result of the rise in prices of imported energy. The depreciation of the euro versus the dollar, the currency in which energy is traditionally priced, amplified this effect.

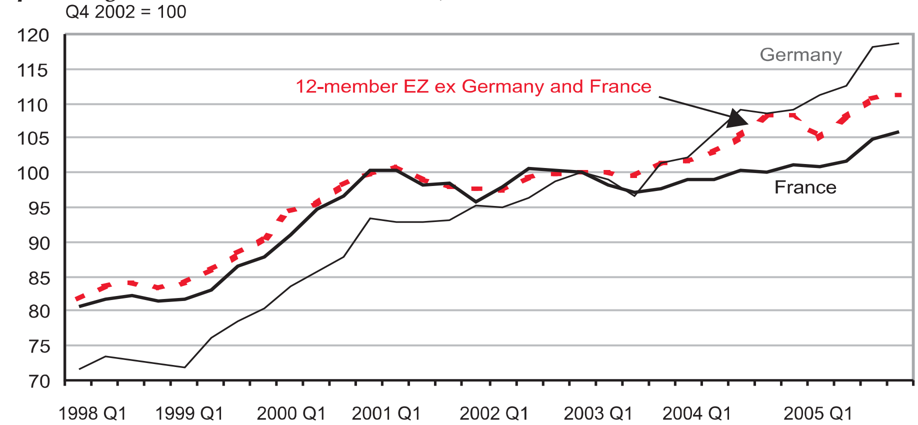
Once again, 2005 saw the growth in French exports turn out to be lower than growth in world trade. However, this phenomenon does not in itself constitute an anomaly. It reflects the major concentration of French foreign trade on Europe and the relatively small share directed towards North America and the fast-growing emerging countries. In 2005, growth in French exports to the euro zone declined in value, at a time when it was rising strongly to other countries, notably to the United States and China, as well as to the OPEC countries and Russia, which were benefiting from additional oil revenue. Following substantial market share losses between 2002 and 2004 in response to the deterioration in the real effective exchange rate, the recovery in the euro versus the dollar in 2005 came as a breath of fresh air for French exporters with positions on non-euro-zone markets. French export price-competitiveness vis-à-vis its OECD partners improved by 1.6 % and overall market share losses in volume were smaller than in previous years.

Export performance lagging behind that of the euro zone

In 2005, the growth in French exports of goods and services in volume (but also in value) was less than the euro-zone average (4.1 %, including intra-zone trade). This was a better performance than that of Italy (0.7 %) and Spain (1.0 %) but distinctly worse than that of Germany (6.6 %), which came close to repeating its strong 2004 performance (8.3 %), thus lifting the European performance as a whole.

Graph 3

Exports of goods and services in volume (Q4 2002 = 100)



Source: Eurostat, Newcronos.

The uncoupling of French export performance from that of the euro zone, more especially Germany, has been visible since 2003. Between 2003 and 2005, French export sales of goods and services rose by less than 7 %, whereas those of Germany rose by more than 15 %. These differences in export performance between France and Germany are partly explained by the more rapid growth in demand in overseas markets for German exports than in French overseas markets. German foreign trade is in fact less concentrated on EU countries, which accounted for 55 % of its sales in 2005, compared with more than 60 % in the case of France. Conversely, however, German foreign trade is more open to the Central and Eastern European countries and to emerging Asia, both of which are now in a catch-up phase and have sharply-rising domestic demand. In both France and Germany, however, the evolution in price-competitiveness has been very similar. Germany has a relative advantage in terms of cost competitiveness, thanks to a drastic cost-cutting policy, but this has been compensated in the case of French exports by greater efforts to trim margins.

Several other possible explanations can be put forward to explain the German outperformance, however. These include : a sectoral specialisation that is less concentrated on innovative products, especially aircraft, than in the case of France ; the scale of outsourcing by German firms, which means that a rising proportion of production takes place in low-wage countries ; and, finally, factors of a macroeconomic nature, such as the larger size of German export firms and the resulting easier attainment of the critical mass needed to operate at international level.

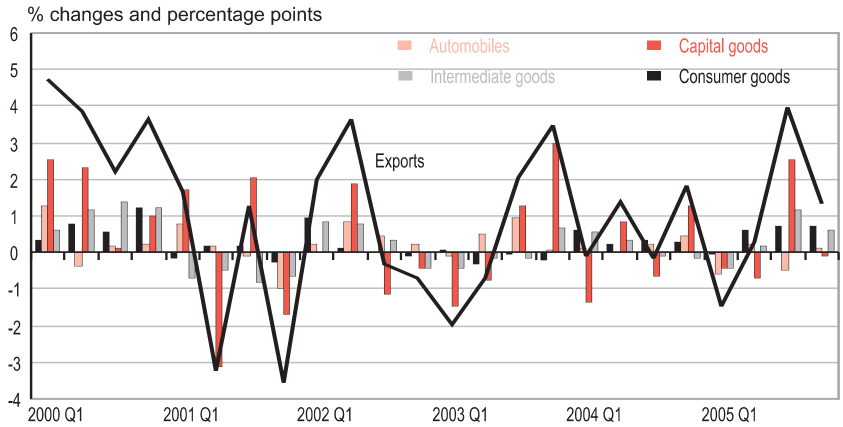
Firm consumer goods exports

In 2005, French exports of manufactures rose by 2.5 % in volume (compared with 5.7 % in 2004). Having been less than brisk at the end of 2004, they levelled out in H1

2005 before rebounding in H2 *(see graph 4)*. Despite the rise in aircraft deliveries (210 Airbus airliners in 2005, compared with 188 in 2004), sales of capital goods, which are more cyclical than other manufactures, slowed down sharply (+ 3.5 %, compared with + 7.9 % in 2004). Exports of consumer goods (+ 7.9 %, up from + 5.2 % in 2004), stimulated by the improved tendency in European household consumption, were the most dynamic component. Conversely, sales of intermediate goods (+ 1.0 %, compared with + 3.6 %) and those of automobiles (- 1.3 %, compared with + 7.0 %), one of the dominant poles of French specialisation, were slack. In the latter sector, the good performances achieved the previous year on the emerging markets (Iran, Turkey, Central and Eastern European countries) were not repeated.

Graph 4

Contributions to the evolution of manufacturing exports in volume (% changes and percentage points)



Source: Insee, national accounts - 2000 base

Growth in export prices of manufactures was held down to 0.8 % in 2005, compared with 0.3 % in 2004. This subdued behaviour was due to the small extent of increases in producer prices and to virtuous mark-up policies on the part of French firms. Since 2001, the evolution of producer prices on foreign markets, excluding energy and processed agricultural products, has shown itself to be much more restrained than the tendency on the domestic market. Constrained by a fiercely competitive environment and by low market power, French exporters were not in fact able to relax their efforts to trim margins, despite the depreciation of the euro.

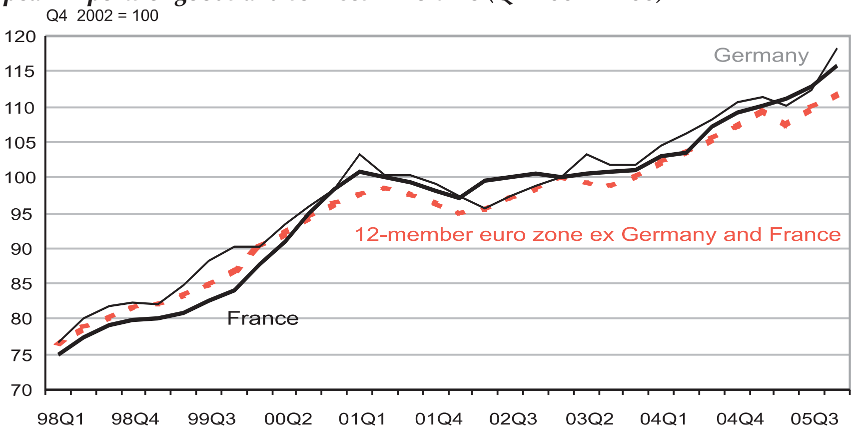
Because of the moderation shown by export prices, growth in value of exports of manufactures was not dissimilar to the corresponding figure in volume (3.3 %, compared with 6.1 % in 2004). Exports of consumer goods in value rose by 6.2 %, compared with 4.1 %.

French import growth faster than that of the euro-zone countries

In 2005, French imports of goods and services in volume maintained firm growth (6.1 % on an annual average basis, compared with 6.6 % in 2004). This growth rate is roughly two points higher than that of euro-zone imports and one point higher than that of German imports, whereas the respective evolutions were comparable in 2004 *(see graph 5).* Since 2003, despite more lively domestic demand, growth of French imports of goods and services in volume, at 13.1 %, has been very similar to that of its trading partners. In particular, it has been very similar to that of Germany (12 %) and barely higher than that of the remaining euro-zone countries (11 %). In value terms, the evolutions have been tending to converge.

Graph 5

European imports of goods and services in volume (Q4 2002 = 100)



Source: Eurostat, Newcronos.

The vitality shown by German imports despite slack domestic demand suggests that the underlying forces driving imports differ substantially from one country to another. In the case of France, imports are mainly intended to meet final demand, whereas in the case of Germany they are intended more to provide backing for exports because of the high import content of these exports, again reflecting the extent of outsourcing. Germany is in fact importing increasing amounts of goods from low-cost countries (notably those of Central and Eastern Europe), which are then assembled in Germany with a view to re-export, the result being to lead certain observers to describe Germany as a *"bazaar economy"*. In any case, the result has been a distinct increase in the penetration ratio of imports of goods and services (ratio of imports to domestic demand) in Germany compared with that of France in the early 2000s.

Except in the case of Spain, domestic demand in the various EU countries has strengthened very little. In Italy, where activity is having difficulty in picking up for lack of domestic driving forces, growth in the volume of imports has been uncoupled from that of the rest of the euro zone since 2003, being 4 % between 2003 and 2005. United Kingdom import growth in volume, thanks to more rapid growth, has been closer to the average (12 %).

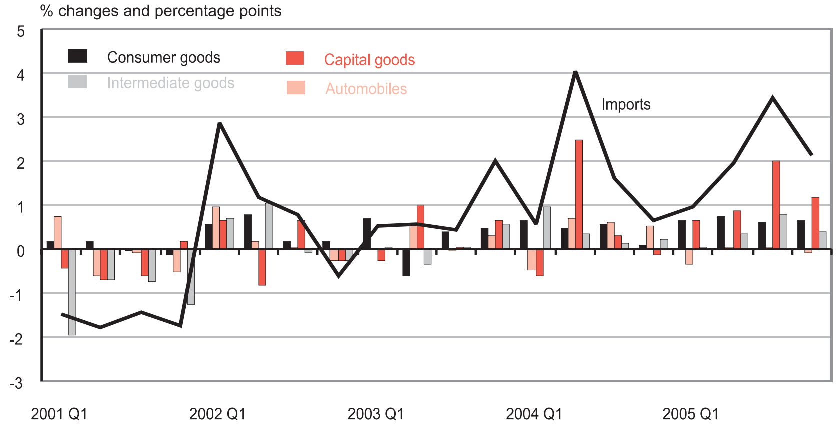
Continued brisk growth in imports of capital goods and consumer goods

In 2005, imports of manufactures in volume remained very robust (+ 6.6 %, following + 7.6 % in 2004). This rise was consistent with the evolutions in domestic demand and in import price-competitiveness. On top of strong demand from businesses (investment and stock building), there was also strong demand from households. The latter was directed in particular towards products with a high import content, such as electrical and electronic products. Even so, the hypothesis of increased penetration of foreign products aimed at meeting the needs of households does not seem to hold good. In 2005, it was only the import content of demand from firms that showed a distinct increase, without modifying that of final demand. The deterioration in import competitiveness, measured by the ratio between import prices and domestic producer prices, also helped to boost manufacturing imports. Import price-competitiveness losses amounted to 1.3 % in 2005, a slightly smaller change than in previous years.

In 2005, imports of capital and consumer goods maintained the momentum they showed in 2004 (+ 11.0 % compared with + 8.9 % in the case of capital goods, + 9.9 % compared with + 9.7 % in the case of consumer goods) *(see graph 6)*. Imports of clothing and leather goods accelerated to a rate of 13 % in volume compared with 8 % in 2004, but rose very little in value. In particular, the complete abolition of quotas for trade in textiles and clothing as of 1st January 2005 brought about a restructuring of French suppliers in favour of China, at the expense of the traditional suppliers (notably Tunisia and Morocco). On the other hand, the upturn in purchases of intermediate goods that had accompanied the revival of activity in 2003 was on a smaller scale (+ 3.0 %, following 5.5 %). Similarly, growth in imports of cars and car parts (+ 3.5 %) was only half that of 2004.

Graph 6

Contributions to the evolution of manufacturing imports in volume (% changes and percentages points)



Source: Insee, national accounts - 2000 base.

The substantial rise in energy imports in volume (37.1 %) was mainly due to the rise in the price of oil and other commodities. Prices of energy purchases leapt by 33 % in euros compared with 2004 and volume continued to grow by more than 4 %. For the year as a whole, the energy deficit therefore reached the record figure of €37.4 billion, compared with €27.8 billion in 2004.

Improvement in the manufacturing terms of trade

The manufacturing terms of trade, measured as the ratio between prices of manufacturing exports and imports, improved slightly in 2004 and 2005, unlike the overall terms of trade in goods, which were subjected to the rise in energy prices. This tendency seems to be in line with the effects to be expected from the appreciation of the euro, which, *"everything else remaining equal"*, should be accompanied by an improvement in the terms of trade. In 2004, however, the improvement had been modest in relation to the size of the variation in the exchange rate, with the rise in prices of manufactures, both exported and imported, remaining remarkably moderate. After trending downwards between 2001 and 2003, against a background of wage restraint and strong foreign competition, export prices of French manufactures returned to faintly positive rates in 2004 and 2005. Despite the substantial competitiveness losses suffered between 2000 and 2004, French exporters seem hardly to have taken advantage of the respite on the foreign exchange front to slacken their efforts in terms of mark-ups in 2005. Export prices of cars and consumer goods, which had risen in 2004, fell in 2005. Prices of intermediate goods, fuelled by the rise in commodity prices, maintained a positive tendency. The rise in import prices of manufactures was not particularly pronounced in either 2004 or 2005. In the end, in both years, the terms of trade gains for manufactures were therefore relatively small, of the order of €1.8 billion.

A smaller contribution from stocks and a slowdown in investment

Stock behaviour neutral for growth

Stock movements, which had been positive for activity in 2004 (contributing 0.6 of a point to GDP growth), played a relatively neutral role in 2005 (a negative contribution of 0.1 of a point).

Between 2001 and 2003, unfavourable economic conditions had led to de-stocking that reduced GDP by 1 point on a cumulative basis. With the recovery, firms substantially restocked in 2004. In 2005, faced with the slowdown in activity in the early part of the year, they adjusted stocks downward, regarding them as too large.

Looking beyond the changed need for stocks as a consequence of the just-in-time management made possible by technical progress, recent evolutions have illustrated the cyclical nature of firms' inventory behaviour. Should unpredictable movements occur, either positive or negative, the resulting modification in their desired stocks levels leads them to try to find the new level they now find desirable. This desired level depends, in particular, on their demand expectations, or simply on the present state of demand if they base their expectations on the recent past.

In 2004, it was this alignment of stocks on the strength of demand that prevailed. Re-stocking was particularly marked in two branches of activity : first, in cars, where

French output was adjusted with a certain timelag to increased penetration of foreign products on the domestic market ; second, in the agriculture/food chain, where re-building of stocks of agricultural products had been made necessary by the massive de-stocking linked to the 2003 heat wave.

In 2005, the influence of inventory behaviour on activity was globally more neutral, Although stock building increased in certain manufacturing branches, probably reflecting more positive expectations on the part of business leaders, re-stocking slowed down in the car sector, where demand was less vigorous then expected. Moreover, following the major re-stocking seen the previous year, the agricultural sector also ran down its stocks.

Corporate investment still dynamic, despite a slowdown

Following a downward adjustment between 2001 and 2003, investment by non-financial corporations and unincorporated enterprises benefited in 2004 from more favourable demand prospects and financing conditions. In 2005, with the cost of borrowing still low, the evolution in investment remained positive, although slightly down on 2004 (+ 3.6 % compared with + 4.7 %). This decline has to be put in perspective by pointing out that it was concentrated on just one sector, namely building and public works.

Growth in productive investment nevertheless seems to have been relatively rapid in 2005 on average, given the slowdown in activity seen between mid-2004 and mid-2005. In fact, signs that the tendency was running out of steam appeared in mid-2004, in response to the erosion of corporate margins and to the fewer calls made by industrial activity. Between Q3 2004 and Q3 2005, corporate investment weakened before picking up again in H2 2005, with the gradual dissipation of uncertainties regarding sales prospects.

The maintenance of advantageous financial conditions, by making financing through borrowing particularly attractive, contributed to sustaining the level of investment. In 2005, nominal rates on medium- and long-term loans to firms remained low, at just above 3 %, or roughly 1 % in real terms. This low cost of borrowing led to an acceleration in loans to non-financial corporations, the consequence being an increase in their debt ratio, marking the end of the debt-reduction phase that had begun in 2001. The debt ratio of non-financial corporations, measured by their outstanding borrowing as a proportion of their value added, accordingly amounted to 107.4 % in 2005, compared with 105.3 % in 2004. While some firms preferred to use shareholder equity for their financing needs - notably listed firms in view of the strong stock-market performance (the CAC40 index put on 24 % between December 2004 and December 2005 and the euro-zone DJ Eurostoxx 50 index 21%) - it was recourse to borrowing that predominated, in conformity with the classical leverage effect[2].

In product terms, the slowdown in investment by non-financial corporations was concentrated in construction, where it stayed at a level close to that of 2004, having risen

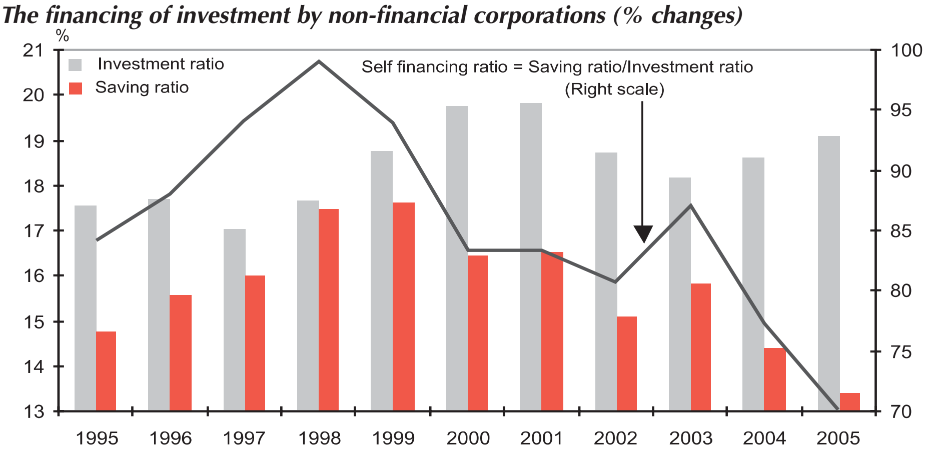
2. In order to finance its investment projects, a firm can call on its past profits (through so-called self-financing) or on external sources of finance. When interest rates are low, recourse to borrowing makes it possible to increase the return on equity (and hence the level of dividends paid to shareholders) but with a corresponding increase in shareholders' risk levels.

sharply the previous year (+ 0.2 %, compared with + 5.1 %). At a time when households' investment in housing remained dynamic and when government investment in building and public works was accelerating markedly, it is not impossible that corporate investment in building and public works suffered from a *"crowding-out"* effect, with supply finding difficulty in meeting demand. Excluding building and public works, corporate investment generally remained positively headed (+ 5.8 % compared with 3.1 % in 2004 in the case of capital goods, + 5.0 % compared with + 6.2 % in automobiles, + 5.6 % compared with + 5.1 % in business services).

All in all, the recovery in the investment ratio of non-financial corporations that had begun in 2004 continued in 2005 *(see graph 7)*. At 19.1 %, it was 0.7 of a point below its 2001 peak. Conversely, the saving ratio of non-financial corporations and unincorporated enterprises (NFCs-UEs)[3] declined to 13.4 % in 2005 from 14.4 % in 2004. This erosion is explained in the first place by the levelling off in companies' trading margins (by 0.7 of a point to 30.2 % in 2005) at a time when the easing of productivity gains and the higher cost of inputs prevailed over wage restraint. It was also explained by the maintenance of generous dividend policies at the expense of self-financing and by higher tax payments. In particular, corporation tax payments rose appreciably, under the impact of a modification in the method used for calculating the fourth down-payment. In the end, the decline in the saving ratio of the NFCs-UEs, combined with a rise in their investment ratio, led to a fall in their self-financing ratio.

Graph 7

The financing of investment by non-financial corporations (% changes)



Source: Insee, national accounts.

Despite the lower self-financing ratio, borrowing by firms enabled them to resume their external growth policies. After a lull of four years, during which they rebuilt their cash resources, the access to cheaper external liquidity was accompanied by an upturn in M&A operations.

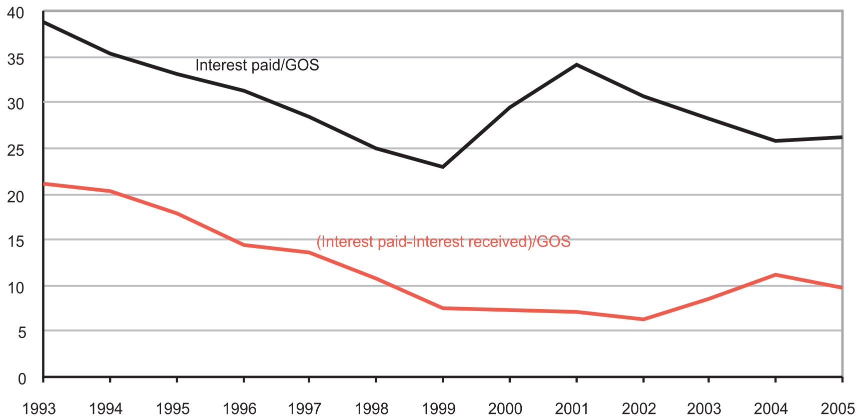
3. The saving ratio of non-financial corporations, which is the ratio of their gross saving to their value added, is an indicator of profit. Its evolution can diverge from that of the margin rate, notably because the transition from the gross operating surplus to saving requires, among other things, taking into account firms' interest payments as well as corporation tax.

Easing of the burden of financial expenses, despite the rise in indebtedness

In 2005, the downward tendency in interest payments by non-financial corporations that had been seen since 2002 was interrupted because the increased recourse to borrowing had raised their interest payments *(see graph 8)*. These payments were equivalent to 26.2 % of their gross operating surplus (GOS), compared with 25.8 % in 2004. The net balance (interest payments minus interest receipts) as a proportion of their GOS, which had risen in the previous two years, nevertheless levelled off at 10.1 % (compared with 11.2 % in 2004) because of the increase in the interest received by the non-financial corporations.

Graph 8

The interest burden in relation to the gross operating surplus (GOS)



Source: Insee, national accounts.

Slack manufacturing activity

In 2005, output and value added in manufacturing rose only slightly in volume (output by 0.3 % compared with 2.0 % and value added by 1.5 % compared with 1.9 %). This mediocre performance was mainly due to the weakness of exports. Exports of manufactures, which had shown signs of recovery towards the end of 2004, were slow to pick up and in fact only did so in H2 2005. Firms were at the same time feeling the impact of strong competition on their domestic markets.

Within manufacturing, the performances of the consumer goods industry and to some extent the capital goods industry contrasted with the general tendency. Benefiting from dynamic household demand, they saw both their output and their value added accelerate. In the case of intermediate goods, activity stagnated. Value added in the car sector, where the volume of output declined, fell appreciably (- 3.0 %, compared with + 4.3 % in 2004).

Activity in the mainly market services sector was barely more dynamic than in manufacturing, with value added rising by 1.8 % in volume, compared with 2.3 %. Being more concentrated on the domestic market and less dependent on inputs of commodities, these branches showed greater resistance. Services to businesses continued to grow briskly as the result of a revival in consultancy and assistance. Services to individuals, despite being boosted by the recovery in households' consumption of leisure activities, posted more modest growth. Assessment of the output of non-market activities, notably healthcare, raises more difficulties.

Renewed decline in activity for agriculture and food processing

The year 2004 had seen a slight increase in the value of agricultural value added, with the large growth in volume (21.0 %) offset by an equivalent decline in prices that was merely a return to normal following the 2003 heat wave. In 2005 agricultural activity showed a further marked decline (by 7.9 % in value and 11.2 % in volume), with falls in harvested volumes (notably cereals and wine) failing to be accompanied by a sufficient increase in prices.

For their part, the food processing industries suffered a pronounced weakening of their activity in value (by 12.1 %), accompanying a modest rise in volumes (1.5 %).

Construction benefiting from firm demand from households and government

In 2004, activity in construction (including public works), helped by the firmness of the property market, had shown a certain tonicity, with output rising by 3.7% in volume. In 2005, the sector's output remained firm, despite slowing down somewhat (+ 2.3 %). Housing starts reached a record level of 410 000 units for the year as a whole. The growth in value added slowed down somewhat more, as a result of greater use of temporary agency labour. However, value added in value terms maintained firm growth (+ 5.7 % compared with + 10 % in 2004 and + 5.7 % in 2003, with the growth in prices testifying to the persistence of bottlenecks, especially those related to the lack of skilled manpower.

General government's construction GFCF accelerated. Households' housing GFCF, which covers both purchases of new dwellings and expenditure on major maintenance, maintained its expansion (+ 4.1 % in volume, following + 4.0 % in 2004), continuing to benefit from firm demand for dwellings on the part of households, despite a slight decline compared with 2004. Spending on maintenance showed little change, with purchases of new dwellings the more dynamic component. Finally, corporate construction GFCF slowed down, perhaps as the result of a crowding-out effect.

In France, the price of new dwellings as recorded in the national accounts[4] rose by 2.4 % in 2005, following 4.8 % in 2004, bringing the rise since 1998 to more than 20 %. The upward tendency in house property prices, relating to existing dwellings, was distinctly greater. Since 1998, prices of house property have shown rapid growth in most western countries (with the notable exception of Germany and Japan), giving rise to fears of the existence of a housing bubble. Prices of existing housing in France more than doubled between 1998 and 2005. Despite a slowdown towards the end of the year, they rose further by almost 15 % in 2005.

This surge in property prices has reflected a growing imbalance between strong demand for housing and supply that was slow to adjust because of the scarcity of building land and manpower constraints. While since 1998 house prices have risen four times as fast as real disposable household income, households' purchasing capacity (measured by the maximum number of square metres that can be purchased by a household receiving the average disposable income) remained within reasonable limits thanks to the very favourable financial conditions available. Real interest rates on housing loans fell from more than 6 % in 2004 to less than 3 % in 2004 and 2005. Meanwhile, there was a large expansion in housing loans, with annual average growth reaching double figures in 2004 (14.6 %) and 2005 (12.2 %). An additional factor was the lengthening of the average duration of housing loans, from 15 years in 1999 to 17 years in 2004. French households' housing indebtedness has risen from 30 % of their disposable income in 1998 to 45 % in 2005. As a result, two thirds of French households' debt is due to the purchase of a dwelling. While this proportion corresponds to the euro-zone average, the figure for the Netherlands is in excess of 90 % and in Italy is no more than 50 %, with Germany in much the same intermediate position as France. These disparities are explained by several factors : the level of GDP per head (housing debt rises with the standard of living), demographic factors, the unemployment rate, the characteristics of loans (fixed or variable rates).

Employment gradually picking up again

The year 2005 saw the beginnings of an upturn in dependent employment following the stagnation in 2004. On a full-time equivalent basis, the total amounted to 22 175 000 in Q4 2005, compared with 22 125 000 in Q4 2004, a rise of 50 000 (compared with 30 000 in 2004). Job creations in the market branches, at 43 000, substantially exceeded those in mainly non-market services[5] (7 000). The reverse phenomenon had been seen in 2004, when the very small rise in market-sector employment (2 000) was in sharp contrast to the more numerous creations in mainly non-market services (22 000). During 2005, the rise in the number of workers with a job (74 000) was greater still, as a result of the increase in part-time working. The number of those with either full-time or part-time dependent jobs was therefore 22 835 000.

On an annual average and full-time equivalent basis, total employment rose by 58 000 in 2005 (12 000 in 2004), a rise of 0.2 %. The non-farm market branches were the main

4. In the national accounts, by convention, the price of new housing is calculated on the basis of construction costs. As a result, the rise in housing prices mainly concerns the price of the land on which the housing is built, which is recorded in the capital account. In recent years the value of building land has in fact risen sharply.
5. Education, health, social work and public administration.

location of job creations, whereas numbers employed in mainly non-market services rose only slightly.

In conformity with the traditional productivity cycle, the upturn in activity was not immediately reflected in additional recruitment in the market sector. Employment in the competitive sector only really revived in 2005, with a slight acceleration in Q4 (+ 0.2 %).

In 2005, the government's employment policy exerted a slightly positive effect on market-sector employment[6], to much the same extent as in 2004 in terms of flows. The Act dated 18 January 2005 concerning the programming of social cohesion profoundly modified the existing arrangements, notably the so-called *"contrat initiative emploi"* (CIE)[7] and the *"contrat insertion - revenu minimum d'activité"* (CI-RMA)[8]. Terminations of former CIE contracts were globally compensated by the numbers involved in the build-up of the corresponding new arrangement and the impact of the CMI-RMA reamined limited. On the other hand, the build-up of the *"sandwich"* contracts had a positive impact on market-sector employment. The latter also benefited from the introduction of the *"contrat nouvelle embauche"* (CNE)[9], the flagship measure in the *"Plan d'urgence pour l'emploi"*[10]. This indefinite-term contract, for use by firms with less than 20 employees, is intended to provide greater flexibility on the labour market, by facilitating layoffs in the first two years of the contract, but with in return the introduction of new guarantees (replacement income, assistance in finding a new job, etc.). Since their introduction on 1 September, the CNEs are estimated to have accounted for roughly 10 % of total registered recruitment in firms with fewer than 20 employees. At this stage, however, it is difficult to put a precise figure on their impact, net of windfall and substitution effects[11].

Despite the growth in activity, the downward tendency in dependent employment in manufacturing industry, measured on a full-time equivalent basis, continued in 2005, with a decline of 2.7 %, compared with 3.5 % in 2004. This tendency, which has been a constant in recent decades, reflects above all the rises in productivity associated with the increased capital-intensity of the manufacturing sector. In 2005, the tertiary market sector (+ 0.8 %, following + 0.5 % in 2004) and construction (+ 2.1 %, following + 2.3 %) were the principal sources of new dependent employment. Among individual market sectors, business services (+ 1.5 %) and services to individuals (+ 0.8 %) posted the best performances. Over the past five years, employment in these sectors has increased by roughly 2 % per year. In 2005, the two branches accounted for more than a quarter of total employment.

6. See Insee (2006), "Conjoncture in France", March, pp 93-94.
7. Employment Initiative Contract, aimed at those excluded from the labour market and involving reductions in social security obligations.
8. Insertion Contract - Minimum Working Income.
9. New Employment Contract.
10. Emergency Plan for Employment.
11. The March 2006 issue of "Conjoncture in France" using conventional methods, put the impact at 10 000 to 20 000 net jobs in Q4 2005. At present, it is only possible to make an *ex ante* evaluation of the impact of the CNE. Such an evaluation has been made by Pierre Cahuc and Stéphane Carcillo (2006), "Que peut-on attendre des Contrats Nouvelle Embauche et Première Embauche", Crest working document. In this study, the total net effect is estimated at between 50 000 and 100 000 jobs, on the basis of a theoretical simulation model. This net positive effect is recorded mainly during the first year following the introduction of the measure.

Table 2

Growth, productivity and unit wage costs

Annual average % changes

	2002	2003	2004	2005
Market branches				
Wage per head	2.7	2.6	3.7	3.0
Productivity per head (1)	- 0.1	1.4	2.6	1.1
Unit wage cost	2.7	1.5	0.8	1.5
Manufacturing industry				
Wage per head	3.2	2.4	3.8	2.6
Productivity per head (1)	2.7	3.7	4.8	4.0
Unit wage cost	0.2	- 0.7	- 1.1	- 1.3
Other market branches				
Wage per head	2.6	2.7	3.7	3.1
Productivity per head (1)	- 0.8	0.8	2.1	0.5
Unit wage cost	3.4	2.0	1.4	2.2

Source: Insee, national accounts - 2000 base.

(1) Full-time equivalent basis.

Employment in the mainly non-market branches stabilised in 2005 after rising by 0.6 % in 2004. The recovery in the number of non-assisted jobs was in fact masked by the decline in the number of beneficiaries of assisted jobs. Following the sharp drop in the number of non-market assisted jobs in the two previous years, in 2005 the fall was less marked, thanks to the introduction as of Q2 of the *"Plan de cohésion sociale"*[12]. The *"Contrat d'Accompagnement dans l'Emploi (CAE)"*[13], to help people in countering particular difficulties in obtaining access to employment, and the *"Contrat d'Avenir"*[14], for people on minimum income support, led to the creation of 131 000 and 15 000 jobs, respectively, in 2005. These two new contracts have taken over from the *"Contrats Emplois Solidarités"*[15] and the *"Contrats Emplois Consolidé (CEC)"*[16]. For the year as a whole, their gradual build-up did not totally make up for the numbers concerned by the ending of the previous arrangements.

Weakening productivity gains

The year 2005 saw a slowdown in the growth of productivity per employee in the market sphere, falling back to + 1.1 % from + 2.6 % in 2004. This would seem to be in conformity with the productivity cycle generated by delays in adjusting employment to fluctuations in demand and in output. While over the long term productivity is driven by technical progress, in the short term it fluctuates according to the position of the economy in the cycle. In upswing phases, labour productivity tends to accelerate, since workforces are adjusted only after a timelag to the upturn in activity. From mid-2003 on, and then in 2004, the upturn in growth led to substantial productivity gains. In 2005, even though job creations remained relatively few in number, the levelling off in growth hampered productivity gains.

12. Social Cohesion Plan.
13. Employment Re-trainging Contract.
14. Contract for the Future.
15. Employment-solidarity-Contract
16. Consolidated Employment Contract.

Between 1988 and 2001, labour productivity per job had fallen sharply under the influence of a set of factors that contributed to enhancing job creation (exemptions from employers' contributions in the case of the lower-paid, development of part-time working, introduction of the 35-hour week). Since 2002, productivity gains have picked up again, returning in 2004 to their long-term trend growth.

In the manufacturing branches, the growth in productivity per full-time employee is traditionally high, averaging more than 4 % over the past 10 years. Following an acceleration in 2004 (+ 4.8 % compared with + 3.7 % the previous year), its growth fell back to 4.0 % in 2005, bringing it back close to its long-period average tendency. In the non-manufacturing market branches, accounting for 80 % of market value added, productivity gains fell back to 0.5 % in 2005 from 2.1 % in 2004.

According to Eurostat, France is ranked first among European countries in terms of productivity per person employed and in terms of hourly labour productivity[17], for which its performance is thought to be better than that of United States. The calculation of a figure for *"structural hourly productivity"*, arrived at by applying the features of the American labour market to the European Union, restores the United States' advantage, but with France still maintaining its lead over its European partners.

Levelling off in the rise of remuneration

The rise in the average unit wage cost (UWC) in the market branches, which was no more than 0.8 % in 2004, accelerated to 1.5 % in 2005. This acceleration is explained by the slowdown in productivity gains at a time of easing of growth in the average wage per head (SMPT)[18] (to 3.0 % from 3.7 %) as well as in the rate of employers' social contributions.

Following limited evolutions between 2001 and 2003, given the morose economic context and also the agreements accompanying the reduction in working hours, the average wage per head in the market sector accelerated markedly in 2004. This acceleration mainly reflected the cyclical recovery and the process of convergence between the various statutory minimum wages. The slowdown in activity seen between mid-2004 and mid-2005 helped to curb growth in the average wage per head, which nevertheless remained vigorous by comparison with previous tendencies. Several factors lay behind this dynamism : first, the reduction of unemployment during the year, creating a more favourable bargaining position for workers in wage negotiations ; second, the final stage of the raising of the hourly SMIC minimum wage begun in 2003 ; and third, the payment in 2005 of an exceptional profit-sharing bonus.

There were deviations between the respective evolutions in unit wage costs in manufacturing and in the market branches. In manufacturing, a sector more exposed to international competition and where technical progress is usually faster, workforce adjustments continued and the decline in unit wage costs that began in 2003 intensified in 2005 (- 1.3%, compared with - 1.1 %). Productivity gains remained high, while growth in the average wage per head was less brisk. By contrast, in the other market branches, which traditionally show relatively small productivity gains, unit wage costs

17. See bibliography.
18. The SMPT includes all types of remuneration, including, in particular, measures applied to particular categories, individual promotions and structural effects.

accelerated. In the public services sector, the average wage per head rose by 2.2 % in 2005, compared with 1.9 % in 2004, benefiting from a 0.9 % average revaluation of the so-called *"point"* that provides the yardstick for the schedule of civil service wages and salaries (giving + 1.8 %, year on year), from a restructuring of the salary schedule for the so-called category C employees and from an exceptional bonus of 1 % granted to staff who had been at the top of their grade for 3 years.

For the second consecutive year, the rate of employers' social contributions declined. On top of the easing of the social contributions due to the build-up of the so-called *"Fillon"* arrangements, there was an easing of contributions by restaurateurs.

Downturn in the unemployment rate

At the end of 2005, the number of unemployed according to the ILO definition stood at 2 622 000 people in Metropolitan France, 124 000 fewer than in 2004 (in 2003 the number of unemployed had declined by 17 000). The unemployment rate ended the year on 9.6 %, down from 10 % at end-2004.

This downturn in unemployment reflected the greater short-term dynamism of employment. Moreover, demographic tendencies related to the ageing of the population were at the same time bringing about slower growth in the labour force. Having been more than 1 % per year on average in the 1970s, labour force growth halved during the 1990s. The share of the 15-24 age group in the labour force has diminished while that of the over-55s increased from 2001 on. In 2005, the labour force as defined in the national accounts fell slightly, following a small rise in 2004. The arrival at retirement age of the first of the baby-boom generations and the taking of early retirement before the age of 60 by those with a long career behind them (those who started their working lives before 16 and had paid 42 years' pension contributions) helped to reduce the labour force despite the effects of the prolongations of working life due to the system of *"oversubscription"* permitted under the 2003 pension reform. These tendencies outweighed the inflection effects linked to the decline in unemployment.

The rise in the unemployment rate for the 15-24 age group, which had been particularly marked since 2001 (rising from 18.9 % at end-2001 to 22.1 % at end-2005), was stemmed during the year. The young are more likely to occupy a temporary post (more than one young active worker in five does so, taking temporary agency jobs or fixed-term contracts). They were accordingly the first to suffer from the slowdown in economic activity that took place between mid-2004 and mid-2005. In a difficult climate, firms made fewer calls on this type of contract, used to even out unexpected short-term movements. However, other coming into force during the summer of the Plan d'urgence pour l'emploi (recruitment bonuses granted to sectors in difficulty, the *"contrats nouvelle embauche",* special interviews by the state employment agency (ANPE) of 57 000 young people out of work for more than one year) was accompanied by a fall in youth unemployment as of Q3. The unemployment rate for this age group accordingly fell by 0.4 of a point between end-2004 and end-2005, when it was 22.1%. This rate remains 4 points higher than the corresponding euro-zone average.

Unemployment among the over-49s, which had been rising since 2001, began to decline somewhat earlier, i.e. as of 2004, thanks to the build-up of retirements of long-career workers. It accordingly fell back to 6.7 % by the end of 2005 from 7.2 % at end-2004.

Decline in inflation despite the higher oil price

Despite a substantial rise in energy prices, the consumer price rise, which had stabilised at 2.1 % in 2004, fell to 1.8 % on average in 2005. Inflation accelerated in Q2 and Q3, pushed up by the oil price, peaking at 2.2 %, year on year, in September (compared with 1.6 % in January) before falling back to 1.5 % in December. Unlike the consumer price index, growth in the household consumption expenditure deflator derived from the national accounts accelerated to 2 % from 1.9 % in 2004, driven up by the rise in rents[19].

The levelling off of inflation was explained mainly by the decline in core inflation[20] (+ 1 % in 2005, compared with + 1.7 % in 2004) that began in mid-2004, and by the absence of any fresh rise in tobacco prices. The decline in core inflation resulted from the particularly moderate evolution in prices of manufactures (- 0.5 % in 2005, compared with + 0.2 % in both 2004 and 2003), reflecting the very restrained tendency of prices in large-scale distribution. Following the agreements reached on 17 June 2004 between the representatives of industry and of large-scale distribution, the rise of prices in the supermarkets, notably those of branded goods, moved back onto a downward slope, to end the year on an average of - 0.6 %, compared with + 1.1 % in 2004. In addition to the manufacturing component, core inflation benefited from the slight decline in food products other than fresh produce (- 0.2 %, compared with + 1.4 % in 2004). Lastly, the absence of any rise in tobacco prices in 2005, following the massive tax increases in 2004 (adding 0.5 of a point to inflation), had a major impact on the evolution in the overall consumer price index.

By contrast, prices of services maintained the cruising speed of slightly less than 3 % seen since 2002 (+ 2.6 % in 2005, as in 2004). In 2005, the acceleration in rents and transport prices was compensated by more measured tendencies in communication and other services. Despite signs of an easing towards the end of the year, the rise in rents seen since 2002 continued in 2005, reaching 3.5 % on average for the year (compared with 3.1 % in 2004), giving a cumulative rise of 13 % over the past five years. Meanwhile, transport prices, pushed up by the higher energy price, rose by 4.4 %, compared with 3.4 % in 2004. In the case of healthcare services, the price rise was barely higher than in 2004 (1 % compared with 0.8 %) as the reform of sickness insurance had only a small impact on the consumer price index[21].

In 2005, growth in energy prices intensified as a result not only of the sharp rise in oil prices but also of the rise in the prices of non-energy commodities. Despite a lull in the autumn following the gradual restoration of world oil supplies, the Brent price exceeded $54/barrel on average in 2005, compared with $38/barrel in 2004, giving an increase of 42 % (33 % in 2004). Nevertheless, the substantial rise in the price of crude

19. The fact that the consumer price index rose less rapidly than the household consumption deflator stems from the difference in coverage. Unlike the deflator, the consumer price index includes neither the imputed rents of owner-occupiers, nor the interest-rate margins of the banks, which have since 2004 been included in household final consumption expenditure.
20. Excluding public-sector tariffs and products with volatile prices such as fresh produce, energy and tobacco, adjusted for tax measures and seasonal variations.
21. For one thing, the application of the fixed price of 1 euro per consultation leads to a decline in social security repayments but makes no difference to the price of medical acts that enter into the calculation of the CPI. For another, the rise in the fixed-rate charge for periods in hospital (from 13 to 14 in January 2005) had no impact on the CPI, since hospital services are not within the coverage of this index. Furthermore, the revaluation of surgical acts from April 2005 on has only a slight impact on the CPI.

was only partly passed on into consumer prices. The *"petroleum products"* component of the index posted a rise of 15.3 % in 2005 (compared with 8.6 % in 2004), contributing 0.6 of a point to inflation. Despite a rise in refinery margins, the existence of the TIPP (domestic tax on petroleum products) meant that the rise in the price of products consumed by households (motor fuel, domestic fuel) was smaller than in the case of crude oil[22]. Given the limited possibilities in the short term of substitution between different types of energy, the rise in prices of petroleum products meant additional expenditure by households on these products, the increase being estimated at €100 per household in 2004 and 200 per household in 2005[23]. Households living on modest incomes, who spend proportionately more of their budget of energy products, were affected to a greater extent.

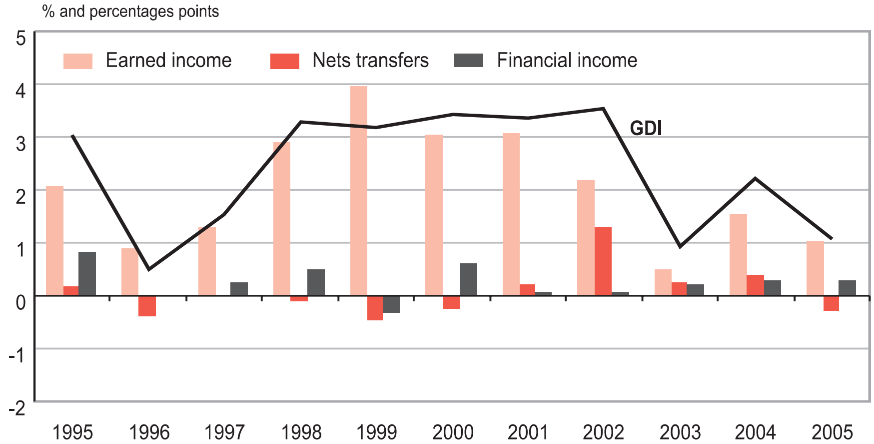
Slowdown in household purchasing power growth

In 2005, growth in household gross disposable income slowed down by one percentage point to 3.1 %. Given the rise in the price of consumption expenditure, growth in real household disposable income fell to 1.1 % from a revised figure of 2.2 % in 2004 and 0.9 % in 2003.

Growth in household purchasing power remained below the firm rate of 3 % seen between 1998 and 2002 *(see graph 9)*. In 2002, the cyclical slowdown had started to have an adverse effect on incomes, but this was compensated by the increase in net transfers (social benefits minus compulsory tax and social payments) received by

Graph 9

Contributions to the evolution in the purchasing power of gross household disposable income (% and percentage points)



Source: Insee, national accounts - 2000 base.

22. Two types of tax are applied to the various petroleum products : VAT and the domestic tax on petroleum products (TIPP). Unlike VAT, the TIPP is a tax, not on value, but on a physical volume (which in fact declined in 2005) and this cushions the impact on prices at the pump. A considerable proportion of the tax-paid price is therefore insensitive to variations in the price of crude. It is in fact necessary to divide the variation in the pre-tax price by a factor of roughly four in order to arrive at the estimated variation in the tax-paid price.
23. See INSEE (2005) *"Conjoncture in France"*, December, page 26.

households. After slowing down markedly in 2003 (growth of 0.9 %), household disposable income rebounded in 2004 (a rise of 2.2 %), benefiting from a more favourable tendency in earned income, linked to the improvement in the economic situation, the rise in dividends paid to share-owning households and an intensification of the reduction in income tax brackets (by 3 %, following 1 % in 2003).

A slower rise in remuneration despite the upturn in employment

The slowdown in household purchasing power growth in 2005 was explained partly by the slower growth in earned income, down to 3.3 % from 3.8 %.

The growth in total gross wages and salaries received by households that began in 2004 (+ 3.5 %), weakened in 2005 (+ 3.0 %). The initial upturn in dependent employment measured on a full-time equivalent basis (+ 0.1%) turned out to be insufficient to counterbalance the slowdown in the average wage per head (+ 2.8 %, compared with + 3.5 %).

In public administration, the growth of total wages and salaries stabilised at 2.2 %. Public employment, which had risen by 0.3 % in 2004, stagnated in 2005, with the recruitment related to measures in favour of assisted employment merely compensating the net withdrawals due to retirement. The various measures in favour of individual categories and the revaluing of the civil service *"point"* led to an acceleration in the average wage per head.

In the private sector, total gross wages and salaries rose more slowly in 2005. Although employment began to pick up (+ 0.2 % compared with - 0.1 %), growth in the average wage per head weakened by 0.7 of a point to + 3.0 %.

In addition, there was erosion of growth in the gross operating surplus of unincorporated enterprises (+ 0.4 %, compared with + 2.4 % in 2004).

Conversely, property income, still dynamic (a rise of 6.1 %, following 5.9 %), helped to sustain household purchasing power in 2005. On the one hand, rents continued to rise strongly (by 7.0 % net of property tax, following 6.7 %). On the other, the strong rise in financial incomes was maintained (+ 5.1 %, following + 4.9 %). There was yet another substantial rise in dividends. This compensated for the fall in net interest received by households, which grew only slightly at a time of low interest rates, while the increase in their borrowing helped to increase their interest payments.

The contribution of public finances to the slowdown in purchasing power growth

In 2005, the consolidation of public finances curbed growth in real disposable income because of the rise in taxes and social contributions and the slowdown in social benefits received. This rise in compulsory levies accounted for half the slowdown in household purchasing power.

The growth in taxes and social contributions affecting households accelerated compared with 2004 under the impact of rises in contributions (+ 3. % compared with

+ 3.1 %) and in tax payments (+ 6.5 %, compared with + 2.5 %). The rates of the CSG (Generalised Social Contribution) were raised following the reform of sickness insurance. In addition, the taxes raised by local authorities, notably the residence tax, rose markedly. Finally, social payments and taxes based on property and share ownership rose particularly strongly.

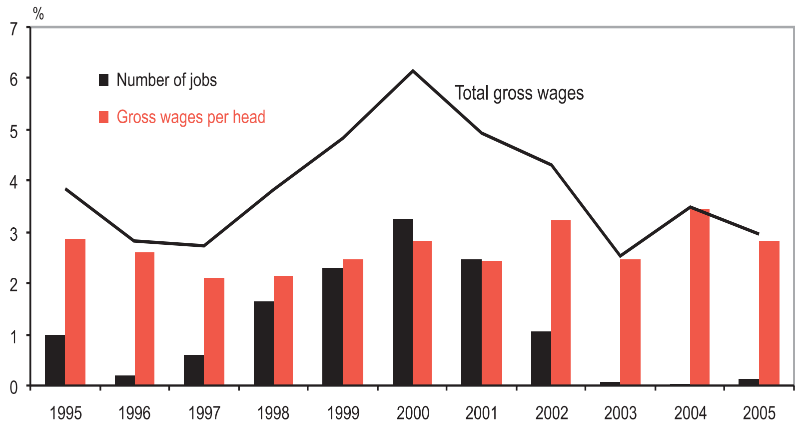
The social benefits in cash received by households maintained lively growth, which stabilised at slightly less than 4 % in 2005. Under the general regime, which accounts for 60 % of the payments in cash, old age and family allowances were boosted by the build-up of early retirements as well as by the *"prestation accueil jeune enfant"* (PAJE)[24]. Meanwhile, unemployment benefits declined because of the fall in unemployment and the tightening of the eligibility conditions. Benefits from the sickness branch rose by 2.3 % (compared with 1.5 % the previous year), moderate growth by comparison with previous tendencies.

Decline in the saving ratio

Growth in households' consumption expenditure, which had steadily weakened between 2000 and 2002 (from 3.6 % to 2.2 %) has since then remained at a firm rate of close to 2 %. It remained brisk in 2005 (2.1 %, compared with 2.3 %), thus remaining the principal prop for growth. At a time when real disposable income was slowing down, this robustness of purchases by households was maintained thanks to the decline of almost one percentage point in the saving ratio (after stabilising at 15.8 % in 2004, it fell to 14.9 %).

This decline in the saving ratio seems consistent with households' usual behaviour in giving preference in the short term to the maintenance of their consumption expenditure by applying a smoothing over time. Faced in 2005 with a slowdown in their real incomes, households were therefore prompted to draw on their savings in such a way as to

Graph 10
Evolution in total gross wages, wages per head and number of jobs (% and percentage points)



Source: Insee, national accounts - 2000 base.

24. Arrival of Young Child Allowance.

maintain the same level of expenditure. The weakening of inflation (bringing about an improvement in the purchasing power of households' cash balances), the decline in unemployment (reduction in the precautionary saving needed to cope with uncertainties) and the maintenance of interest rates at very low levels (expansion of consumer credit, little incentive to invest) probably also contributed to the phenomenon.

Certain tax measures also facilitated the process. The so-called Sarkozy measures adopted in 2004 (relating to gifts inter vivos, unfreezing of corporate savings plan balances, reduction in taxes on consumer credit) had operated in favour of a decline in saving. While continuing to have their effects in H1 2005, but on a more diluted scale, their role was partly taken up in October 2005 by a new set of measures relating to *"confidence and modernisation of the economy"*: exceptional unfreezing of the sums allocated to employees in profit-sharing schemes and the introduction of an exceptional profit-sharing bonus and incentives for firms to grant a bonus of €1 000 to their employees (exempted from corporation tax and employers' social contributions).

Finally, the continued rise in house prices, like the strength of the stock market, also gave an additional incentive, via the wealth effect, for households to reduce their saving ratio.

For a long time, the French household saving ratio has been above the euro-zone average. It began to fall in 2003, in contrast to rises in Italy and Germany where, among other things, house prices have been much more subdued. As a result, in 2005 the French saving ratio was similar to those of Germany and Italy. The saving ratios of countries in the euro zone nevertheless remain much higher than in the United States, where it was even negative in net terms (deducting the consumption of fixed capital) in 2005. This enormous discrepancy reflects the greater dynamism of consumption by American households, on the back of increased borrowing. It also reflects the strong growth of the American property market, as well as the nature of the American retirement pension system, which is based to great extent on investment in equities, whose yields have been high recently.

Slowdown in expenditure made by government on behalf of households

Expenditure for the benefit of households and financed by general government (known as "individual expenditure" because the beneficiary is easily identifiable) rose by 2.0 % in value and by 1.7 % in volume, having slowed down distinctly since 2003. This expenditure covers mainly education and healthcare, which account for more than 80 % of the total. Individual healthcare expenditure had risen sharply in volume between 1997 and 2004, but the growth eased in 2005, falling to 4.5 % from 6.6 %.

For the second consecutive year, individual expenditure rose less rapidly than households' final consumption expenditure (financed by the households themselves). This therefore helped to ease the tendency in their actual consumption (the sum of individual expenditure by government and households' final consumption expenditure), whose growth fell back to 1.9 % from 2.3 % in 2004.

Continued decline in the public deficit

In 2005, the public deficit as defined in the Maastricht Treaty came to 2.9 % of GDP (compared with 3.7 % in 2004 and 4.2 % in 2003). This decline was due to the fact that the rise in expenditure was more than compensated by the growth in public revenue.

Revenue as a share of GDP rose for the second consecutive year (to 50.9 % compared with 49.6 % in 2004 and 49.2 % in 2003). The ratio of taxes and compulsory contributions rose by almost one percentage point in 2005 (to 44.0 % of GDP compared with 43.1 %) as the result of the new measures (backing for the IEG regime from the general regime, the supplementary civil service regime, the rise in CSG rates) and of the upward tendency in existing taxes. Just as in 2004, government benefited from strong tax revenue (+ 5.4 %, compared with + 6.1 % in 2004, following + 1.9 % in 2003 and + 1.2 % in 2002). It was the current taxes on income and wealth (+ 6.2 %) that made the greatest contribution to this increase. Social contributions also accelerated (+ 4.4 %, following + 3.1 % in 2004).

In 2005, spending rose by 4.1 %, following a slowdown in 2004 (+ 3.7 % compared with + 4.4 % in 2003). The total wages and salaries paid out rose by 3.0 % (compared with + 2.4 % in 2004). Social benefits in cash, up by 4.7 %, made a strong contribution to the acceleration in spending. On the other hand, benefits in kind (+ 4.3 % in 2005) continued the slowdown that began in 2003 (+ 7.6 % in that year and + 5.8 % in 2004). In addition, investment growth remained high (+ 7.1 %). After two successive years' decline, interest payments rose by 1.6 % in 2005 because of the interruption in the downward tendency in interest rates.

The improvement in the public accounts is mainly attributable to the tendency in the social security sub-sector, which benefited in particular from the incorporation of the balance paid by the IEG to the basic organisations as part of the adhesion of their pension regimes (€7.6 billion to the AGIRC supplementary regime and €0.8 billion as *"entry fee"* to the ARRCO supplementary regime) and an increase in their revenue related to the reform of the sickness insurance scheme. On the side of expenditure, benefits paid remained dynamic as a result of the upturn in old age benefits. On the other hand, healthcare reimbursements slowed down, notably because of the introduction of a flat-rate contribution of €1 for each medical act and the slowdown in unemployment benefits due to the decline in unemployment in H2 2005. All in all, the social security deficit, which had widened in two previous years, narrowed distinctly in 2005 (€3.8 billion, compared with €15.9 billion in 2004 and €10 billion in 2003). The central government deficit, for its part, fell slightly.

The public debt as defined in the Maastricht Treaty, which amounted at the end of 2005 to €1 138.4 billion, rose by 6.5 % in 2005 (compared with 7.5 % the previous year). This was equivalent to 66.6 % of GDP (64.4 % in 2004). The French debt ratio is close to the EU average of 63.4 % and to that of the euro zone (70.8 %). ❐

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