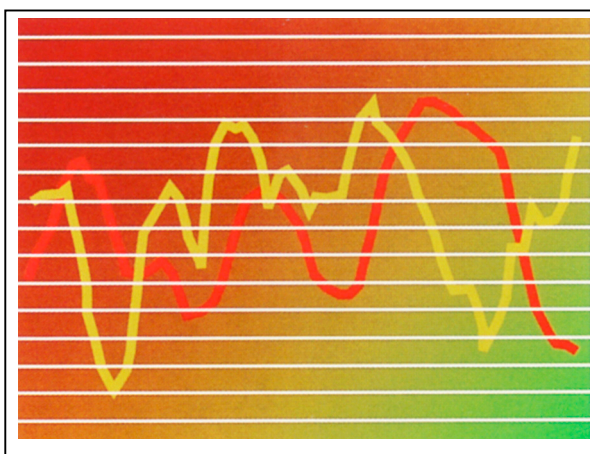


***CONJONCTURE* IN FRANCE**

JUNE 2008



GEARING DOWN

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Gearing down

After a significant weakening in Q4 2007, world growth rebounded in Q1 2008. However, this is a temporary upturn, and the slowdown under way since mid-2007 should span 2008.

Three factors continue to weigh on the global economy. The first is the fall in real-estate construction, which shows no signs of easing and has hit not only the United States but also Ireland, Spain, and the United Kingdom.

The second is the continuing surge in prices of agricultural and oil commodities, which is driving up consumer prices. This levy on purchasing power is combining with the fall in real-estate asset values to curb household consumption.

The third is the persistent financial-market crisis, which is prompting banks to tighten credit access.

Until now, France has eluded the global slowdown, posting further robust GDP growth of 0.6% in Q1 2008. But confidence surveys in all sectors now indicate a downturn in business managers' expectations.

The world economic slowdown is eroding order books. As a result, French manufacturing output should barely grow, if at all, in the quarters ahead.

French household demand is weakening. As in the other industrialized countries, consumption is suffering from the rise in commodity prices and real income is forecast to register limp gains this year. As usual in income-slowdown phases, the saving ratio

should decline, sustaining consumption. But the shift will probably be modest, as households should maintain abundant precautionary saving.

France, too, is now experiencing a real-estate market downturn. Household residential investment, still growing last year, should fall significantly in 2008, as heralded by the drop in housing starts since the beginning of the year.

French GDP growth should thus remain weak until year-end, at 0.0%-0.2% per quarter. Annual average growth should ease to 1.6%. The decline in unemployment, still significant in Q1, is likely to come to a near-halt. Our scenario puts the unemployment rate in metropolitan France at 7.1% by year-end.

The recurrent uncertainties over France's international environment have not disappeared: they include oil, exchange rates, and the pace at which financial tensions may ease.

Our scenario also incorporates two newer uncertainties. On the downside, if the early-2008 decline in housing starts were to continue in the months ahead, household investment might undercut French growth even further. On the upside, the resilience of business investment to date might last longer than expected and thus sustain economic activity, amid lingering pressure on productive capacity. ■

General outlook

Strong Q1 growth in the euro zone and Japan came as a surprise

GDP growth in the advanced economies rebounded mildly from 0.3% in Q4 2007 to 0.5% in Q1 2008. As expected, the U.S. economy remained nearly stagnant and the United Kingdom stayed on a downtrend, moving from 0.6% growth in Q4 2007 to 0.4% in Q1 2008. By contrast, the Q1 upswing proved surprisingly brisk in Japan (1.0%) and in the euro zone (0.8%). Germany's growth rate was particularly high at 1.5%.

But it seems partly overestimated

These performances, however, need to be put into context. Japan has revised its Q4 growth downward and its official statistics may have under-adjusted for the extra leap-year day in February; moreover, the return to normal in building-permit issuance has temporarily boosted households' residential investment. Similarly, in Germany, the working-day adjustment was strongly positive in Q1 (with Easter falling in that quarter) and mild weather stimulated construction activity.

The global economic slowdown may merely have paused

Qualitative surveys continued to indicate a worsening economic climate (Chart 1). The Q1 rebound in world growth, therefore, does not call into question the reality of the current slowdown. The global economy is still burdened by the financial crisis and the inflation surge, which is eroding household purchasing power.

Financial disturbances set to persist in 2008

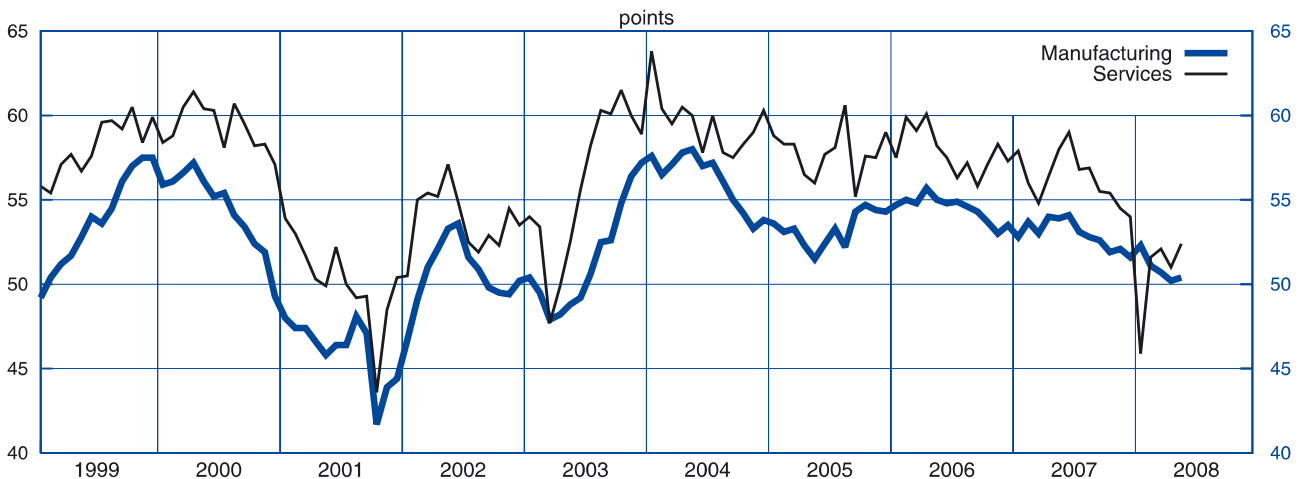
Despite repeated liquidity injections by the main central banks and the U.S. Federal Reserve's interest-rate cuts, money-market tensions persist. This situation—a deterrent to project financing through bank loans—will likely continue in 2008 as long as losses due to the financial crisis have not been totally compensated. Nevertheless, the easing of the flight to quality observed since April seems to herald a gradual alleviation of tensions.

World inflation is high

Oil prices expected to stay high

Inflation is high in most countries. It is fueled by the rise in commodity prices. The barrel price of Brent crude oil has gained approximately 50% since the start of the year, from \$90 in January to over \$135 in early June before dipping slightly. Even if the global economy slows, oil demand is strong and will probably remain so, driven by emerging countries and the Middle East. At the same time, the supply outlook is worrying: OPEC seems unwilling to tap limited spare capacity; the lack

1 - Activity indicator (Purchasing Managers' Index) in advanced economies



Source: INSEE

of investment is cramping Russian production; and geopolitical tensions, especially in Nigeria, continue to disrupt oil extraction. The Brent barrel price should therefore stay high, fluctuating around \$130 between now and year-end.

Food inflation is hitting the emerging countries especially hard

Prices of staple foodstuffs such as wheat and rice have also reached high levels and their decline can only be gradual (Chart 2), given the time required to expand production. In addition, higher prices for farm equipment and fertilizers have probably curtailed new investment more than usual. Recent natural disasters have hit major rice-producing areas in China and Burma. At the end of the supply chain, the rise in agricultural commodity prices is spreading to processed foods. Its effect is strongest on households that devote a large share of their budget to food, particularly households in emerging countries and the lowest-income households in the advanced economies.

Consumption should suffer

The emerging economies are projected to lose momentum as well, because of inflation—which is undermining household purchasing power—and the world trade slowdown. In most advanced economies, consumption should slow sharply, with the notable exception of the United States, where the tax-rebate stimulus package is giving a temporary but significant boost to household income.

Inflation is narrowing the leeway for monetary policies to cope with the economic slowdown

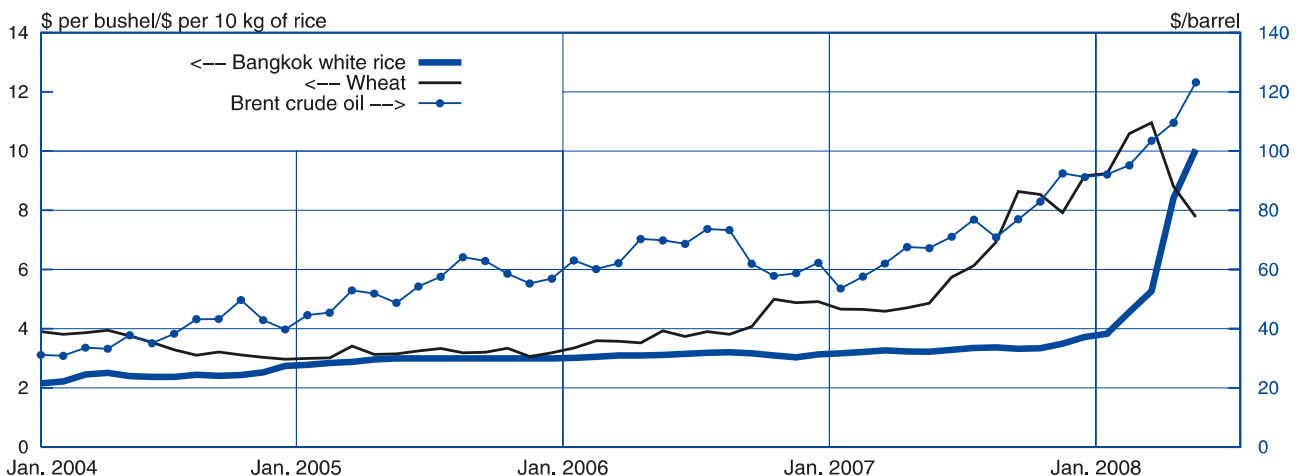
In this inflationary climate, the U.S. Federal Reserve and the Bank of England have recently opted for the status quo in monetary policy. This situation is expected to persist: with inflation exceeding their targets, central banks will have less latitude to respond to the slowdown by easing monetary policy. The European Central Bank (ECB), which has not changed its rate since last summer, actually seems inclined to lift it.

The economic downturn is amplified by the problems of the real-estate sector

The U.S. real-estate crisis is one of the worst since World War II

The economic slowdown is sharpest in countries where the real-estate market has undergone an abrupt downswing. In the United States, the crisis in the real-estate market is not over: home sales are still declining, unsold housing inventories are still at a record high, and housing starts are at a record low. This real-estate crisis is already one of the worst since World War II. Household residential investment continues to plunge, and personal consumption is starting to suffer from the fall in real-estate asset values. U.S. GDP growth should thus be nearly stagnant in the

2 - Oil, bushel of wheat, and rice



Source: INSEE

quarters ahead. In our scenario, however, the economy will continue to be sustained by external trade—boosted by the dollar’s accumulated depreciation—and, temporarily, by the tax stimulus package.

A steep downswing in real-estate prices in the United Kingdom as well

The real-estate market has registered a downswing in the United Kingdom as well. Household residential investment appears to have fallen in Q1, in step with a rather severe adjustment in real-estate prices. We expect anemic GDP growth by year-end.

By and large, the real-estate market situation is less worrying in the euro zone

The real-estate situation is less worrying in the euro zone as a whole, although real-estate markets are adjusting severely in some countries such as Spain, Finland, and Ireland—and others may follow. Moreover, non-residential investment should keep total construction investment on a growth path. Unlike the U.S. and U.K., the euro zone should continue to enjoy slightly firmer domestic demand thanks to stronger wage growth, particularly in Germany and Italy. Nevertheless, consumption will likely be constrained by high inflation, and external trade should suffer from the euro’s appreciation to date and the world slowdown. We therefore expect GDP growth to remain modest, as suggested by the steadily rising pessimism recorded in EU confidence surveys.

French external trade likely to be hurt by slacker global demand

French exports projected to stall

After the pleasant surprise of Q1, French exports are likely to have stalled by Q2, undermined by a lackluster international environment and the euro’s accumulated appreciation. The latest customs data and the expected downturn in imports by France’s main EU partners point to a 0.1% contraction. Our forecast shows anemic exports in H2, as suggested by the nearly uninterrupted fall in international order bookings since end-2007.

Import growth headed for stagnation

French import growth should slow as well. Imports are projected to stagnate in Q2 because of a negative rebound effect after a buoyant Q1, notably for energy purchases. The domestic-demand slowdown should restrict annual average growth of total imports to 2.7% in 2008.

External trade likely to drag down growth

All in all, French external trade is unlikely to keep up the good performance of late 2007 and early 2008. External trade is forecast to make another slightly negative contribution to GDP growth, and the trade deficit is set to widen.

The French labor market continued to improve

Gradual slowdown in employment seen for 2008

French employment boomed in 2007, with more than 380,000 jobs added, of which 352,000 payroll jobs in market sectors. In 2008, the economy is likely to add only 200,000 jobs, including 193,000 payroll jobs in market sectors. The first reason is a gradual adjustment in market-sector employment to the economic downturn. The second is that exits from subsidized work programs should continue to exceed entries, curbing the rise in non-market payroll jobs. But the employment slowdown will probably be gradual. Business services, with 79,000 new jobs, and personal services, with 70,000 new jobs, are expected to remain the top job-creating sectors.

The decline in unemployment should be modest

In Q1, unemployment under the International Labour Organization (ILO) definition eased by another 0.2 points. As in Q4 2007, this decline is steeper than what one would have expected from employment growth and the trend rise in the active population. From Q2 onward, slacker employment growth and the active population’s return to trend should limit the decrease in unemployment, which our scenario puts at 7.1% by end-2008.

Inflation cuts purchasing power

Nominal household income projected to slow in 2008

In our H1 2008 scenario, gains in wage and salary income will remain fairly brisk thanks to the robust labor market. By contrast, they will gradually lose momentum in H2 because of the employment slowdown. Moreover, compulsory levies (taxes and social contributions) should grow at a faster pace in 2008, despite the moderating effect of the “TEPA” Act to promote labor, employment, and purchasing power. The likely uptrend will be driven by two factors. First, income tax should return to its normal growth rate after a one-time cut in 2007. Second, the introduction of a withholding system for collecting the Contribution Sociale Généralisée (CSG) on asset and investment income should entail an earlier payment of this tax, which is levied on all forms of income and serves to fund the social-insurance system. In our scenario, growth in nominal household income will slow from 2.8% in H2 2007 to 2% in H1 2008 and 1.3% in H2 2008.

Year-on-year inflation heading toward 3.6% this summer

This slowdown coincides with a steep rise in consumer prices. Food inflation should remain high, as the surge in agricultural commodities will continue to impact consumer prices. In addition, the new jump in oil prices is driving up energy inflation. The total year-on-year rise in retail prices is forecast to exceed 3%, peaking at 3.6% this summer (Chart 3). Under the conventional hypothesis that the barrel price of Brent will remain stable at around \$130, energy inflation should start to decline in the fall, leading to a reduction in year-on-year consumer-price growth to 2.8% or so by end-2008.

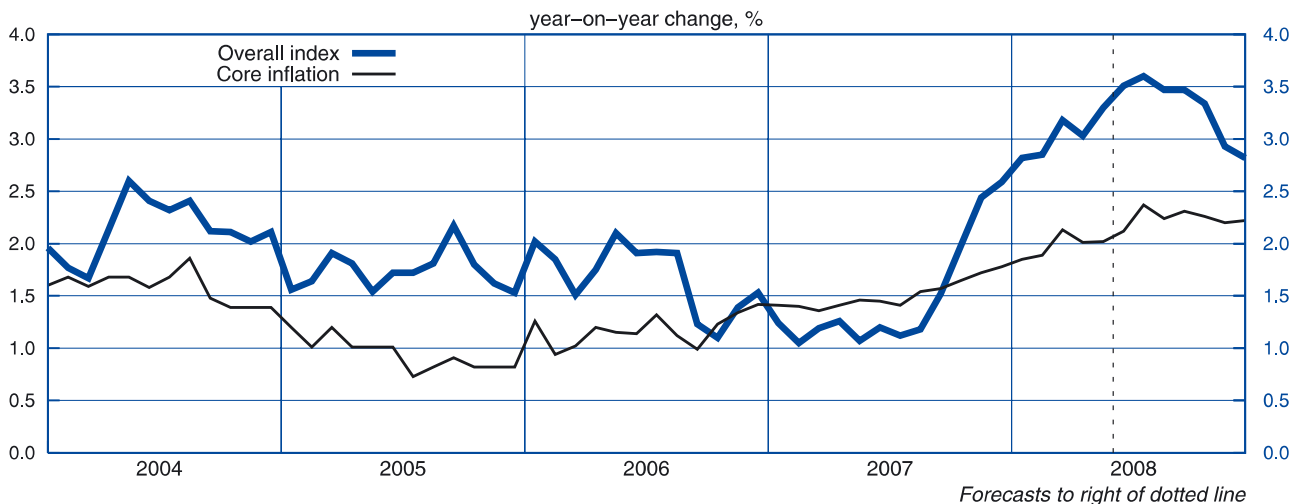
Core inflation slightly over 2%

The steady uptrend in core inflation since the start of 2006 is therefore expected to continue, reaching 2.2% year-on-year in Q4 2008. This pattern reflects the gradual spread of commodity price rises to goods produced in France and abroad, in particular processed foods and non-energy industrial goods. However, the transmission of higher producer prices to consumer prices may ease somewhat, as the “Modernization of the Economy” Act and the Chatel Act should begin to dampen price growth in large retail chains.

Inflation should average 3.2% in 2008

Our scenario sees annual average inflation climbing from 1.5% in 2007 to 3.2% in 2008—a level not observed in over fifteen years (the same value of 3.2% was recorded in 1991). The rises in food prices and energy prices should each contribute about one percentage point to the total increase.

3 - French consumer prices



Source: INSEE

Purchasing-power gains should remain modest throughout 2008

Rising inflation and slower income growth are expected to result in weak gains for real household income. We project weak annual average growth of 0.9%, or 0.0% per consumption unit. In particular, real wages per capita will slow sharply. The impact of these changes on consumption should be dampened, as households are likely to tap their extra savings accumulated in 2007. The saving ratio should therefore dip from 15.7% in 2007 to 15.3% in 2008.

Domestic demand expected to weaken

A sharp slowdown in consumption

However, consumption growth may have trouble rebounding after its slippage from 0.6% in Q4 2007 to 0.1% in Q1 2008. Its quarterly gains this year should range between 0.1% and 0.3%, well below the long-term trend. Food consumption will continue to suffer from rising food prices. However, the early release of employee share ownership plans authorized by the "TEPA" Act to boost purchasing power may provide some stimulus to consumption in H2.

Household residential investment set to decline

French household investment is poised to decline in Q2 after a stagnant Q1, for three reasons. First, the housing-start data are admittedly fragile owing to a change in collection method, but the downturn is so steep that its reality does not seem in doubt. Second, unsold new-home inventories have topped their 1992 peak and the number of transactions has slumped since end-2007. Third, real-estate prices seem to have leveled off and interest rates on housing loans have edged up since summer 2007. The downturn in household residential investment is now under way in France, although some uncertainty remains over its scale.

Productive investment forecast to show some resilience

The strong consumption slowdown and weaker household investment will likely erode French domestic demand. By contrast, productive investment may give it mild support. In the short run, its slowdown should be moderate, from 7.3% in 2007 to 4.4% in 2008. The deceleration in economic activity and tighter credit access will not encourage new projects. But the enduring vigor of investment until early 2008 could mean a slower downswing than in previous cycles.

A weak growth forecast

French growth forecast at 1.6% in 2008

On balance, we expect very moderate French growth between now and end-2008. After the 0.6% rebound in Q1, it should range between 0.0% and 0.2% per quarter. Our baseline scenario ("*Focus: Assessing uncertainty over the forecast*") puts annual average GDP growth at 1.6% in 2008.

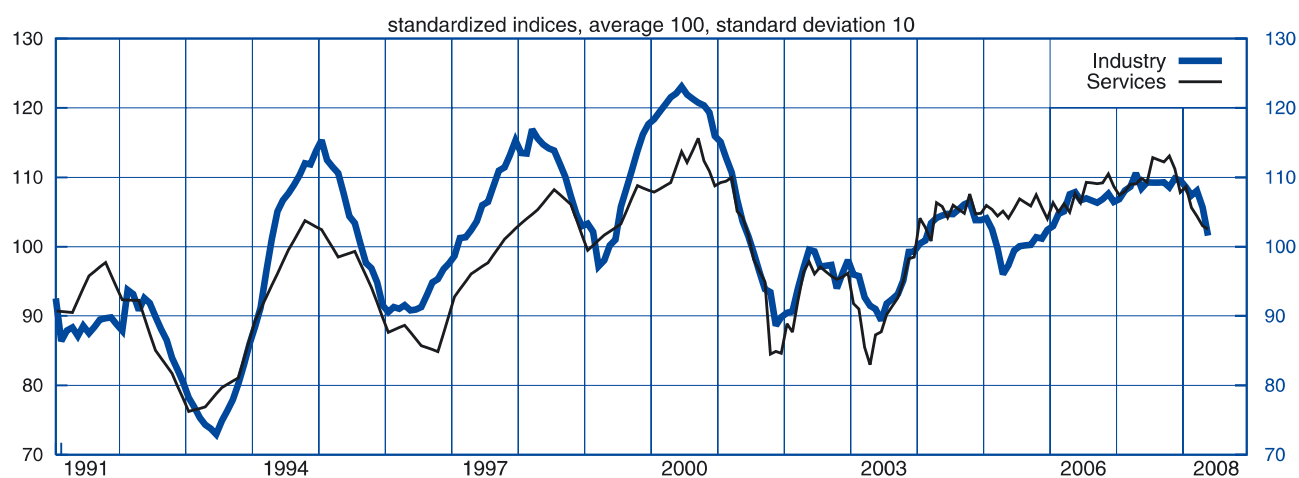
The rising pessimism reported in surveys is expected to translate into an activity slowdown by Q2

The rising pessimism measured by confidence surveys in all economic sectors (Chart 4) will likely materialize into a clear economic slowdown by Q2. We notably expect production to dip sharply in the service sector and to decline in the construction industry. In our H2 scenario, production will remain slack: market services will be hit by the consumption slump; manufacturing output will stagnate, in line with the weaker production outlook in the May survey; production in the building and civil-engineering sector will suffer from the real-estate downturn and the customary fall-off in public-works spending after the municipal elections.

The main uncertainty is the scale of the real-estate downturn

The scale of the real-estate market contraction is a significant downward uncertainty in our scenario, as our forecast assumes that the fall in construction starts will not last. On the positive side, the persistent vigor of business investment may extend beyond the start of the year. Today's relatively atypical productive-investment cycle may thus result in a milder-than-expected slowdown in total investment. ■

4 – French business climate in industry and services



Source: INSEE

France: supply and use

in real terms, at previous year's chain-linked prices, seasonally and working-day adjusted, quarterly and annual changes, %

	2006				2007				2008				2006	2007	2008
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
GDP	0.7	1.0	0.0	0.5	0.6	0.6	0.7	0.3	0.6	0.2	0.0	0.2	2.4	2.1	1.6
Imports	1.0	2.0	-0.5	1.7	2.3	1.8	1.8	-1.1	1.9	0.0	0.3	0.5	6.5	5.9	2.7
Household consumption	0.9	0.1	0.5	0.4	0.8	0.8	0.6	0.6	0.1	0.1	0.1	0.3	2.5	2.5	1.3
Public consumption ¹	0.5	0.4	0.2	0.4	0.2	0.4	0.4	0.3	0.2	0.4	0.3	0.3	1.4	1.3	1.2
Total GFCF ²	0.8	2.1	0.8	1.9	1.2	0.6	1.0	1.1	1.1	0.0	-0.4	-0.4	5.0	4.9	2.2
of which:															
NFEs ³	0.5	2.5	1.1	2.7	2.0	1.1	1.7	1.2	1.8	0.4	0.2	0.6	5.4	7.3	4.4
Households	1.9	2.3	1.4	0.8	0.5	0.3	0.3	0.8	0.0	-1.1	-1.7	-2.5	7.1	3.0	-1.5
Exports	2.3	1.9	-1.4	1.0	0.9	1.6	1.1	-0.2	3.1	-0.1	0.0	0.3	5.6	3.2	3.9
Domestic demand excluding change in inventories	0.8	0.6	0.5	0.7	0.8	0.7	0.6	0.6	0.4	0.1	0.1	0.2	2.8	2.7	1.5
Change in inventories ⁴	-0.4	0.4	-0.2	0.0	0.2	-0.1	0.3	-0.6	0.0	0.1	0.0	0.0	-0.1	0.2	-0.2
Net foreign trade	0.3	0.0	-0.2	-0.2	-0.4	-0.1	-0.2	0.3	0.3	0.0	-0.1	0.0	-0.3	-0.8	0.3

Forecast

1. Expenditures by general government and non-profit institutions serving households (NPISHs)
2. Gross fixed capital formation
3. Non-financial enterprises
4. Including acquisitions net of sales of valuables

Source: INSEE

Focus: Assessing uncertainty over the forecast

The forecasts in this report are shown as precise values. For instance, we forecast France's annual average GDP growth at 1.6% for 2008. Assuming that INSEE forecasts are not consistently over-optimistic or over-pessimistic—in other words, that they are “unbiased”—this forecast may be regarded as the expected or average figure given the information available today.

However, the forecast is not free of uncertainty. This is due to the many shocks that may affect the international environment in regard to oil prices, exchange rates, interest rates, and other variables. Another source is economists' imperfect knowledge of the behavior of French and international economic agents, such as household saving ratios and business firms' expectations concerning demand. Such behavior can be estimated only imprecisely over the past. It can also change, and may diverge in the forecasting period from its past pattern.

The potential scenarios are therefore numerous. Yet it would be impractical to present all of them: one issue of “*Conjoncture in France*” would not suffice! That is why, as a rule, forecasters condense their analysis into a single, “baseline” scenario.

In so doing, the readers of our report—and, indeed, its producers—may lose sight of the uncertainty inherent in this type of exercise. To dispel this risk, we describe two complementary approaches that will provide a concise illustration of the uncertainty affecting our forecast:

- a “fan chart” modeled on the Bank of England's approach, which depicts in graphic form the overall uncertainty surrounding the GDP growth forecast;
- an assessment of how divergences concerning selected key variables (exchange rates, oil prices) could impact the overall scenario—all other things being equal.

Systematic uncertainty surrounding the forecast: the “fan chart”

Popularized by the Bank of England, the *fan chart* plots the distribution of scenario probabilities around the baseline forecast. The first and darkest band covers the most likely outcomes around the baseline scenario: these scenarios combined have a total probability of 10%. If we add the two lighter bands just above and just below the central band, the combined probability of the three central bands reaches 20%. We can repeat the process moving out from the center, from the darkest to the lightest bands, up to a combined probability of 90%. Thus, as the bands widen, they cover an ever-wider range of possible outcomes.

To construct the fan chart shown here, we estimated the width of these bands from the time series of forecasting errors in the “*Conjoncture in France*” reports published by INSEE between 1989 and 2006. The rationale for this is as follows: assuming no change in the volatility of growth figures and the methodology used by INSEE forecasters during the period, the distribution of forecasting errors calculated from past exercises is a reliable indicator of the distribution of future errors and hence of the uncertainty surrounding a given forecast. These hypotheses seem “heroic” but, in practice, we observe no downtrend (fortunately!) or uptrend (alas!) in forecasting quality.

We computed forecasting errors by comparing the GDP growth forecast with the figure published in the preliminary quarterly accounts. We may regard these errors as obeying a zero-mean normal distribution in each quarter, with standard deviations of 0.28%, 0.33%, and 0.37% for the first, second, and third forecasting quarters respectively. Concerning the forecasts published in “*Conjoncture in France*,” the outcome for the first forecasting quarter (Q2 2008 in this issue) has, for example, a 90% probability of lying within an interval of $\pm 0.45\%$ ¹ around the forecast.

These values may seem high. But they are lower than the volatility of the GDP growth figures derived from the preliminary quarterly accounts, which display a standard deviation of 0.43% for the same period. Moreover, they are comparable to the values chosen by the Bank of England to build its own fan chart for the period Q4 1997-Q2 2006.² Thirdly, we can substantially reduce the interval if we limit ourselves to a 50% probability.

Fan charts constructed by central banks are based on past forecasting errors but, in some cases, they may diverge from the historical record depending on the risk analysis by members of their monetary policy committees. Today, for instance, financial-market turmoil has arguably made forecasts more uncertain than usual. In some circumstances, we may consider that the risks surrounding the likeliest scenario—the one set out in the report—are asymmetrical. For example, the Bank of England made such an assumption when British households received one-time dividends after several building societies were “demutualized” and turned into banks in 1997. The Bank believed that these extraordinary dividends would have a weak impact on consumption and hence on growth; but the main risk incurred by the Bank of England was clearly that of understating the impact, and therefore of underestimating rather than overestimating GDP growth. This assessment of risk asymmetry is important for central banks, as events that diverge very significantly from the baseline forecast (such as a decline in consumer prices) can have disastrous consequences (such as triggering deflation).

In this report, however, we have chosen not to depart from the historic variance of forecasting errors, as the injection of a dose of subjectivity seems hard to justify.

The fan chart built on the scenario in this report may thus be interpreted in the following ways (*Chart 1*):

- The baseline forecast for Q2 2008 is 0.2%, which should be viewed as the most probable figure.
- The corresponding figure that will be published in the quarterly accounts has a 50% chance of ranging between 0.0% and 0.4%. With a higher degree of probability (90%), we can say that it ought to range between -0.3% and 0.6%. The likelihood

1. I.e., the product of 0.28 times 1.65, the value that a zero-mean normal distribution will exceed in absolute terms in 10% of cases.

2. At the time, the Bank of England had chosen 0.28%, 0.55%, and 0.73% as the average standard deviations for the corresponding year-on-year values. As regards INSEE's forecasting errors, the average standard deviations for these year-on-year values are 0.28%, 0.40%, and 0.71% respectively.

that growth will be weaker in Q2 than in Q1 is therefore very high. Moreover, the probability of the quarterly-accounts figure being negative is not negligible, at around 30%.

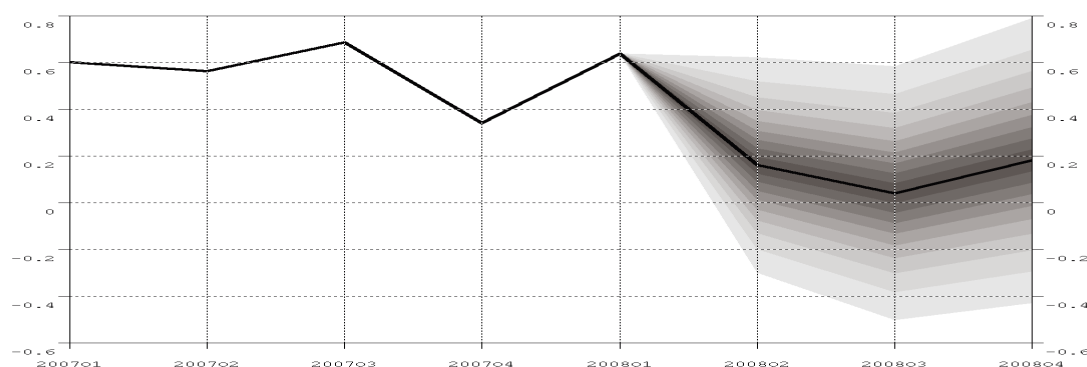
- For Q3, the uncertainty over the forecast is slightly higher. We estimate that the figure to be published in the quarterly accounts has a 50% chance of ranging between -0.2% and 0.25%, and a 90% chance of ranging between -0.5% and 0.6%. As with Q2, the likelihood that the figure will be lower than Q1 growth is high, at over 95%. And the risk that the quarterly-accounts figure will be negative rises to nearly 50%.
- For Q4 2008, the uncertainty is higher still. As against a forecast 0.2%, the figure to be published in the quarterly accounts has a 50% chance of ranging between -0.1% and 0.4%, and a 90% chance of ranging between -0.4% and 0.8%. The likelihood that the figure will exceed Q1 growth remains weak, at around 10%. The probability of a negative quarterly-accounts figure is approximately 30%.

Under certain assumptions, we can construct the same type of chart for 2008 annual average GDP growth. As against a 1.6% baseline forecast, the first annual growth rate to be published in the national accounts has a 50% chance of ranging between 1.3% and 1.8%. It has a 90% chance of ranging between 0.9% and 2.2%. The probability of exceeding 2% is low: we estimate it here at approximately 15% (Chart 2).

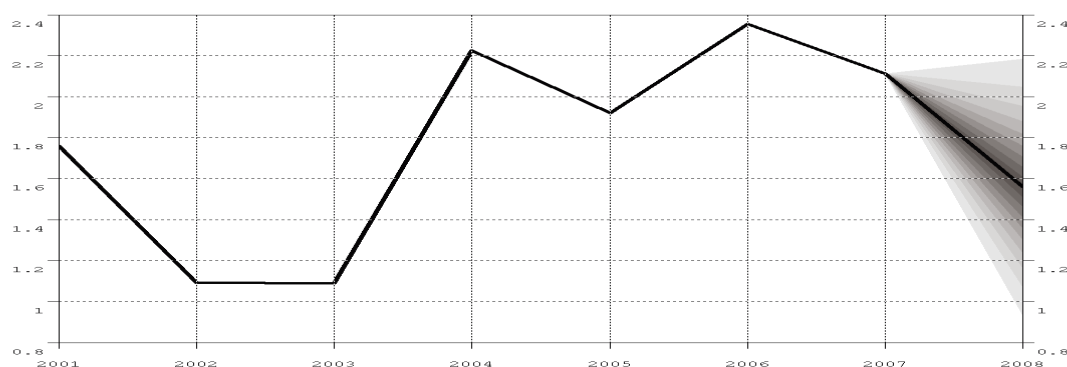
The impact of different oil-price and exchange-rate hypotheses on our forecasts

Among the shocks that can cause the economy to diverge from the forecast in this report, the most important concern oil prices and the euro exchange rate. The scenario offered here rests on the hypothesis that these variables will remain stable over the forecasting horizon. Nevertheless, their volatility has been so high

1 – Fan chart for "Conjoncture in France" scenario (quarterly forecasts)



2 – Fan chart for "Conjoncture in France" scenario (annual forecasts)



in recent years that their actual levels within this period may turn out to be much higher or much lower than those specified in our forecast.

For instance, the forecast in our June 2007 “*Conjoncture in France*” report assumed stable oil prices at around \$65/barrel for Brent crude and a stable exchange rate of around \$1.35 per €. In the event, the barrel price rose to \$75 in Q3 and \$89 in Q4. As for the euro, it appreciated in H2 2007, reaching \$1.37 in Q3 and \$1.45 in Q4.

If actual changes diverge very significantly from those specified in our scenario, the impact on Q2 should be negligible, as actual oil prices and exchange rates are largely observed (two and half months out of three) by the time we finalize our forecast. But later quarters are likely to be far more affected.

We cannot describe the resulting scenarios with precision, for beyond these changes in assumptions, it is important to establish their causes. For example, an identical increase in oil prices may be due to stronger demand, scarcer supply, or greater geopolitical tensions—with very different implications for underlying world growth, which we would need to incorporate into a full scenario. Accordingly, we provide orders of magnitude obtained with “standard” simulations using macroeconomic models (Tables 1 and 2). The uncertainty over the specific effects of the shocks mentioned is not insignificant.

These results enable us to estimate the consequences of, for example, lower oil prices averaging \$110 in H2 2008. In other words, oil prices would be \$20 below our baseline scenario in this forecast. *All other things being equal*, year-on-year inflation would be 0.4 points lower in Q3 and 0.7 points lower in Q4 (Table 1). In the baseline scenario, year-on-year inflation would reach 2.8% in December. With oil prices at \$110 in H2, it could ease to around 2%. GDP growth would be mildly higher in Q3 at 0.1% instead of 0.0%, and 0.2 points higher in Q4 at 0.4% instead of the forecast 0.2%. Annual average GDP growth for 2008 would be 0.1 points higher at 1.7% instead of 1.6%.

We can use the same approach to estimate the effects of an H2 oil price \$20 higher than in our baseline scenario, at \$150 instead of \$130, for we can regard the impact as symmetrical to the previous one. *All other things being equal*, year-on-year inflation annual would be 0.4 points higher in Q3 and 0.7 points higher in Q4, reaching 3.5% at year-end. GDP growth would be 0.1 points below baseline in Q3 and 0.2 points below in Q4. Its values would thus be negative or null in both quarters. Annual average growth would come to 1.5%.

We can also illustrate the impact of an appreciation of the euro’s effective exchange rate (Table 2). Let us suppose, for example, a 5% appreciation in Q3. This would put the H2 appreciation at one-half the value observed between May 2007 and April 2008, but over a period twice as long—i.e., a 9.3% appreciation against other currencies, weighted by the share of those currencies in the competition faced by French exporters. On the basis of those same changes observed in the past year, the euro would reach \$1.67 (instead of \$1.55), £0.86 (instead of £0.79), and ¥161 (instead of ¥162). French GDP growth, *all other things being equal*, should accordingly be 0.1 points weaker in Q3 and 0.05 points weaker in Q4, resulting in slightly negative growth (-0.1%) in Q3 and slightly positive growth (0.1%) in Q4. This would put annual average growth at 1.5% (Table 2).³

The impact of an equivalent depreciation of the euro (to \$1.44, £0.73, and ¥160) should be symmetrical. French growth might then strengthen to 0.2%-0.3% in Q3 and Q4. This would lift annual average growth to 1.7%.

We remind readers that these calculations are merely illustrative, but they offer orders of magnitude for the uncertainty over the forecast due to the sole fact that major variables such as exchange rates and oil prices can undergo wide swings that are extremely hard to predict. They also allow readers who do not share INSEE’s assumptions on the variables to adjust our forecasts so as to fit their own hypotheses. Obviously, this does not exhaust all potential sources of uncertainty. ■

3. For the sake of legibility, Table 2 shows a 10% effect and not a 5% effect as in the simulation described above.

Table 1

**Effect of \$20 decline in barrel oil price at constant exchange rate
(divergence from “*Conjoncture in France*” scenario)**

	2008 - Q3	2008 - Q4	2008 (annual average)
GDP growth (points)	0.1	0.2	0.1
Inflation (y-on-y CPI) (points)	-0.4	-0.7	-0.4
Employment (thousand)	0	20	5

Source: INSEE simulation, based on *Mésange* and NIGEM models

Table 2

**Effect of 10% rise in euro against other currencies
(divergence from “*Conjoncture in France*” scenario)**

	2008 - Q3	2008 - Q4	2008 (annual average)
GDP growth (%)	-0.3	-0.1	-0.2
Inflation (y-on-y CPI) (%)	-0.1	-0.1	-0.1
Employment (thousand)	-25	-50	-20

Source: “*Les effets macroéconomiques de la hausse de l’euro*,” Note de conjoncture (French edition of “*Conjoncture in France*”), INSEE