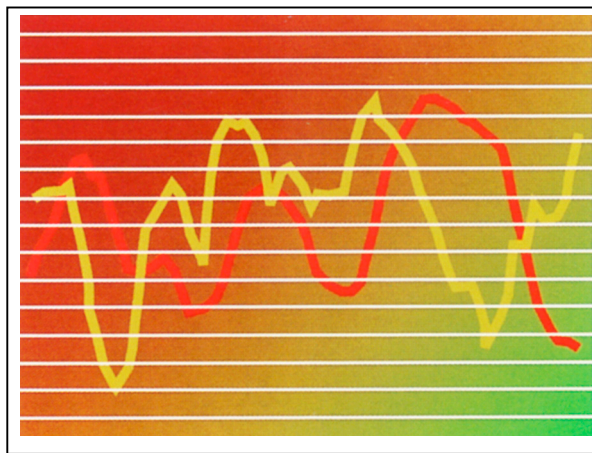


CONJONCTURE IN FRANCE

DECEMBER 2009



DISPARITIES

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DISPARITIES

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Disparities

In Q3 2009, it became clear that most of the advanced countries were coming out of recession, thanks to improving financial conditions and the stimulus plans implemented in the course of 2009. For Q4, the economic outlook continues to improve on the whole, according to business leaders. In particular, the boost provided by world trade looks set to remain strong, although slightly less so than in the previous quarter.

However, this general trend does hide some divergences: prospects are weakening in certain zones (United States, Japan, Spain), or in certain sectors. In France, the business climate is improving strongly in services, but it is marking time in industry and remains depressed in construction.

Our scenario makes a distinction between two groups of countries with clear differences in growth trends through to mid-2010: the first group (Japan, United Kingdom, Italy, and Spain) is likely to be held back by weak domestic demand, for a variety of reasons: activity there looks set to stagnate or even take a fresh downturn in coming months. In the second group (United States, Germany, France), business and household demand should rise again, sometimes boosted by the extension of State support, although it is likely to prove difficult for growth rates to return to their long-term trend.

France should therefore be one of the countries benefiting from an upturn, although it is likely to be a laborious one. The French economy should grow through to mid-2010 at a rate close to 0.4% per quarter. This regular rhythm hides a slowdown in industry, however, after an upturn in mid 2009. On the other hand, although not completely at an end, the adjustment in the property market should hold

growth back less and less in coming quarters. Service-sector activity, meanwhile, should continue to buoy up the economy.

For businesses, the upturn in demand is likely to be slow: investment should resume gradually with the return of growth, but still-considerable overcapacity is likely to limit the upturn. Market sector employment is likely to decline further, meanwhile, as companies continue to improve their productivity. Unemployment is therefore likely to continue rising through to mid-2010, although less quickly than in previous quarters. Household purchasing power should slow down in H1 2010: it is likely to be hit by an upswing in inflation coming from rising commodity prices, as well as by the disappearance of the exceptional support measures implemented in 2009. It should progress moderately, however, thanks to more dynamic earned income.

French growth should therefore be driven by its traditional powerhouse, consumption, although it will not be operating at full speed: after the marked upturn in Q4, explained by the “scrapage allowance”, household consumption should then increase at a rate of 0.2% per quarter.

The rate at which companies build up their stocks could be an unknown factor in our forecast that might have a key positive effect: the upturn in stocks could prove to be more pronounced than we have forecast here. On the other hand, the after-effects of the end of scrapage allowances in France and abroad could be more brutal than expected. Finally, and on a more general note, the recession is coming to an end without any major correction of the imbalances on real-estate markets or of excessive debt levels, and these are factors that could have negative impacts on household consumption or investment in the coming quarters. ■

Emerging from recession in scattered order

Not all the advanced economies have emerged from recession yet

After levelling out in Q2 (0.0%), activity in the advanced economies rose in Q3 2009 (+0.5%), mainly thanks to the stimulus plans and the return to normal of the financial situation, boosting household demand and stabilising that of businesses. However, this upturn in activity has not been the same everywhere, and some countries are still in recession. For instance, while the upturn in activity has been clear in the United States, Germany, Italy and Japan, it has been more moderate in France, and Spain and the United Kingdom are yet to come out of recession.

The advanced economies are also boosting world trade

In Q2, the upturn in demand in emerging countries led to world trade levelling out after falling for two quarters (see graph 1). In Q3, with demand also improving in the advanced economies, world trade increased noticeably (+4.3%). This was of particular benefit to those economies that are highly dependent on foreign trade, such as Germany and Japan. For example, Japanese exports continued the strong upturn they had enjoyed in Q2 (+6.5% in Q3, the same figure as in Q2) and those of Germany improved distinctly (+3.4%), thereby contributing to the upturn in those countries.

Dynamism restored to emerging economies

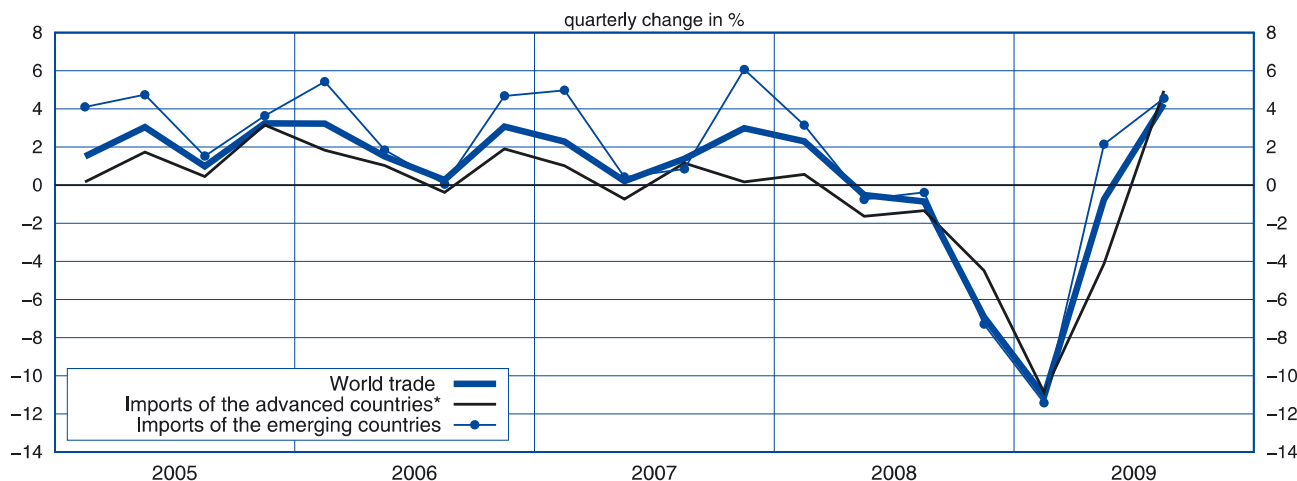
In the emerging countries, and more particularly those in South-East Asia, activity progressed clearly in Q3 2009: productive investment and exports were highly dynamic there. In China in particular, growth was buoyed up by implementation of the stimulus plan and the easing of credit extension terms. The strength of the Chinese economy has pulled the whole of South-East Asia along in its wake.

Financial markets return to normal, property markets pick up

Financial conditions return to normal but remain difficult

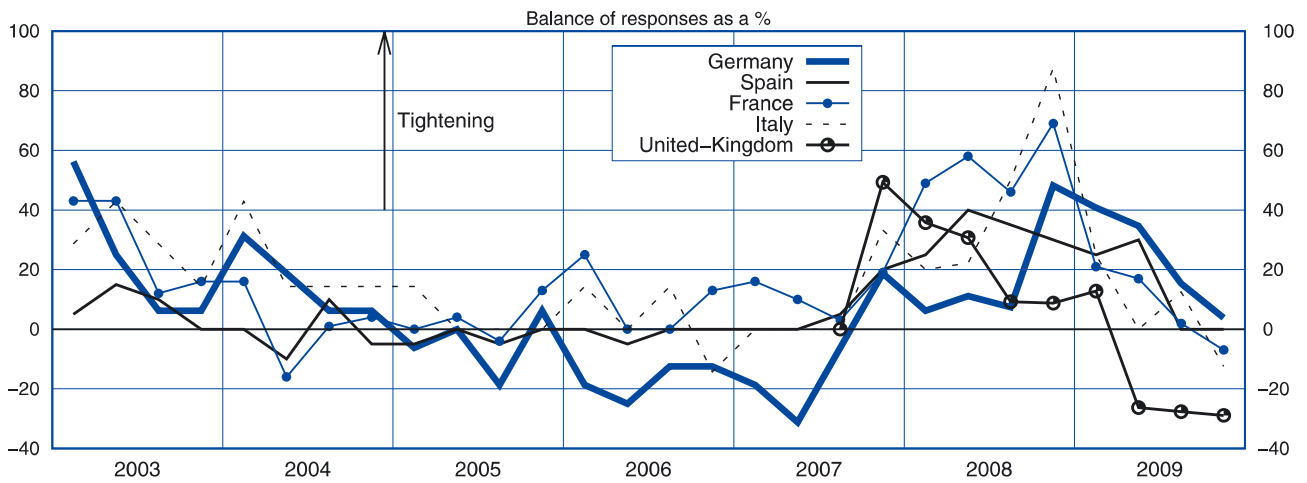
Interbank markets have seen a return to normal in Q3 and this is having a knock-on effect on the interest rates banks offer households and businesses. These rates have fallen considerably since the high point reached after the Lehman Brothers bankruptcy. Likewise, the number of banks declaring that they are tightening their financing terms has dropped distinctly. However, the cost of financing for businesses remains higher than that observed in early 2007, and although the banks are no longer tightening the conditions on which they grant loans, they have not yet started easing them, except in the United Kingdom (see graph 2). All in all, financing conditions for households and businesses should continue to improve in coming quarters, although they should remain tougher than they were prior to the crisis.

1 - World trade, imports of the advanced and emerging economies



* OECD minus Turkey, Mexico, Korea and Central Europe
Source: Centraal Planbureau

2 - Lending criteria to businesses



Source: national central banks

After a brutal crisis, real estate seems to be picking up

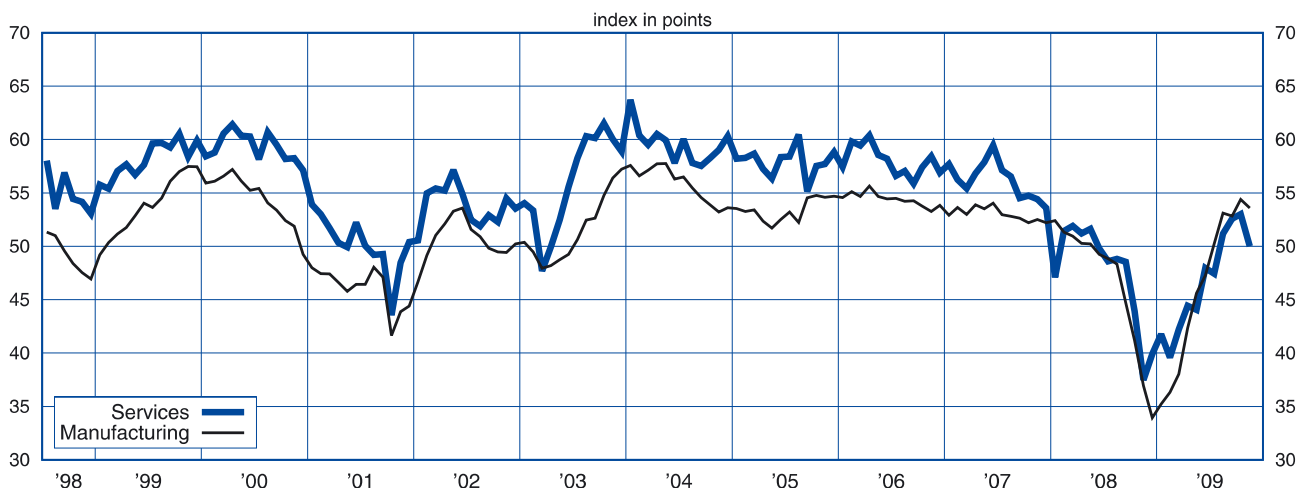
In many countries, property markets seem to be picking up after the violent crisis they have been through. For example, prices and transaction volumes are on the up in the United States and United Kingdom. In France, the prices of old dwellings have levelled out in Q3 and new housing stocks have fallen back sharply thanks to an upturn in sales. In Spain, the fall in prices has slowed down since Q2. However, the signs of improvement are still weak. In addition, levels of activity in the housing construction sector and transaction volumes are well below their pre-crisis levels.

Differences remain between the performances of the advanced economies

Moderate world growth...

At the start of Q4 2009, businesses in the advanced economies are reporting that the business climate continues to improve, in industry and services alike (see graph 3). Overall, the GDP of the advanced economies should grow by about 0.4% a quarter through to mid-2010 (after +0.5% in Q3). This more moderate growth of the advanced economies is due to less support from stimulus plans. It is likely to weigh on world trade, which should see a slight slowdown.

3 - The world* business climate continues to improve



*Purchasing Manager' Index (PMI)
Source: Data Insight, Markit

... hiding big disparities

This average growth through to mid-2010 is likely to hide major variations between the advanced economies. On the one hand, several countries should be somewhat dynamic. Activity in the United States should continue to benefit from the stimulus plan providing considerable household purchasing power support measures in the first half of 2010. Activity in Germany should continue to increase in H1 2010 (+0.4% then +0.5%): investment should remain dynamic there and the support provided under the stimulus plan to boost purchasing power should keep consumption stable, while exports should slow down only slightly. On the other hand, however, and for reasons specific to each of them, another group of countries should record very weak growth: Spain should continue to be very hard hit by the property crisis; the weakness of Italian domestic demand, which has hardly been supported by a stimulus plan at all, should hold back activity; that of the United Kingdom should be clearly penalised by the rise in VAT on 1st January; domestic demand in Japan should continue to be handicapped by the chronic weakness of household income.

French exports will gradually moderate their growth

In the wake of world trade trends, world demand for French products should slow down somewhat through to mid-2010, returning to its average growth. French exports should follow a similar trend: after a leap of 2.3% in Q3, they should progress by 1.3% in Q4, then by 1.0% in the next two quarters. Overall, they should be sharply down over 2009 (-10.8%) but their growth overhang in mid-2010 should be clearly positive (+4.1%).

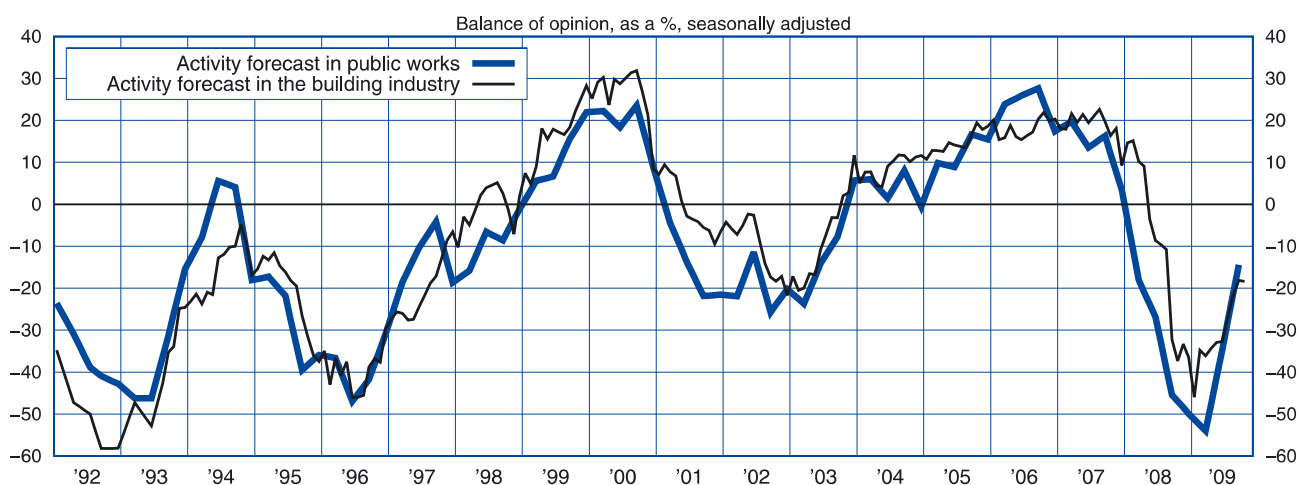
In France, a moderate rise in output in industry and services...

Industrial output accelerated distinctly in Q3 2009. For the coming quarters, the business tendency surveys continue to improve, but more moderately. They also suggest there will be an increase in production but at a less sustained rate. All in all, over 2009 as a whole, the fall in industrial output should therefore remain considerable (-11.0%), but the growth overhang for 2010 at the end of Q2 should be clearly positive (+2.8%). In services, the rise in activity was robust in Q3 and that should carry on through to mid-2010.

... and a smaller fall in construction

In contrast, production in the construction sector again contracted significantly in Q3 2009: -2.1% after -0.7% in Q2 2009. This contraction affected both the building and public works sectors. The upturn in the business tendency surveys, however, suggests that the decline in activity in this sector should become less and less pronounced (see graph 4). The drop in activity over 2009 as a whole should be marked (-5.6%), while the growth overhang at mid-2010 should still be very much in the red (-3.3%).

4 - Construction activity trends



Source: INSEE and National Federation of Public Works

In France, growth set to be moderate

Economic activity should show moderate growth in France over the next three quarters (about +0.4% per quarter), with the slowdown in manufacturing industry being made up for by the smaller fall in construction activity. French performance should be somewhere around average for all the advanced economies. Over 2009, GDP looks set to have fallen by 2.3%, after growth of 0.3% in 2008, but the growth overhang for 2010 at the end of Q2 should be positive (+1.1%).

Gradual pick-up in investment

The turnaround in activity and easing of financing terms support investment

Thanks to the upturn in activity that commenced in Q2 2009 and to less difficult financing conditions, corporate investment should pick up little by little through to mid-2010. This increase should initially be limited by business prospects that remain modest and production capacities that continue to be underused (see graph 5).

A slight decline in core inflation

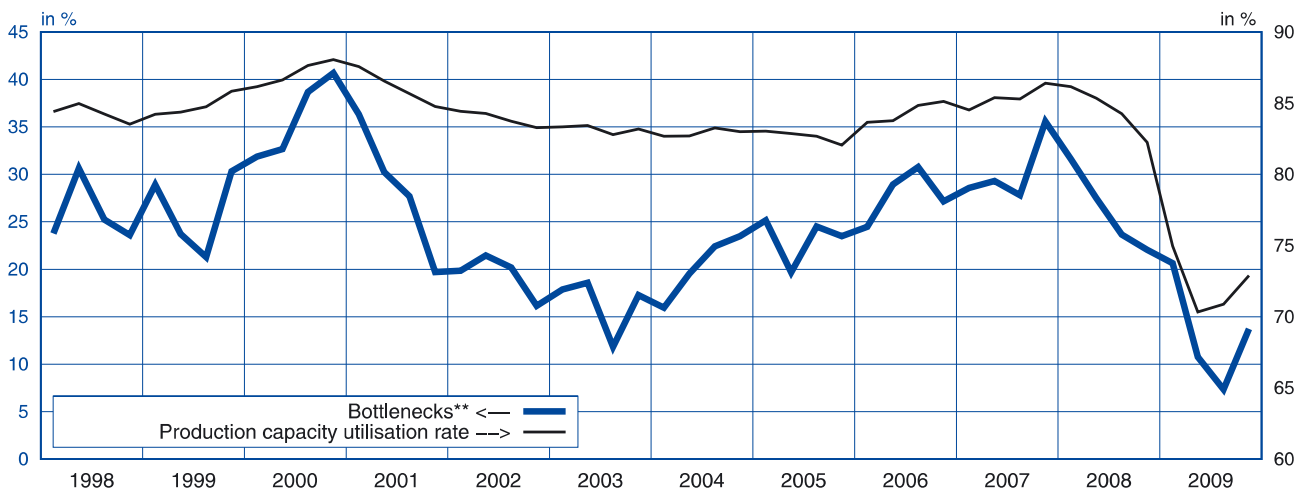
Gradual fall in core inflation

In the advanced economies, "core" inflation is on a downward trend but remains positive almost everywhere. The fall in inflation is due first of all to weak demand forcing entrepreneurs throughout the production and distribution chain to hold back on their prices to keep their customers. It is also due to the rise in unemployment and the moderate wage demands it induces. The recent rise in commodity prices, and notably oil, should limit this fall as it gradually works its way through into consumer prices. Consequently, price moderation should continue, but the fall in core inflation should be much less pronounced in coming months. For example, core inflation should fall back to 1.7% in France in June 2010, after 1.8% in October, and in the Euro Zone it should stand at 0.9% in June 2010, after 1.2% in October 2009.

Japan in deflation, uncertainties surrounding Spain and Ireland

Japan has never really put deflation behind it and is now confirming that it is back. Ireland seems to have fallen into deflation and Spain could follow. In both these countries, year-on-year consumer prices are negative and are only likely to increase under the effect of rising energy prices. Above all, activity is lagging considerably in both countries. Core inflation has thus been negative since the start of the year in Ireland, reaching -2.2% in September, and is falling fast and already close to zero in Spain.

5 - Tensions on manufacturing output capacity



* Proportion of enterprises which, if they received more orders, could not produce more with their current facilities.
Source: INSEE

General outlook

Oil prices should fluctuate around \$80 a barrel

Since the end of 2008, oil prices have doubled: starting out from a low point at \$40 a barrel, they had risen to around \$80 by mid-October. They are forecast to fluctuate around this level through to mid-2010. The oil market would seem to be balanced overall through to the time horizon of our forecast and the variations in demand expected in our scenario should be absorbed by rises in production without any major tensions. Therefore, after a slight deficit in Q4 2009, the oil market should gradually ease over H1 2010.

Headline inflation picks up with energy prices, plus the carbon tax in France

Headline inflation has been rising since the summer and should continue to increase through to mid-2010, mainly due to the increase in energy inflation in the wake of that in oil prices. Inflation in the Euro Zone should reach 0.9% in June 2009 against -0.1% in October 2009. In France, it should stand at 1.5% in June 2010 against -0.2% in October 2009 (see graph 6). Application of the carbon tax on 1st January 2010 should increase French inflation by 0.3 points. Given the compensation mechanism that has been designed for households, this measure should be neutral, however, for household purchasing power over 2010 as a whole.

The labour market should continue to feel the delayed effects of the recession

Employment down again, but gradually less markedly

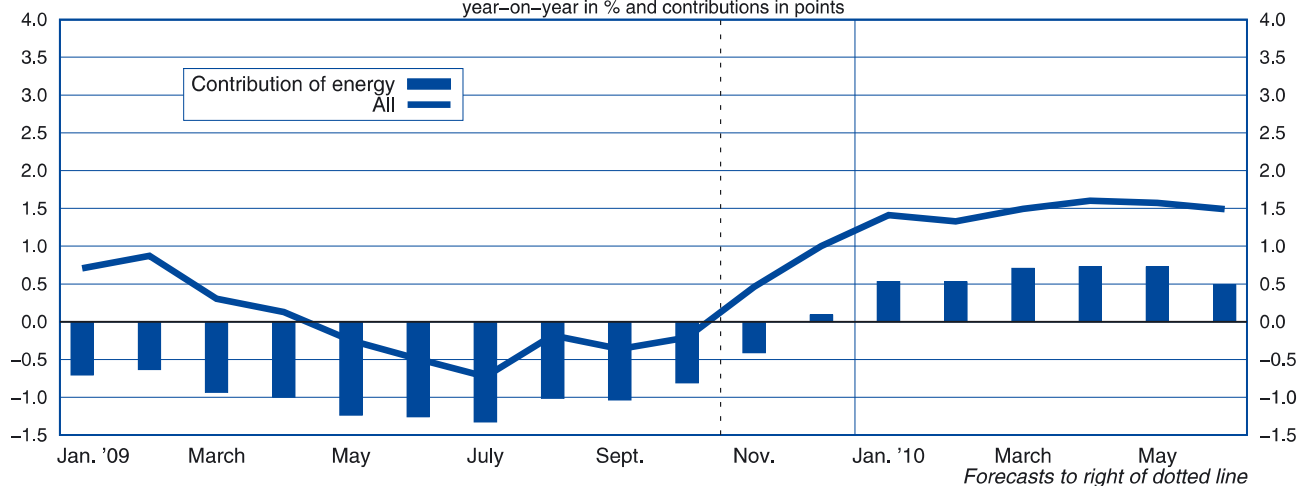
Due to the sharp contraction in activity recorded at the turn of 2009, the labour market should continue to see job losses. However, thanks to the upturn in activity underway since Q2 2009, this fall in employment should gradually become more moderate. After losing 280,000 jobs in H1 2009, the non-agricultural market sectors should lose another 170,000 in H2 2009 and 125,000 in H1 2010. Non-market paid employment should remain dynamic in H2 2009, before slowing down in H1 2010 due to the stabilisation of the number of beneficiaries of State-aided contracts. All in all, after losing almost 260,000 jobs in H1 2009, the French economy looks set to lose about 110,000 in H2 and as many again in H1 2010.

The rise in unemployment slowing down

Since Q2 2009, the rise in unemployment has become more moderate. This less pronounced increase is mainly due to a smaller drop in employment brought about by the upturn in activity. This moderate trend should therefore continue through the coming quarters (see graph 7). The unemployment rate, which was 9.1% of the working population in Metropolitan France in Q2 2009 (9.5% including the overseas départements), should reach 9.4% on average in Metropolitan France in Q4 2009 (9.8% including the overseas départements), and 9.8% in Q2 2010 (10.2% including the overseas départements).

6 - Inflation in France

year-on-year in % and contributions in points



Source: INSEE

Consumption is holding firm

Modest rise in earned income

With job losses easing up and wages remaining on a moderate upward trend, earned income should be slightly up. The improvement should be a clear one over H1 2009 but progress should remain very moderate as the outlook is still very poor on the labour market.

Purchasing power should slow down over the period...

Purchasing power should slow down in H2. It was dynamic in H1 2009, notably thanks to disinflation and the rise in social benefits. In H2, however, inflation should head upwards again and social benefits should slow down after the one-off payments of various bonuses in H1.

... but the profile is likely to be irregular

In H1 2010, the slowdown in purchasing power should continue, with average growth of 0.2% per quarter. Looking beyond this trend, the quarterly profile should be extremely irregular in early 2010 due to the terms of implementation of the carbon tax.

A clear upturn in consumption at the end of 2009, then a sharp slowdown

Household consumption has progressed little but has held firm during the crisis. In Q4 2009, households should increase their automobile purchases, getting in before the bonus terms become stricter and before the scrappage allowance is reduced. They should therefore increase their investment significantly in Q4 (+0.7%). To do so, they should draw to a certain extent on the sums saved in the previous quarter. In early 2010, due to the slowdown in their purchasing power compared with H2 2009 and even more so in relation to H1, households are likely to put the brakes on their expenditure (+0.3% the +0.2%).

Towards stabilisation of household investment

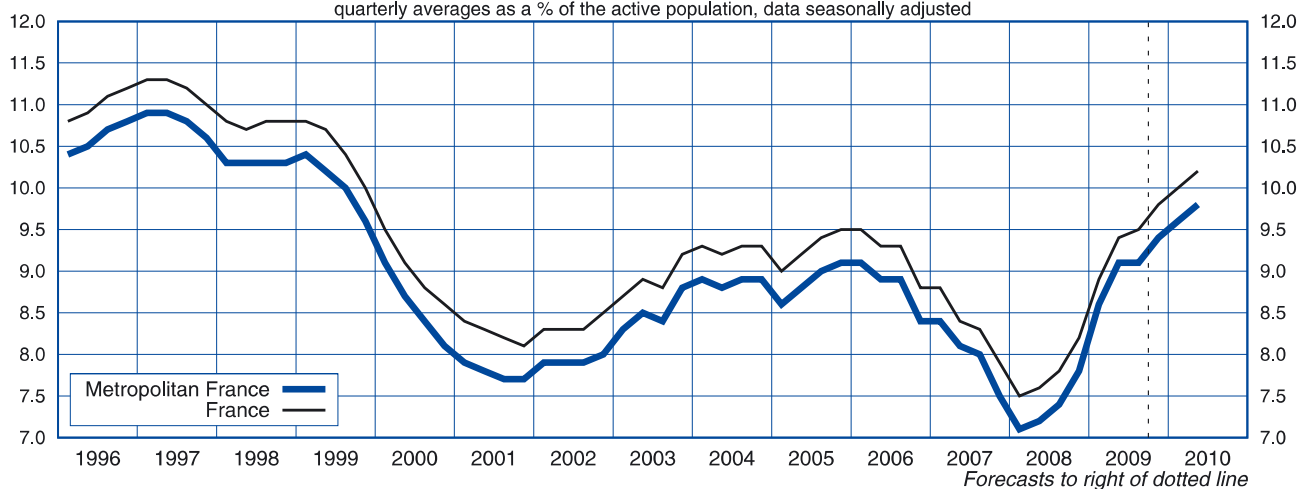
Due to the fall in property prices, household investment has no longer benefited from the prospects of rapid capital gains, unlike in previous years. Tighter access to credit also weighed on real-estate purchases but financing terms are starting to improve. In Q2, new housing sales picked up, pushing stocks downwards. However, the weakness of building sector production prospects in the business tendency surveys does not suggest any significant upturn is on the way. Housing starts are only just starting to pick up. Consequently, household investment on housing should continue to fall back but tending to level out.

More dynamic imports with the improvement in domestic demand

To the time horizon of our forecast, imports should be more dynamic than in Q3 when they only slightly picked up, driven by the improvement in domestic demand. Their growth overhang in mid-2010 should also be positive (+2.2%, after -9.9% in 2009).

7 - Rate of unemployment in the sense of the ILO

quarterly averages as a % of the active population, data seasonally adjusted



Scope: population of households, people aged 15 or over
 France = Metropolitan France + Overseas départements
 Source: INSEE, Employment survey

Great uncertainties surround this scenario

The great volatility of oil and commodity prices makes the forecast uncertain

For a year and a half, prices of oil, like of other commodities, have shown very great volatility which has not always been directly linked with trends in the physical oil market, and notably those in supply and demand. This makes forecasting these prices highly uncertain.

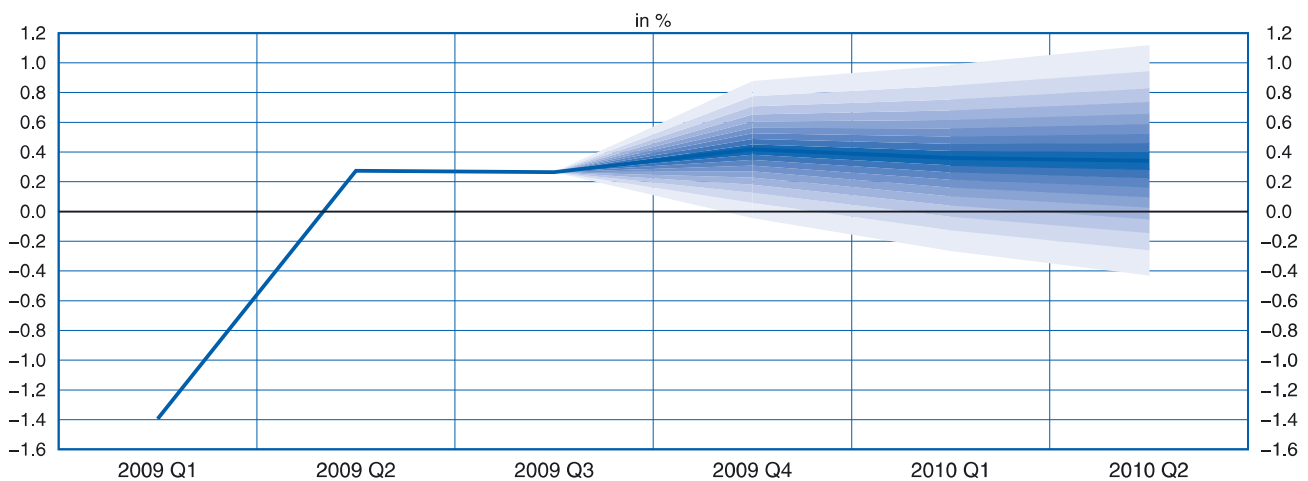
A move to build up stocks could buoy up activity

From the end of 2007 to mid-2009, the fall in stocks globally weighed down on activity in the advanced countries, more particularly in H1 2009. These stock movements then only supported activity in a limited manner in Q3. In such a context, companies could therefore be led to build up their stocks more quickly than anticipated. Such a stocking up trend would increase growth in France and abroad.

The after-effects of the disappearance of the scrappage allowance could be more brutal

In all the countries that have implemented scrappage bonuses, these allowances have significantly supported the automobile market. We forecast that the end of these measures could trigger a backlash in the form of a sharp drop in household automobile consumption. This backlash could be more brutal than expected, however, which would hit growth. ■

8 - Fan chart for Conjoncture in France



How to read it: the fan chart plots 90% of the likely scenarios around the baseline forecast (blue line). The first and darkest band covers the likeliest scenarios around the baseline, which have a combined probability of 10%. The second band, which is a shade lighter, comprises two sub-bands just above and just below the central band. It contains the next most likely scenarios, raising the total probability of the first two bands to 20%. We can repeat the process, moving from the centre outwards and from the darkest band to the lightest, up to a 90% probability (see the INSEE Conjoncture in France for June 2008, pages 15 to 18).

It can therefore be estimated that the first result published by the quarterly accounts for Q4 2009 has a 50% chance of being between +0.2% (lower limit of the fifth band from the bottom) and +0.6% (upper limit of the fifth band from the top). Likewise, it has a 90% chance of being between -0.0% and +0.9% in Q4 2009. In Q1 and Q2, the 90% confidence intervals are respectively [-0.3 % ; +1.0 %] and [-0.4 % ; +1.1 %].

Source: INSEE

Key figures: France and its international environment

seasonally adjusted / working-day adjusted data (for prices), quarterly or annual averages, as a %

	2008				2009				2010		2008	2009	2010 ovhg
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
International environment													
Advanced economy GDP	0.4	-0.2	-0.6	-1.8	-2.0	0.0	0.5	0.5	0.4	0.4	0.3	-3.6	1.2
Euro Zone GDP	0.8	-0.3	-0.4	-1.9	-2.4	-0.2	0.4	0.3	0.3	0.3	0.5	-3.9	1.0
Barrel of Brent oil (in dollars)	97	122	115	55	45	59	68	77	80	80	97	62	80
Euro-dollar exchange rate	1.5	1.6	1.5	1.3	1.3	1.4	1.4	1.5	1.5	1.5	1.5	1.4	1.5
World demand for French products	1.2	-0.3	0.0	-7.4	-10.3	-1.7	2.7	1.8	1.5	1.5	1.0	-15.0	5.0
France - supply and use													
GDP	0.5	-0.4	-0.2	-1.5	-1.4	0.3	0.3	0.4	0.4	0.3	0.3	-2.3	1.1
Imports	1.4	-1.2	0.1	-3.3	-6.0	-2.6	0.4	1.3	1.0	0.9	0.6	-9.9	2.2
Household consumption	-0.2	0.1	0.2	0.1	0.1	0.3	0.0	0.7	0.3	0.2	0.9	0.7	1.1
Public and NPISH consumption	0.3	0.3	0.6	0.4	0.1	0.5	0.7	0.6	0.6	0.5	1.3	1.7	1.9
Total GFCF	1.0	-1.5	-1.3	-2.6	-2.6	-1.2	-1.4	-0.9	-0.4	0.3	0.4	-7.1	-1.8
of which: NFEs	2.1	-1.4	-0.7	-2.9	-3.4	-1.0	-0.7	-0.1	0.2	0.6	2.4	-7.2	0.0
Households	0.2	-1.4	-2.9	-2.8	-2.2	-2.2	-2.9	-3.1	-1.8	-0.2	-1.4	-9.6	-6.3
Exports	2.3	-2.4	-0.5	-6.1	-7.4	0.6	2.3	1.3	1.0	1.0	-0.6	-10.8	4.1
Contributions													
Domestic demand excluding change in inventories(**)	0.2	-0.2	0.0	-0.4	-0.5	0.1	-0.1	0.4	0.2	0.3	0.9	-0.7	0.7
Change in inventories(**)	0.1	0.1	0.0	-0.4	-0.8	-0.6	-0.1	0.1	0.1	0.1	-0.3	-1.6	0.0
Net foreign trade	0.2	-0.3	-0.2	-0.7	-0.2	0.9	0.4	0.0	0.0	0.0	-0.3	0.0	0.4
France - situation of households													
Total employment (variation at end of quarter) ⁽²⁾	48	-54	-38	-65	-171	-88	-59	-55	-65	-44	-109	-373	-
Non-agricultural market sector employment ⁽²⁾	40	-63	-47	-75	-186	-94	-93	-79	-74	-51	-145	-451	-
Unemployment rate (quarterly average)	7.1	7.2	7.4	7.8	8.6	9.1	9.1	9.4	9.6	9.8	7.8	9.4	-
Unemployment rate (quarterly average)	7.5	7.6	7.8	8.2	8.9	9.4	9.5	9.8	10.0	10.2	8.2	9.8	-
Consumer price index ^(*)	3.2	3.6	3.0	1.0	0.3	-0.5	-0.4	1.0	1.5	1.5	2.8	0.1	-
Core inflation ^(*)	2.1	2.0	2.1	1.9	1.6	1.5	2.0	1.8	1.7	1.7	2.0	1.8	-
Household purchasing power	0.0	-0.3	0.0	1.0	0.4	1.0	0.6	0.0	0.7	-0.3	0.7	2.2	1.0

Forecast

(*) Year on year on the last month of the quarter

(**) Inventory changes include acquisitions net of sales of valuables

Note: the volumes are calculated at the previous year's chain-linked prices, seasonally and working-day adjusted, quarterly and annual averages, as a %

Source: INSEE

Review of the previous forecast

In Q3, the end of the recession as described in the scenario in October was confirmed, now with two consecutive quarters of growth. However, the growth in activity was slightly weaker than expected in October's Conjoncture in France (+0.3% against +0.5%). The main reason behind this gap is the more pronounced fall than expected in investment in construction. Concerning Q4 2009, we maintain our hypothesis that activity should continue to rise, but not at a very sustained rate.

Half of the forecasting error in Q3 can therefore be explained by the under-estimation of the fall in construction investment. The rest comes essentially from a sharp drop in energy output which was not anticipated (-3.1% against a forecast of -0.2%). Output in this sector is usually quite volatile, but a variation on this kind of scale is nonetheless exceptional.

End of the recession confirmed

In Q3 2009, GDP increased by 0.3%, after a leap of the same amount in Q2. The end-of-recession scenario elaborated in October has been confirmed, although growth was slightly less strong than anticipated (+0.5% forecast, see graph 1).

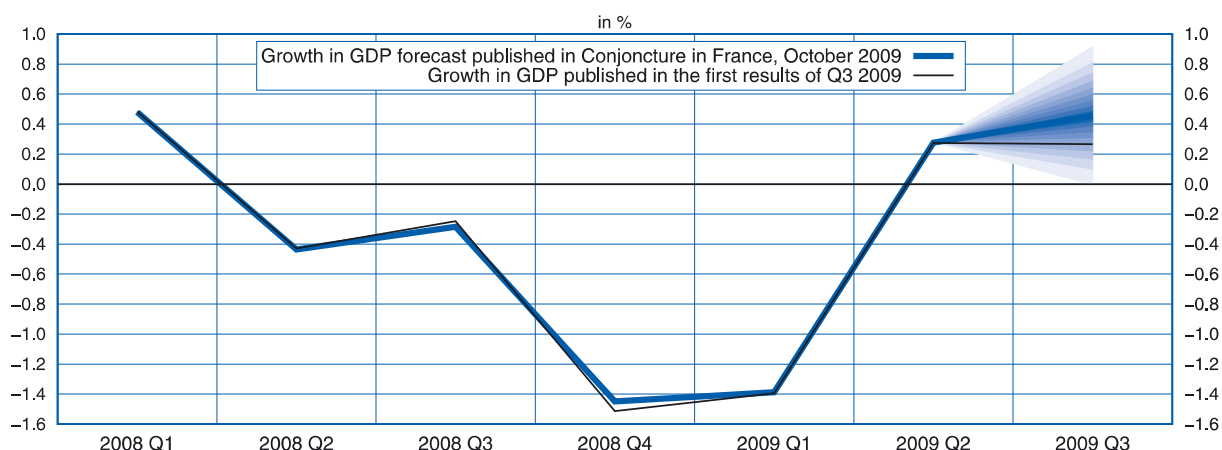
Like in Q2, the rise in GDP in Q3 can mainly be put down to dynamic manufacturing output (+2.3% actual figure against a forecast of +1.7%) buoyed up by the upturn in world trade. However, while we were counting on a less sharp fall in construction leading to stabilisation of output in Q4, activity in this sector fell heavily in Q3 (-2.1% against a forecast of -0.4%). The slide was therefore accentuated over Q2 due to the fall in investment in building and public works.

Exports have continued to improve as expected

Regarding demand, exports continued to pick up in the wake of world trade, as we described in October. Total exports progressed by 2.3% (forecast of +1.9%) with a particularly noticeable rise in exports of manufactured goods (+3.9% against a forecast of +3.0%). Imports progressed by 0.4% as expected. Finally, foreign trade contributed +0.4 points to activity, against the figure of +0.3 points forecast in October.

The bad surprise came from domestic demand, which contributed -0.1 points to growth in GDP, against the +0.1 points that had been forecast. In fact, household consumption was slightly overestimated, proving to be flat (0.0%) against a forecast of +0.2%. In addition, the fall in household investment was more pronounced than expected (-2.9% against -0.9%). For businesses on

1- Fan chart for Conjoncture in France for October 2009 and growth achieved



Source: INSEE

Review of the previous forecast

the other hand, although investment in capital goods did continue to fall, it did so a little less sharply than had been forecast (-0.3% against -1.0%). All in all, the difference in relation to the forecast for total investment by businesses was small (-0.1 points).

Over H2 2009, the upturn in activity set to continue

Over the year 2009, the growth forecast in our December scenario is close to that anticipated in October (-2.3% against -2.1%). In particular, the turnaround in activity started in Q2 in France should be confirmed over the second half of the year. However, the rate of growth should not be very sustained.

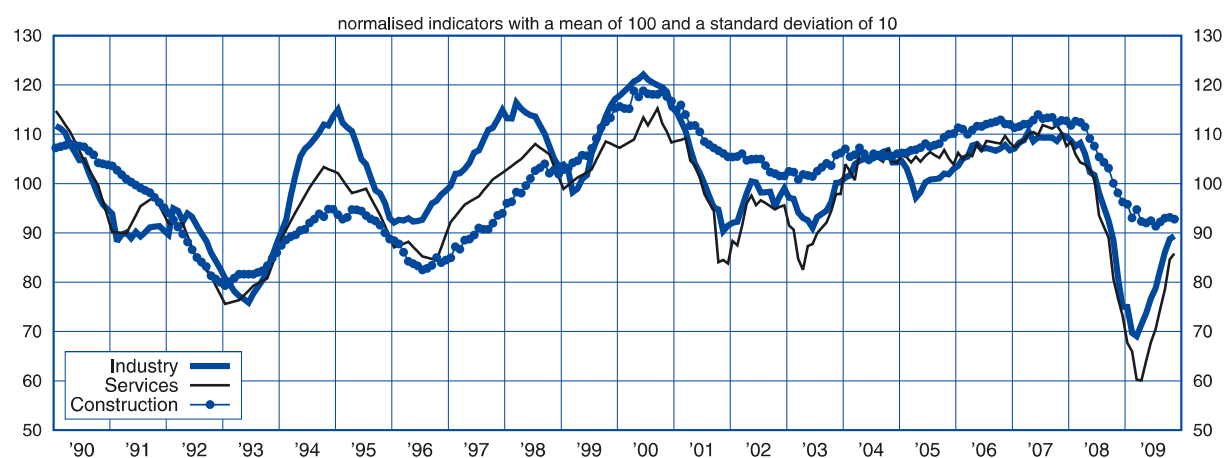
For Q4, our scenario is very comparable to that in our October *Conjoncture* in France. GDP should increase by 0.4% (+0.1 point on the previous forecast), supported in particular by the industrial sector (+0.9% against +0.8% forecast in October) and services. In both these sectors, the business climate has picked up significantly since

the low points reached in early 2009, although it is taking its time turning around in the construction sector.

Exports and household consumption in Q4 have been revised upwards. Due to the ever-positive signals coming from world trade in goods, world demand for French products should indeed be dynamic, and this should show in exports of non-energy industrial goods (+2.1% against +1.0%). In addition to this, household purchasing power should increase a little more than previously expected in H2 and the reduction in the automobile scrappage allowance and ecological bonus at 1st January 2010 is likely to lead households to bring forward their car purchases. Due to this, their consumption in Q4 should be more dynamic than forecast.

In contrast, construction sector output should be lower than that forecast in October: although commencements are starting to turn around little by little (see box, "Towards a stabilisation of the property market in France"), the drop accumulated over recent months should continue to have a very negative impact given the production lead times inherent to this sector. ■

2 - Business climate in the industrial, construction and service sectors



Source: INSEE