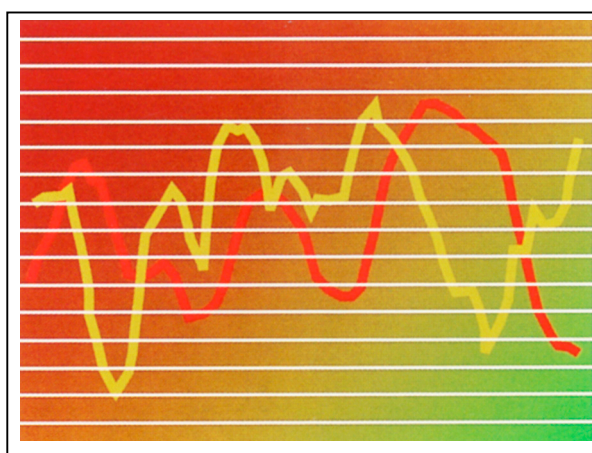


# ***CONJONCTURE IN FRANCE***

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**JUNE 2010**



**IN MIDSTREAM**

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# **CONJONCTURE IN FRANCE**

**June 2010**

**IN MIDSTREAM**

# **IN MEADSTREAM**

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# In midstream

*In Q1 2010, growth was disappointing in Europe and in France, linked with sluggish domestic demand. These results contrast with the dynamism observed in the United States and in Japan: the former sustained by still-massive stimulus measures, and the latter benefiting from its proximity to emerging Asia.*

*For Q2, the surveys conducted on business leaders have led to predictions of a strong rebound in terms of output in the Euro Zone, particularly of non-energy goods. Activity should be bolstered by the continuing dynamism of world trade. The depreciation of the euro should also start to show its positive effects. The rebound is likely to be sharp in Germany, where surveys point to very favourable prospects according to industrialists. France should also benefit from this more promising context: GDP growth is set to reach 0.5% in Q2, after 0.1% in Q1.*

*The rest of the year, however, does not look to be quite so positive. The dynamism of the emerging economies should be tempered somewhat, in particular in China, and in many countries growth is set to drop off due to the negative effects of the imbalances in public finances. In the United States economic conditions will gradually become tighter, for example. In certain European countries too, the first fiscal retrenchment measures are to be enforced from this summer. Last, the renewed rise in tensions observed in Europe on the sovereign debt markets and the interbank money markets could counter the*

*easing of financing terms for households and businesses. All in all, growth should dip somewhat in H2 in the advanced economies.*

*In France, activity should rise at a rate of 0.4% in both Q3 and Q4. The current dynamism of exports looks set to spread gradually to domestic demand. This should in turn have a knock-on effect on production investment by companies, and the labour market should then start to improve slightly in the market sectors. However, the rate of unemployment is likely to remain stable throughout the year.*

*Household purchasing power is likely to benefit only gradually from this improvement, with the upturn in earned income being offset by a new rise in inflation. Ultimately, consumption should return to modest growth levels once the after-effect of the scrappage allowance has been absorbed. The savings ratio should then increase slightly, reflecting a certain level of prudence among households.*

*Even more than usual, our scenario is affected by a large number of uncertainties. If the tensions observed on the financial markets were suddenly to be exacerbated, the return-to-growth scenario described in this report could be called into question. The same would be true if households boosted their precautionary savings in order to cope with future measures to correct public finances. Conversely, if the euro continued to depreciate, European and French growth would be strengthened.*

## Economic policies around the world are less accommodating, and in some countries are tightening

### Disappointing European growth in Q1

In Q1 2010, growth was modest in Europe while it was sustained in both the USA and Japan. The European economies suffered from sluggish domestic demand which was penalised by low income levels, the after-effects of the scrappage allowances, and the continuing overcapacity in industry. Additionally, the winter was harsher than usual, leaving its mark on construction in Germany and, to a lesser extent, in France. Last, certain Euro Zone countries such as Spain are still struggling to get out of recession (see Graph 1).

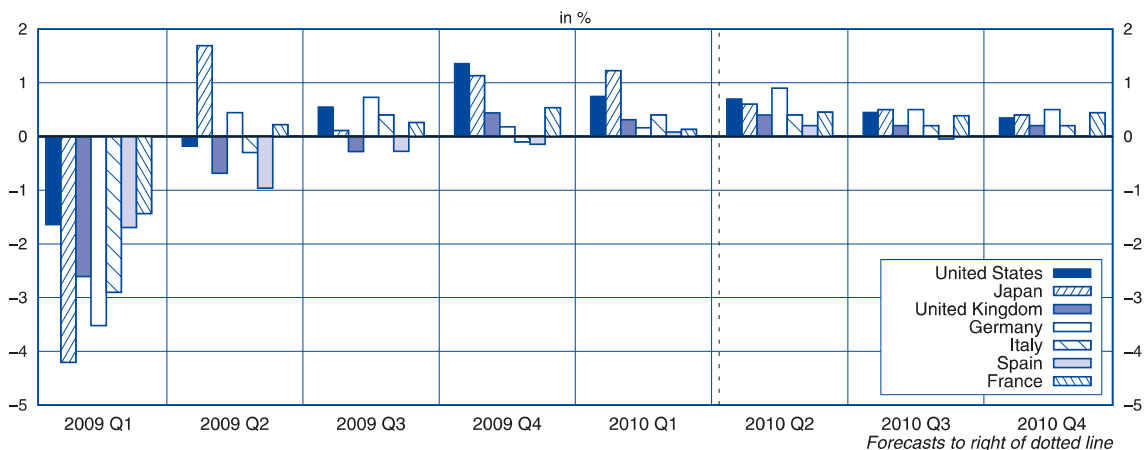
### Towards acceleration in Q2

The business climate in the advanced economies has improved clearly since the start of the year, both in industry and in services, although it started to plateau in April and May (see Graph 2). The GDP of the advanced economies thus looks set to grow in Q2 (+0.6%, see Table), helped by the recovery in the Euro Zone where the one-off factors of the previous quarter should dissipate. Domestic demand, notably investment, should therefore accelerate in Europe in the wake of exports. This leap should be particularly sharp in Germany, with growth of 0.9% after +0.2% in Q1, and quite sharp in France (+0.5% after +0.1%).

### From an upswing...

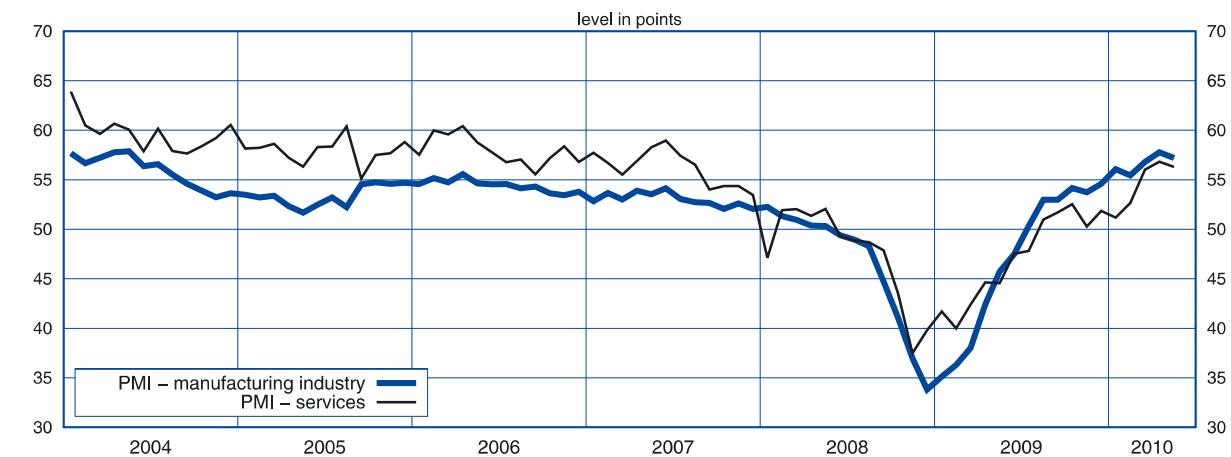
In 2009, the industrialised countries implemented economic support policies in order to overcome the crisis. They relied on mechanisms to support the financial sectors as well as stimulus plans aiming to bring down taxes, increase social

1 - Quarterly growth in the main advanced economies



Source: national statistics institutes, INSEE forecasts

2 - 'Manufacturing' and 'services' components of the global purchasing managers survey in the advanced economies



Source: Markit

benefits and boost public spending, without neglecting sector-specific support measures such as the scrappage allowances. The central banks eased their monetary policies, bringing their intervention rates down very sharply, supplying massive amounts of cash to banks, and even buying a variety of financial assets themselves. These interventions helped restore the interbank money markets to normal conditions of operation. In this environment, tensions surrounding the debt of non-financial enterprises eased, as did the banks' lending standards.

*... to the beginnings of a return to normal of monetary policies...*

In 2010, certain central banks have already started to raise their interest rates again, although this is not the case of the central banks of the biggest industrialised countries (Federal Reserve, European Central Bank, Bank of England) which are just starting to prepare for the withdrawal of their quantitative easing measures. Faced with risks of overheating and the resurgence of inflationary tensions, China is likely to tighten its economic policy in the coming months.

*... and perhaps a tightening of budgets*

But it is in financial policy that the biggest differences can be seen today. Certain countries such as Germany, Japan and the United States are continuing to boost their stimulus plans, although Germany has already announced an austerity plan to control its public finances starting in 2011. Conversely, following the Greek crisis which raised the issue of the sustainability of the sovereign debt of certain Euro Zone countries, several states have announced more stringent austerity plans, or have brought their plans forward. This has happened in Greece, obviously, but also in Spain, for example. After the expiry of the scrappage allowance at the end of April, the Spanish government announced a 2-point rise in the VAT rate for 1<sup>st</sup> July, a drop in civil service wages, and a reduction of public investment expenditure. In the United Kingdom, after the VAT rise on 1<sup>st</sup> January and the end of the scrappage allowance in March, the new government has decided, among other things, to raise income tax and bring down public spending.

### The advanced economies are set to slow

*A slowdown in Q2, but disparities in evidence*

The advanced economies look likely to suffer a slowdown in Q2 (+0.4% then +0.3%), under the effect of the progressive withdrawal of the stimulus plans, the implementation of austerity programmes, and the slowdown of the emerging economies. This moderation of growth in the advanced economies should take its toll on world trade, which seems likely to lose some of its dynamism. The economic outlook should differ from country to country among the advanced economies. For example, growth should remain strong in the USA and Japan but more moderate in the Euro Zone and the United Kingdom. This disparity is likely to be in evidence within the Euro Zone itself, where Germany should be dynamic while Spain struggles to leave the recession behind it.

*The rise in French exports looks set to slow by the end of 2010*

French exports should remain strong until the end of 2010, although they look likely to slow down gradually in line with world trade and the still-sluggish European demand. But they should still be sustained by the sharp depreciation of the euro since the start of the year, which has made French products more competitive. Over the year as a whole, exports should rise by 8.6% after falling by 12.2% in 2009.

*In France, the upturn is likely to continue – but slowly*

Following the general trend, after a small rebound in Q2 (+0.5%), the French economy should show moderate growth (+0.4%) in Q3 and Q4 (see Graph 7). This growth would put France in an intermediate position, between Germany and the southern Euro Zone countries. Activity should grow by 1.4% in 2010, after last year's recession (-2.5%<sup>(1)</sup>).

(1) Corrected for seasonal variations and working days.

## General outlook

**A dynamic service sector** After a vacuum in Q1 2010, business in the service industry should get back on track. Indeed, the outlook improved significantly at the start of Q2 2010: the composite business climate index increased by six points between March and April, almost returning to its long-term average. Services should thus be the main driver of activity over the last three quarters of 2010 (see Graph 3).

**Minimal return to growth for industrial production** After slowing sharply at the start of the year, industrial production should enjoy something of a revival in Q2 (+1.5%) before returning to a more normal pace in H2 (in the region of +0.5% per quarter). The business climate did indeed improve in May and industrialists report an increase in their output; but they also mention a slight decline in production prospects. At the end of the year, industrial production is likely to remain much lower than its pre-crisis level (-11%).

**Towards stabilisation in construction** In Q1 2010, production in the construction sector once again dropped sharply (-1.9%, after -1.8% in Q4 2009), against a backdrop of the general fall in investment in construction, made worse by a cold winter. Activity in this sector should still head downwards for the rest of the year, although this decline is likely to become less pronounced. In the public works sector activity should rebound in Q2, as entrepreneurs make up for the lost production time caused by the difficult weather conditions at the start of the year. Production in construction should thus stabilise in Q2 (+0.0%), before falling once again in Q3 (-0.7%). Finally, activity is expected to stabilise in Q4 (+0.1%). All in all, production in the construction sector should remain firmly down (-4.7%, after -5.1% in 2009).

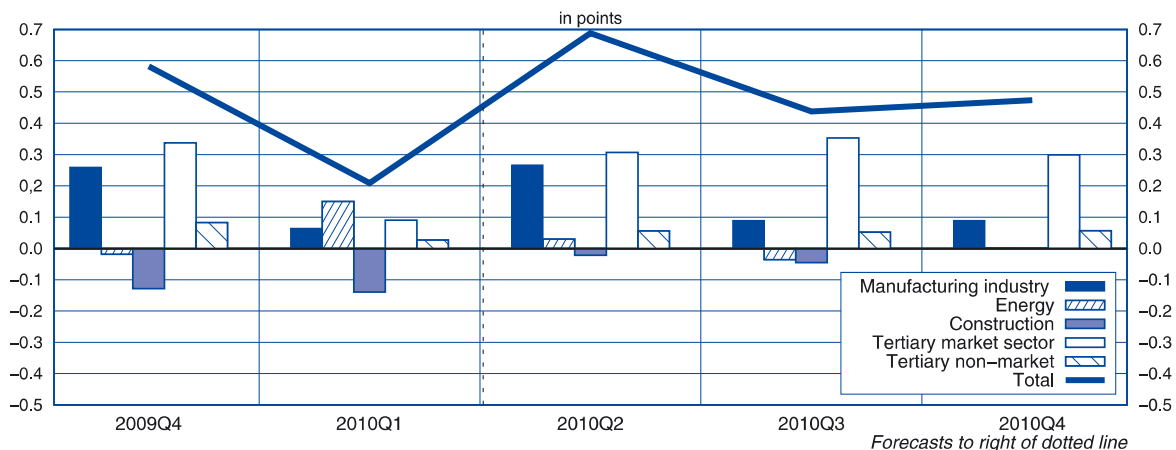
### Gradual recovery of investment

**Investment returns to growth – except in construction** Entrepreneurs should increase investment moderately starting from Q2 2010: the economic outlook is brightening but production capacities remain under-utilised. However, this global recovery is likely to mask contrasting trends. Investment in industrial goods should continue to grow. But investment in construction is still likely to fall, with the catching-up effects in the public works sector merely limiting the damage. All in all, corporate investment should drop by 2.0% in 2010, after a fall of 7.9% in 2009.

### Depreciation of the euro set to put an end to disinflation in Europe

**Imported inflation should offset the fall in core inflation** Core inflation has fallen in the Euro Zone, although it has remained positive in most of these countries. However, owing to the severity of the crisis they are going through, some Euro Zone countries are showing divergent trajectories and

#### 3 – Sector-by-sector contributions to the growth of total production



Source: INSEE

disinflationary, or even deflationary, trends are still at work: core inflation was negative in April in Spain (-0.1%), Portugal (-0.4%) and above all in Ireland (-2.9%). The prospects of a rebound in world activity sustained the prices of commodities throughout 2009, particularly oil. These increases should gradually filter through to other products via production costs. Additionally, the depreciation of the euro is likely to feed inflation both in France and the rest of the Euro Zone, via the rise in the prices of imported goods. Nonetheless, the still-high unemployment rate, bringing with it a moderation of wages, and the low level of demand should continue to weigh heavily on prices. All in all, the slide of core inflation should come to a halt in the Euro Zone (+0.8% in December 2010) and a small rise should take place in France (see Graph 4).

*Headline inflation virtually stable in France and the Euro Zone*

On the assumption that oil prices stabilise at around \$75 per barrel of Brent and that food prices return to their usual seasonal levels, year-on-year prices should stabilise in H2 in the Euro Zone and in France. They should reach +1.6% in December 2010 in France and 1.7% in the Euro Zone.

**Stabilisation of the labour market**

*Small upturn in employment*

Total employment fell heavily in 2009, dragged down by the drop in activity. With the upturn, it should recover slightly in 2010 (+63 000 jobs). The non-agricultural labour market started to benefit from the first effects of the upswing and then grew in Q1 2010. It should progress slightly over 2010 as a whole (+32 000 jobs in H1 then +19 000 in H2). But in the non-market sectors, employment, which was still rising at the start of the year, is set to decline in H2 because the number of newcomers to the subsidised work contract scheme should fall.

*Stabilisation of the rate of unemployment in 2010*

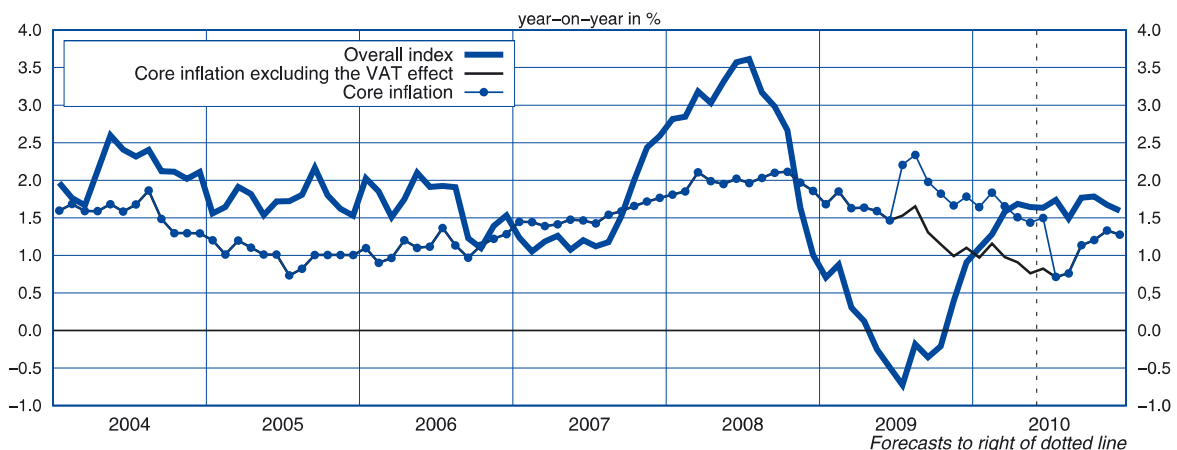
After 6 quarters in which the unemployment rate rose continually to reach its level of 1999, it should be stable throughout 2010, at 9.5% in Metropolitan France (9.9% including overseas departments). The expected job creations, although modest, are of the same order as the now-moderate rise in the working population.

**Consumption and purchasing power slowing**

*Slowdown in purchasing power in 2010*

Household purchasing power should slow in 2010 (+1.1% after +1.6% in 2009). The economic upturn may contribute to improved levels of earned income, but growth in social benefits should be more modest than in 2009 since

**4 - Inflation indicators in France**



Source: Eurostat, INSEE



## General outlook

the exceptional stimulus plans are no longer in place, and the tax burden is likely to rise again after the drop in taxes last year. Above all, the rebound of consumer prices should take its toll on purchasing power.

### Consumption showing a slight rise

After a sluggish Q2, household consumption is set to grow slightly in H2: +0.3% per quarter. Faced with the high level of unemployment and the rise in inflation, households are being careful. They are likely to increase their savings ratio, and their consumption should be down, in line with purchasing power which is showing few signs of dynamism. Additionally, in Q2 the after-effect of the scrappage allowance is also likely to be felt – as it was in Q1 – in terms of consumer spending (see *Graph 5*).

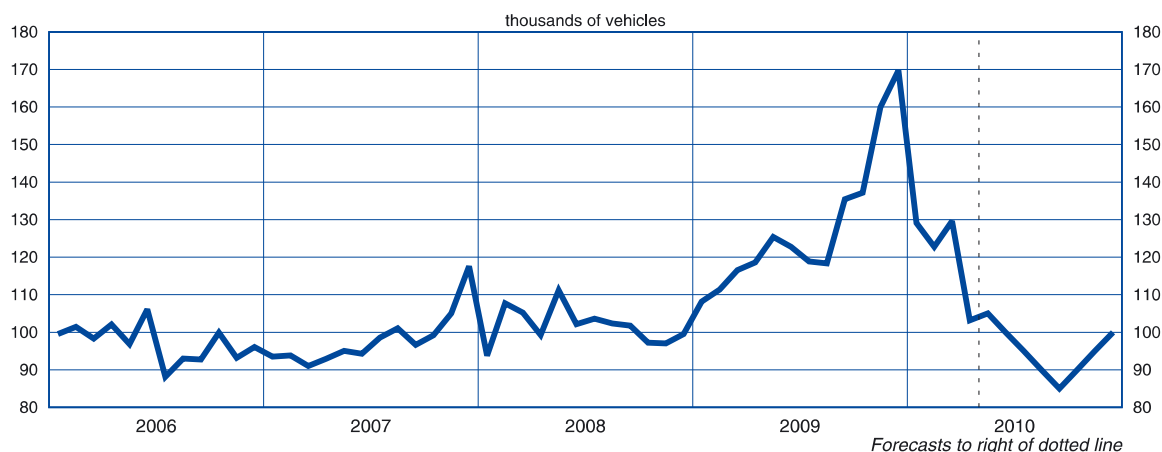
### Household investment looking to be on the road to recovery

Since the beginning of 2008, households have sharply reduced their investment, which mainly comprises the purchase of new housing. In Q1 2010, it was 15% lower than its level at the end of 2007. However, some positive signs are emerging. For example, housing starts have seen an upswing over the last quarters (see *Graph 6*) and the demand for housing loans is showing an upward trend. As a result, household investment should fall back less in Q2 and enjoy renewed growth in H2. All in all, it should nonetheless decline by 3.2% in 2010 after a fall of 8.7% in 2009.

### Stabilisation of the growth in imports

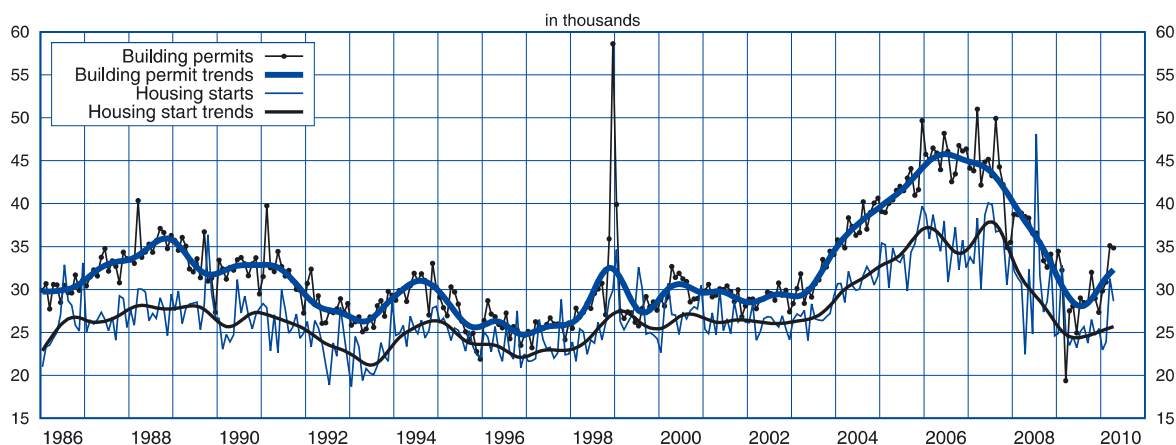
To the end of 2010, growth in total imports should stabilise (+2.0% in Q2 then +1.7% and +1.6% in Q3 and Q4). Imports should benefit from the upturn in domestic demand but suffer from the slowdown in exports. Over 2010 as a whole, imports should rebound sharply (+6.2%) after the drop in 2009 (-10.6%).

## 5 – Vehicle registrations in France, observed then forecast



Source: INSEE, CCFA, SOeS

## 6 – Building permits and housing starts of new dwellings in France



Source: Sitadel2 (SoeS), INSEE calculations

**Uncertainties: resurgence of financial tensions, impact of measures to reduce the deficit, and support from the euro for foreign trade**

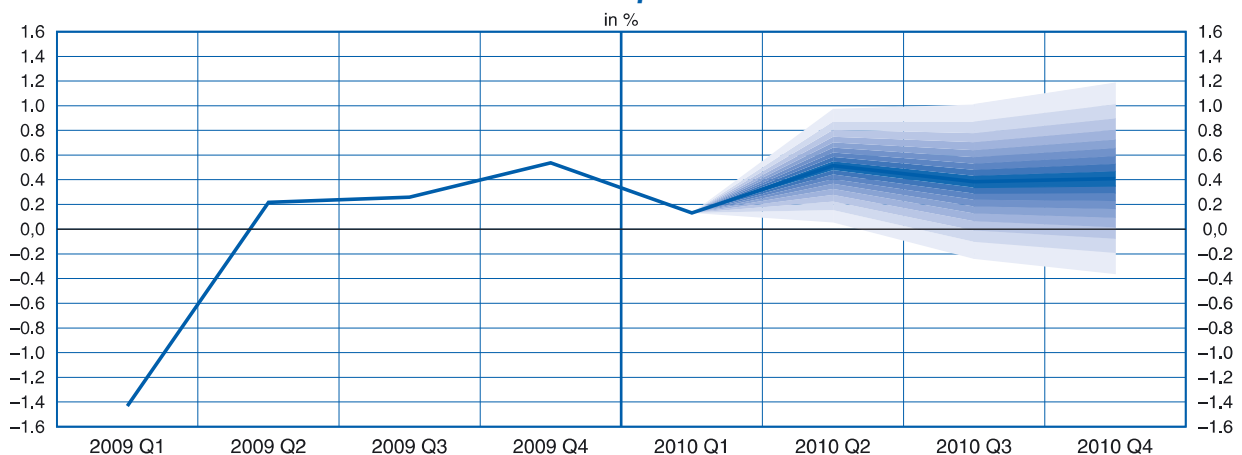
*Risk of financial tensions and impact of budget consolidation measures*

The tensions that have emerged over the sovereign debt of certain countries, and the austerity plans to control the public accounts that have come in their wake constitute a source of uncertainty for our forecast. If the financial tensions were to worsen, they would eventually take their toll on the financing of private economic agents and thus on growth of the French economy. Additionally, the impact of these plans on growth, notably via the reactions of households and enterprises, is still very uncertain.

*The slide of the euro could help countries profit from the dynamism of world trade*

The euro has depreciated sharply over the last six months: in terms of the nominal effective exchange rates, it has now fallen by more than 12%. This depreciation could allow the Euro Zone countries to profit more from the dynamism of world trade – all the more so if it were to continue. The result would be surplus growth in the European countries. ■

**7 - 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 Q2 2010 has a 50% chance of being between +0.3% (lower limit of the fifth band from the bottom) and +0.7% (upper limit of the fifth band from the top). Likewise, it has a 90% chance of being between +0.1% and +1.0%. In Q3 and Q4, the 90% confidence intervals are respectively [-0.2%; +1.0%] and [-0.4%; +1.2%].

Source: INSEE

## General outlook

### 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 |
|--|------|------|------|------|------|------|------|------|------|------|-----|------|------|-------|------|
|  | Q1   | Q2   | Q3   | Q4   | Q1   | Q2   | Q3   | Q4   | Q1   | Q2   | Q3  | Q4   |      |       |      |
| <b>International environment</b>                               |      |      |      |      |      |      |      |      |      |      |     |      |      |       |      |
| Advanced economy GDP   | 0.3  | -0.1 | -0.7 | -1.8 | -2.4 | 0.1  | 0.4  | 0.8  | 0.6  | 0.6  | 0.4 | 0.3  | 0.2  | -3.6  | 2.2  |
| Euro Zone GDP  | 0.8  | -0.4 | -0.5 | -1.9 | -2.5 | -0.1 | 0.4  | 0.1  | 0.2  | 0.6  | 0.3 | 0.3  | 0.4  | -4.1  | 1.1  |
| Barrel of Brent oil (in dollars)                               | 97   | 122  | 115  | 55   | 45   | 59   | 68   | 75   | 76   | 79   | 75  | 75   | 97   | 62    | 76   |
| Euro-dollar exchange rate                                      | 1.5  | 1.6  | 1.5  | 1.3  | 1.3  | 1.4  | 1.4  | 1.5  | 1.4  | 1.3  | 1.2 | 1.2  | 1.5  | 1.4   | 1.3  |
| World demand for French products                               | 1.5  | -0.2 | -0.2 | -6.0 | -9.8 | -1.4 | 4.0  | 4.8  | 3.5  | 2.9  | 2.0 | 1.4  | 1.6  | -12.3 | 12.7 |
| <b>France - supply and use</b>                                 |      |      |      |      |      |      |      |      |      |      |     |      |      |       |      |
| GDP  | 0.5  | -0.6 | -0.3 | -1.7 | -1.4 | 0.2  | 0.3  | 0.5  | 0.1  | 0.5  | 0.4 | 0.4  | 0.1  | -2.5  | 1.4  |
| Imports  | 1.5  | -1.0 | -0.2 | -4.0 | -6.0 | -3.0 | 0.2  | 2.6  | 2.0  | 2.0  | 1.7 | 1.6  | 0.3  | -10.6 | 6.2  |
| Household consumption  | -0.3 | -0.1 | 0.1  | 0.0  | 0.0  | 0.4  | 0.3  | 0.9  | 0.0  | 0.0  | 0.3 | 0.3  | 0.5  | 0.7   | 1.2  |
| Public and NPISH consumption                                   | 0.4  | 0.4  | 0.7  | 0.6  | 0.5  | 0.7  | 0.8  | 0.7  | 0.1  | 0.4  | 0.4 | 0.4  | 1.6  | 2.6   | 1.8  |
| Total GFCF   | 0.9  | -1.6 | -0.9 | -2.5 | -2.5 | -1.3 | -1.3 | -1.1 | -0.8 | 0.4  | 0.1 | 0.5  | 0.3  | -7.0  | -2.2 |
| of which: NFEs   | 1.9  | -1.6 | -0.2 | -3.0 | -3.4 | -1.4 | -1.3 | -1.2 | -0.9 | 0.6  | 0.2 | 0.7  | 2.2  | -7.9  | -2.0 |
| Households   | -0.4 | -1.7 | -2.7 | -2.7 | -2.4 | -2.0 | -1.7 | -1.5 | -0.7 | -0.4 | 0.3 | 0.4  | -2.7 | -8.7  | -3.2 |
| Exports  | 1.9  | -2.2 | -0.6 | -6.6 | -7.7 | 0.2  | 1.7  | 0.4  | 3.9  | 2.4  | 2.1 | 1.5  | -0.8 | -12.2 | 8.6  |
| <b>Contributions</b>   |      |      |      |      |      |      |      |      |      |      |     |      |      |       |      |
| Domestic demand excluding change in inventories <sup>(*)</sup> | 0.1  | -0.3 | 0.0  | -0.4 | -0.4 | 0.1  | 0.1  | 0.5  | -0.1 | 0.2  | 0.3 | 0.4  | 0.7  | -0.5  | 0.7  |
| Change in inventories <sup>(**)</sup>                          | 0.3  | 0.0  | -0.2 | -0.7 | -0.8 | -0.8 | -0.2 | 0.6  | -0.1 | 0.2  | 0.0 | 0.0  | -0.3 | -1.8  | 0.3  |
| Net foreign trade  | 0.1  | -0.3 | -0.1 | -0.6 | -0.3 | 0.9  | 0.4  | -0.6 | 0.4  | 0.1  | 0.1 | -0.1 | -0.3 | -0.2  | 0.4  |
| <b>France - situation of households</b>                        |      |      |      |      |      |      |      |      |      |      |     |      |      |       |      |
| Total employment (variation at end of quarter)                 | 63   | -45  | -52  | -111 | -143 | -89  | -45  | 22   | 37   | 26   | -4  | 4    | -145 | -255  | 63   |
| Non-agricultural market sector employment                      | 51   | -57  | -63  | -121 | -158 | -93  | -78  | -7   | 24   | 8    | 4   | 15   | -190 | -337  | 51   |
| Unemployment rate (quarterly average)                          | 7.2  | 7.2  | 7.4  | 7.7  | 8.7  | 9.1  | 9.2  | 9.5  | 9.5  | 9.5  | 9.5 | 9.5  | 7.7  | 9.5   | 9.5  |
| Unemployment rate (quarterly average)                          | 7.6  | 7.6  | 7.8  | 8.1  | 9.0  | 9.5  | 9.6  | 9.9  | 9.9  | 9.9  | 9.9 | 9.9  | 8.1  | 9.9   | 9.9  |
| Consumer price index <sup>(†)</sup>                            | 3.2  | 3.6  | 3.0  | 1.0  | 0.3  | -0.5 | -0.4 | 0.9  | 1.6  | 1.6  | 1.8 | 1.6  | 2.8  | 0.1   | 1.6  |
| Core inflation <sup>(†)</sup>                                  | 2.1  | 2.0  | 2.1  | 1.9  | 1.6  | 1.5  | 2.0  | 1.8  | 1.7  | 1.5  | 1.1 | 1.3  | 2.0  | 1.8   | 1.3  |
| Household purchasing power                                     | -0.1 | -0.4 | -0.4 | 0.9  | 0.3  | 0.8  | 0.6  | 0.1  | -0.1 | 0.4  | 0.3 | 0.4  | 0.3  | 1.6   | 1.1  |

Forecast

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

(\*\*) Inventory changes include acquisitions net of sales of valuable

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