



International developments



Oil and raw materials

The market is easing but the price of crude remains high

Since early 2014, the price of a barrel of Brent has remained at a high level (\$108), due to high geopolitical tensions while those on the physical market remain low. In Q1, the drop in demand from the OECD countries was accompanied by a slight increase of world production.

In Q2 2014, demand should only increase slightly due to a seasonal lull in the OECD countries. Furthermore, certain OPEC nations (Libya, Saudi Arabia) should be able to once again increase their production, while American production should remain dynamic.

Demand should increase in H2 2014, essentially driven by the OECD countries, and supply, bolstered by a high level of production both in the OPEC nations and on the American continent, should meet this demand. The price of a barrel of Brent, forecast to remain at \$108, is nonetheless subject to several uncertainties: about the rebound in production capacities in the OPEC nations, the international tensions engendered by the Ukrainian crisis and the agreement on the nuclear issue in Iran.

Demand shrank in Q1 2014, while supply increased

Demand shrank in Q1 in Europe where energy needs were low as a result of a mild winter. In the United States, despite a harsh winter, demand dropped off due to less traffic on the roads and the

maintenance period of the refineries. Supply increased, especially in the OPEC nations, but less than had been expected because of lower production in the central European countries (Russia, Kazakhstan).

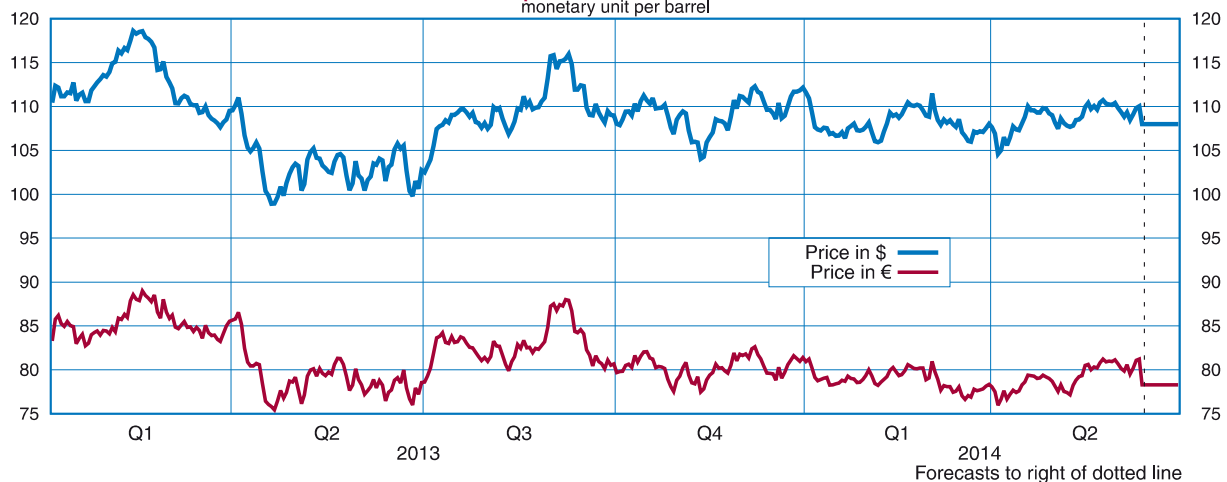
Nevertheless, the price of a barrel of Brent remained high (on average \$108, *see Graph 1*). After a period of slight easing at the start of Q1, the rise in international tensions around the Ukrainian crisis served to maintain the price of oil at a high level.

In Q2 2014, supply and demand should increase in parallel

In Q2 2014, demand should only increase slightly (+0.7 Mbpd). It is likely to drop in the OECD countries (-0.5 Mbpd), mainly in Japan (-0.9 Mbpd) where the fall in consumption is seasonal at the end of winter. However, it should be more dynamic in the non-OECD countries (+1.2 Mbpd), in particular in the Middle East (+0.4 Mbpd) where higher temperatures lead to an increase in the electricity consumption required for air-conditioning.

Supply should also show a slight increase (+0.4 Mbpd), benefiting from both the seasonal rise in the production of biofuels (+0.4 Mbpd) and the resumption of production from the OPEC nations (*see Graph 2*), especially in Libya where a political compromise between central government and the

1 - Price of Brent in € and in \$
Last point: June 12th 2014
monetary unit per barrel



Source: Financial Times

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rebel forces should enable the gradual restart of several terminals. In Iraq, production has once again been on the increase since the end of Q1 2014, but internal tensions make the continuation of this recovery uncertain. Finally, Saudi Arabia has pledged to increase its offer if necessary.

In H2 2014, the sustained dynamism of supply should match an increase in demand

In Q3, production should continue to increase in Libya, in Iraq and in Saudi Arabia. Moreover, production may also rise in Iran if an agreement is reached with the G5 countries and Germany in July. Production should however drop slightly in Europe (-0.3 Mbd) due to the period of maintenance of the infrastructures in the North Sea. Demand should increase within the OECD

countries (+1.0 Mbd) as a result of the driving season, and in the Middle East (+0.4 Mbd).

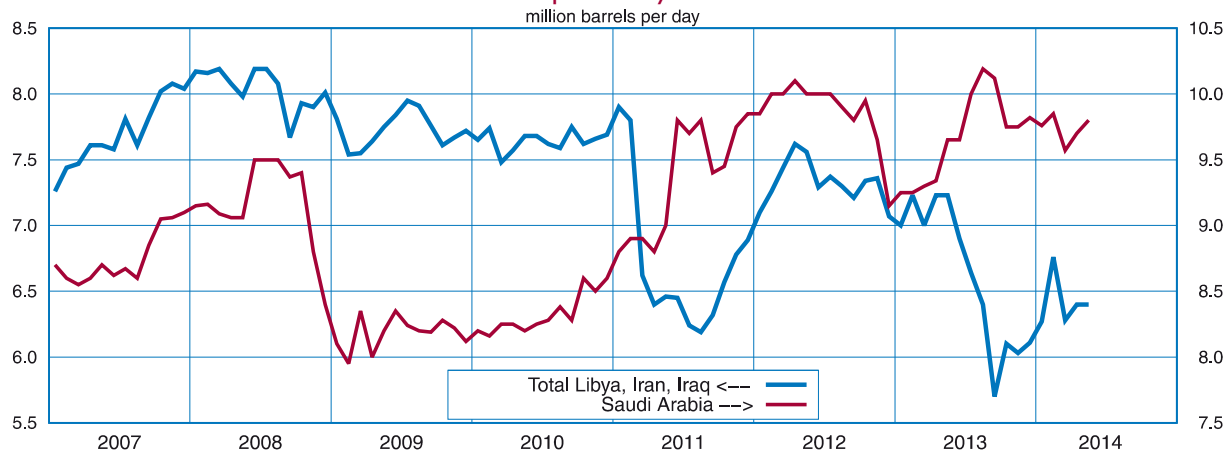
In Q4, production should be boosted by the restart of facilities in Europe, by an increase in the American capacities of shipping oil to the Gulf of Mexico and by continuing dynamic production by the OPEC nations. Demand should also continue to rise, boosted by the reinforcement of business in the OECD countries.

The price of the barrel of Brent crude likely to stabilise at around \$108

All in all, given that the increases in supply and demand are likely to be equal, the price of Brent should stabilise through to the end of the year. By convention it is thus set close to its last observed price (on average \$108 in April 2014). The

2 - Oil production in Saudi Arabia, Libya, Iran and Iraq

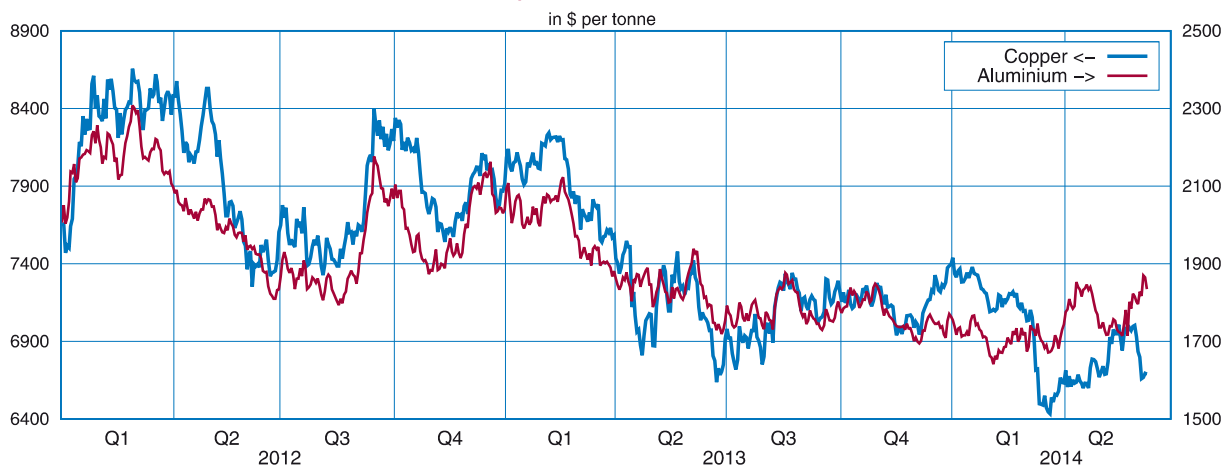
Last point: May 2014



Source: AIE

3 - Prices of industrial metals

Last point: June, 12th 2014



Source: London Metal Market

internal difficulties of the OPEC nations could weigh on the cartel's production. Furthermore, any worsening of the Ukrainian crisis would probably bring about new increases in the price of oil. Conversely, an improvement in relations between Iran and the Western powers could foster an easing of prices.

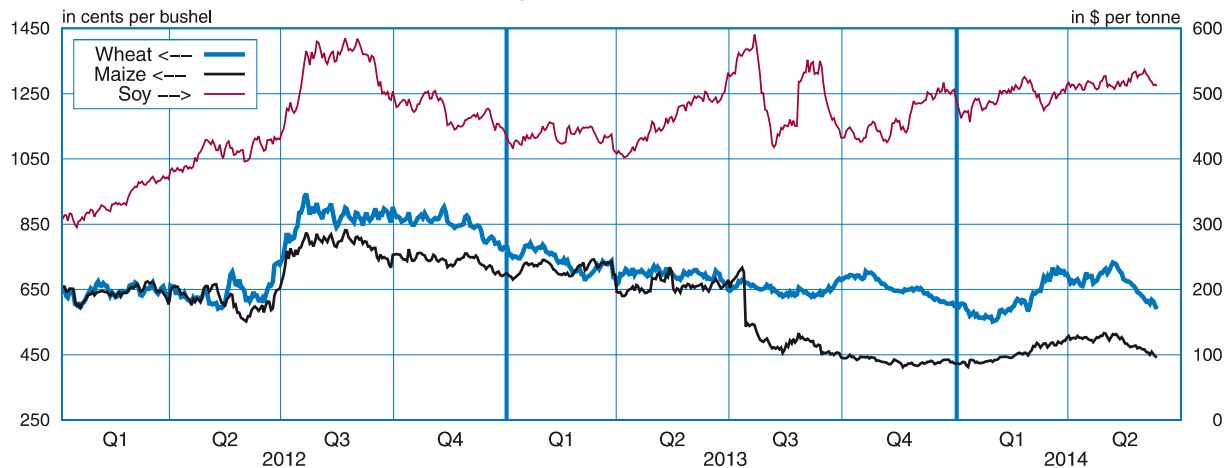
In Q2, industrial commodity prices are picking up.

Marked by slow growth worldwide and by surplus production resulting in an increase in stocks, prices on the industrial metals market dropped in Q1 2014 (see *Graph 3*). This is particularly the case of the price of copper, due to an industrial slowdown in China. Prices are recovering in Q2 as a result of

strong demand worldwide. Similarly, the prices of aluminium should rise sharply in Q2 because of the embargo on the export of raw ore in Indonesia and to extremely long supply lead times.

Prices of agricultural commodities increased in Q1 (see *Graph 4*), as a result of the tensions engendered by the crisis in Ukraine (one of the leading producers of cereals). The increase has however remained relatively modest, given the high level of maize production bolstered by record harvests in the United States. The same applies to wheat which benefited from better weather conditions and substantial reserves worldwide. Future price prospects depend on the evolution of the geopolitical tensions in central Europe. ■

4 - Prices of food commodities
Last point: June, 12th 2014



Source: Data Insight

Financial markets

Monetary policies put to the test of recovery

Faced with signs of economic recovery, albeit slow in the Eurozone but somewhat stronger in the other developed countries and in particular in the United States, the issue of the monetary policy to be adopted is critical on both sides of the Atlantic.

For the moment, the Fed, faced with the consolidation of the recovery and the upturn in the labour market, continues to maintain its strategy towards an end to quantitative easing by reducing the amount of its monthly securities purchases.

The ECB is faced with weak inflation, a lasting shrinkage of loans to the private sector and the high level of the Euro which has taken its toll on the competitiveness of the monetary union. In June 2014, it lowered its base rate to 0.15% and announced the implementation, as from the Q3 2014, of several very long-term refinancing operations.

Despite these persistent difficulties, the increasingly apparent return of growth in the Eurozone and the reallocation of international capital flows in Euros are all beneficial to the sovereign debt market, especially in the peripheral nations. This attractiveness is sustaining the Euro exchange rate which stands at a high level against the dollar despite the trend towards a tightening of monetary policy in the United States.

Over the forecasting period, the conventional assumptions for exchange rates against the Euro are 1.36 dollars, 139 yen and 0.81 pounds.

Monetary policy continues to return to normal in the United States but eases in the Eurozone

In Q2 2014, the Fed maintained the push to bring its monetary policy back to normal. It once again reduced the pace of its securities purchasing at the end of April 2014 for the fourth consecutive time. Since May 2014, the Fed's monthly purchases are 20 billion dollars in mortgage backed securities (MBS) and 25 billion dollars in Treasury bonds, just half of what it was purchasing at the end of 2013. Its securities purchasing should end completely at the end of 2014, marking the end of the period of

expansion of its balance sheet that began in 2008. At the same time, the interest rate policy of the Fed remains unchanged. Its base rate has stood at 0.25% since September 2009. Any change in that policy is conditional upon a new, substantial upturn in the labour market.

The gradual drop in inflation in the Eurozone is a matter of concern for the ECB. Consequently, at its meeting of June 5, 2014, the Board of Governors considerably eased the bank's monetary policy. The deposit rate was lowered by 10 base points to 0.15% and the credit facility rate, where the banks deposit their surplus liquidity on a day-to-day basis, was lowered to 0.1%. Furthermore, as from September 2014, the ECB will undertake targeted longer-term refinancing operations in two stages:

- in September and December 2014, the ECB will offer European banks a four-year loan the amount of which may reach up to 7% of their outstanding loans to the non-financial private sector (to the exclusion of property loans to households) as recorded in April 2014, i.e. an amount of approximately €400 billion;

- between March 2015 and June 2016, each quarter the ECB will loan banks up to three times the amount of their new net loans to the non-financial private sector (again to the exclusion of property loans to households) at a rate close to the base rate.

Finally, the ECB will extend its list of collaterals eligible as backing for its refinancing operations and will maintain its procedure of calls for tender entirely serviced at a fixed rate for the main refinancing operations up to at least December 2016. It has also announced that it will be stepping up its preparation for the eventual implementation of a programme for the purchasing of securities backed by loans to non-financial enterprises.

In the United Kingdom, as in Japan, monetary policy has remained unchanged. The Bank of England (BoE) has kept its base rate (at 0.5%) and still holds a substantial amount (unchanged since the summer of 2012) of Treasury bonds to the amount of 375 billion pounds or 20% of GDP. The rapid drop in unemployment below the target of 7% initially quoted by the BoE suggests the end of the *status quo* in the coming quarters. In Japan, the central bank maintains its highly accommodative policy that began in early 2013 to enable the

country to put an end to deflation. It therefore continues to expand its monetary base at an annual rate of 60 to 70 trillion yen (approximately 15% of GDP per year between 2013 and 2015).

In the Eurozone, the interbank market is picking up but lending continues to shrink

Despite the reduction in the surplus liquidity held by the banks, a large number of European banks continue to refinance at the ECB counter thanks to the liquidity loaned during the extra-long-term refinancing operations at the end of 2011 and in early 2012. This is the case in particular in the peripheral nations where financial institutions remain fragile. Nevertheless, the interbank market has been showing signs of improvement since early 2014: the volumes traded on a day-to-day basis are definitely on the rise, leading to a return of some volatility. Exchanges are, however, still made preferentially between banks in countries at the «core» of the Eurozone to the detriment of those in the peripheral nations, resulting in persistent disparities.

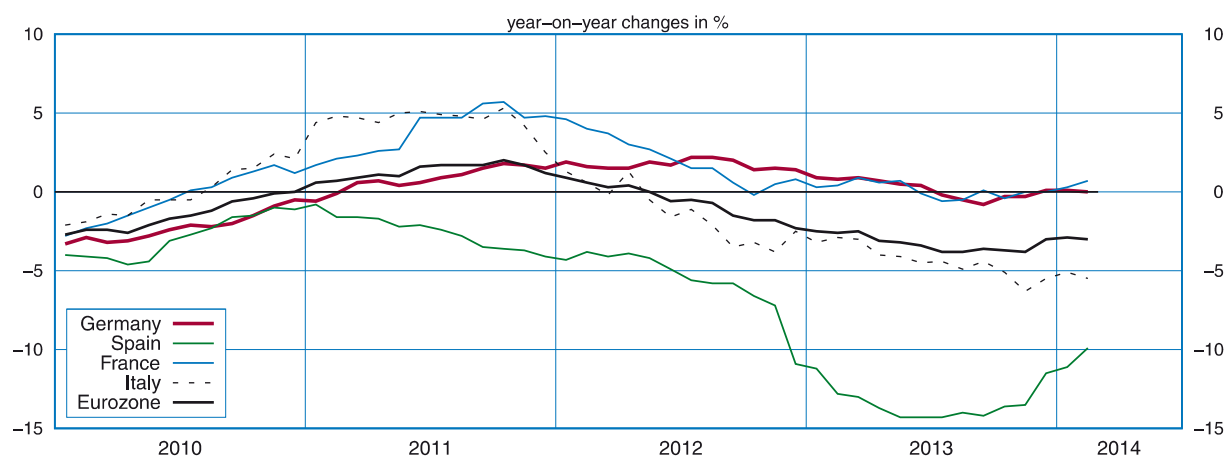
Lending to businesses remains marked by the drop in outstanding loans in Q1 2014, albeit at a slightly slower pace than at the end of 2013. This drop is particularly noticeable in Italy and Spain (see Graph 1). The Bank Lending Survey undertaken by the ECB released in April 2014 attributes the smaller drop in outstanding loans to the fact that applications to the banks have gained momentum in a context of stability of supply. However, according to the survey on access by European SMEs to financing also undertaken by the ECB (the SAFE survey) covering the period from

October 2013 to March 2014, 14% of European SMEs are still faced with difficulties in obtaining external financing (for an analysis of the impact of lending conditions on French firms between 2003 and 2013, see the report in this *Conjoncture in France* "The corporate credit market in France: is there an accelerator effect on the economy?"). Furthermore, within the Eurozone, there are still considerable disparities between the different bank loan rates charged to businesses. The average interest rates on new loans granted to Italian and Spanish business are in fact more than one point higher than those granted to German and French businesses (see Graph 2).

The sovereign debt market continues gradually to return to normal

In the Eurozone, the return to normal of the financing conditions of European sovereign debt continues and the main countries impacted by the sovereign debt crisis in 2011 are beginning to enjoy more favourable conditions. The sovereign 10-year yields in Spain and Italy continue to drop, and were around 2.9% and 3.0% respectively in May. The situation in the countries that were harder hit is also improving: in April, Greece made its first issue of long term sovereign debt since 2010 (€3 billion at 5 years at 4.9%); in May, Portugal exited the Troika bailout programme without opening any new line of credit. At the same time, Germany and France continue to benefit from very advantageous financing conditions (with rates at 1.4% and 1.8% respectively in May). Similarly, the United States and the United Kingdom have kept low and stable rates since the start of the year.

1 – Outstanding bank lending to non-financial enterprises in the Eurozone
Last point: April 2014



Source: European Central Bank

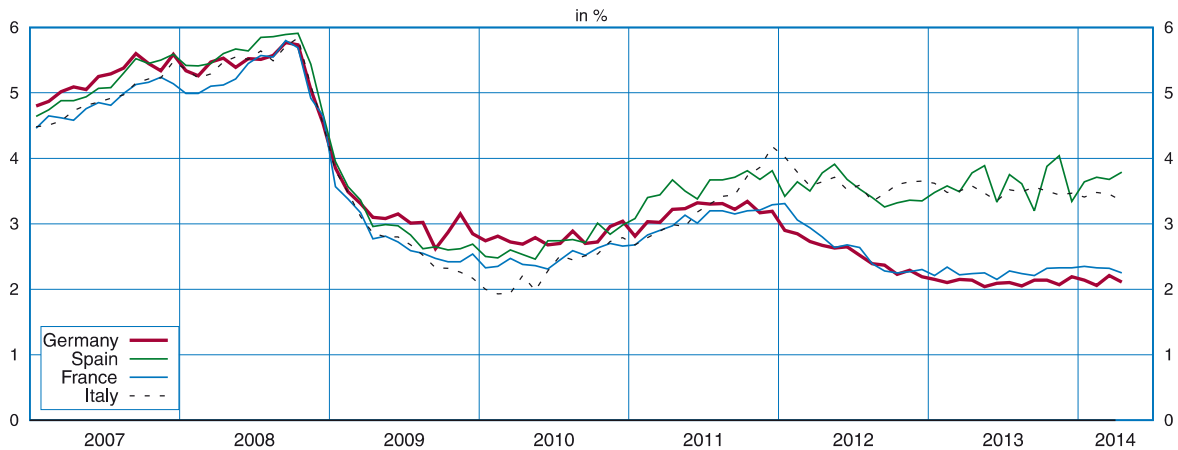
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The Euro remains strong

Despite the slowdown in American quantitative easing and the expected differentials in inflation and growth rates, the Euro remains strong against the dollar (see Graph 3). This can be partially explained by the renewed attractiveness of European investments and in particular the sovereign debt of the peripheral nations which present relatively high yields and that are again

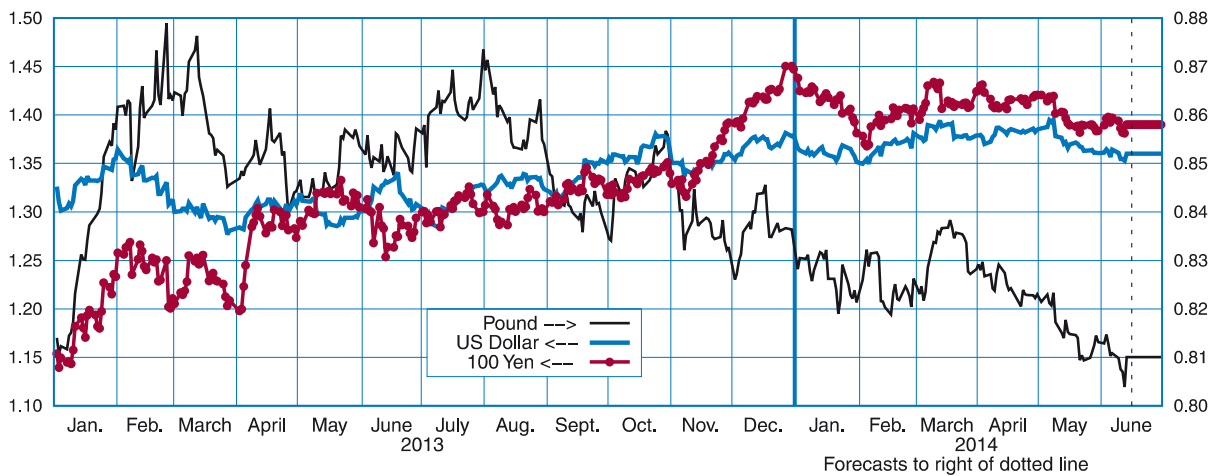
considered as bearing little risk. At the same time, the Yen has remained stable despite the continuation of the quantitative easing programme implemented by the Japanese central bank. On the other hand, the Pound continues its appreciation which started in the summer of 2013. Furthermore, the Chinese authorities have continued to allow the Yuan to depreciate against the dollar. As of May 1st, 2013, it was at its lowest level since the end of 2012. ■

2 – Average bank lending rate to non-financial enterprises
Last point: April 2014



Source: European Central Bank

3 – Euro exchange rates
Last point: June, 12th 2014



Source: European Central Bank

Eurozone

A soft recovery

In Q1 2014, activity grew again in the Eurozone: +0.2%, after +0.3% in Q4 2013. This rise was on a smaller scale than expected, mainly because of a disappointing world trade. But the increase in domestic demand (+0.2% after +0.1%) confirmed the gradual return of growth inside the zone.

This trend should continue until the end of the year, with domestic demand still progressing moderately (+0.2% in Q2, then +0.3% per quarter in H2). Although sluggish (+0.3% per quarter), consumption should improve thanks to modest increases in real wages and the weakening of fiscal consolidation, while the upturn in corporate investment should gather pace.

All in all, GDP in the Eurozone should rise by 1.0% in 2014, after falling by 0.4% in 2013.

Moderate growth in Q1 2014

In Q1 2014, activity in the Eurozone rose moderately, as in late 2013 (+0.2% after +0.3%). This rise is not as much as was forecast in the Conjoncture in France for March 2013 (+0.4%), mainly due to the only slight increase in exports (+0.3%). However, gradual recovery in the Eurozone is confirmed: as expected, domestic demand excluding inventory rose slightly (+0.2% after +0.1%), particularly private consumption

(+0.1% after +0.0%). Capital expenditure, although slowing slightly, also remains dynamic (+1.5% after +2.7%).

According to the business tendency surveys, activity should continue to grow

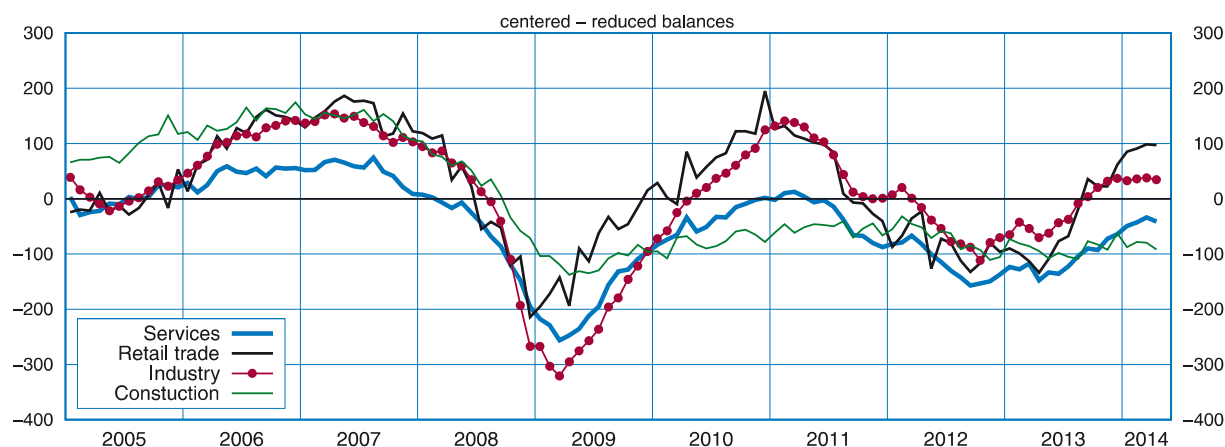
After a strong improvement between mid-2013 and late 2013, the business tendency surveys have been globally stable since the beginning of the year, at a level that is consistent with moderate growth. Only the construction sector continues to be in a clearly adverse phase (see Graph 1).

The surveys indicate continued modest growth in the order of +0.3% per quarter until the end of the year.

Growth mainly driven by domestic demand: consumption...

Household purchasing power should increase again in 2014 (+0.8%), after a slump of four consecutive years, with the conjunction of two favourable factors. On the one hand, growth in activity should generate growth in employment, at a rate comparable to that of late 2013 (+0.1% per quarter). However, this increase is unlikely to be sufficient to lower the unemployment rate, which should stabilise at its April level (11.7%). The upswing in activity should also foster moderate growth in real wages (particularly in Germany and

1 - Confidence index by sector



Source: European commission

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Spain). On the other hand, with the rate of fiscal consolidation weakening, the tax pressure on households should lessen (particularly in Italy).

In these conditions, consumption should again grow (+0.7% on average over the year), after a slump of two consecutive years (-0.6% in 2013 after -1.4% in 2012).

... and corporate investment, in spite of the decline in construction

After a steep downturn between mid-2011 and mid-2013, corporate investment has returned to relatively dynamic growth since the middle of last year (+1.5% on average since H2 2013). It is forecast to maintain this pace, supported by improved demand prospects and the need to renew production capacities after a marked phase of adjustment. This solid growth in investment should be in evidence in the leading countries in the Eurozone, with the exception of France, where the need for renewal is limited by the relatively good level of capital expenditure since 2010.

However, investment in construction remained sluggish in Q1 and should fall in Q2 2014 (-0.7%, mainly in reaction to the mild winter in Germany). Expenditure should then stagnate in H2, with contrasting developments depending on the country: in Germany, construction expenditure should rise sharply, particularly thanks to the release of reconstruction funds after the floods of spring 2013; conversely, in Spain, Italy and France, investment should continue to fall, though at a progressively slower rate. These short-term phase differences in construction between Germany and its main partners account for about half of the GDP growth differentials forecast for 2014.

Foreign trade no longer contributing to growth

Having stagnated in Q1, exports should then develop in a manner that is consistent with world demand: +1.2% in Q2 in reaction to the sluggishness of Q1, then +0.8% per quarter. In the wake of domestic demand, imports should also increase again at a relatively sustained pace (about +1% per quarter) and the contribution of foreign trade to growth should be nil in 2014, a sign of renewed vigour in domestic demand (see Graph 2).

Inflation set to remain limited

In May 2014, headline inflation stands at +0.5% year-on-year. It should increase slightly to +0.8% by December, as a result of the new rise in energy prices. Assuming that the price of Brent remains stable at \$108 (€79.4) and as the decline observed in October and November 2013 comes to an end, the year-on-year variation in energy prices should see an increase of +0.5% in December 2014, after 0.0% in May. Moreover, the upturn in the price of food commodities observed since the beginning of 2014 should contribute to stepping up food prices by the end of the year. On the other hand, core inflation should remain limited: +0.8% over one year in December, after +0.7% in May. ■

2 - Domestic demand set to take over from foreign demand

