International developments

Oil and raw materials

Towards a return to market equilibrium

In Q3 2016, the price of Brent hovered around $47 per barrel on average, as it had done in Q2. Supply rebounded, driven by record production by the OPEC countries, and demand returned to trend growth. All in all, the surplus in the physical crude market increased.By June 2017, the gap between supply and demand is likely to narrow: world oil production should stabilise, especially in the OPEC countries and Russia which should be cutting their output after the agreement reached at the end of November, as well as in North America. The pace of demand is unlikely to alter. Stocks are expected to remain high. Through to June 2017, the conventional assumption is that oil prices will be around $50, their level at the beginning of December. The increasing pressure to tighten the physical market should be contained by the high level of stocks. Commodity prices in Euros climbed back slightly in Q3 2016, although levels remained low. Prices of industrial commodities continued to increase. However, cereal prices plummeted during the summer (–11.3%) as a result of abundant global harvests.

In Q3 2016, the price of Brent held at around $47 per barrel

In Q3 2016, the price of a barrel of oil (Brent) averaged $47, as in Q2, a level that was one third higher than in Q1. At the end of September, the price reached $50 per barrel (*Graph 1*), following the announcement by OPEC of a possible agreement by the cartel to cut production, details of which were finalised at the end of November. The price of oil is hovering around $50 on average in Q4 2016.

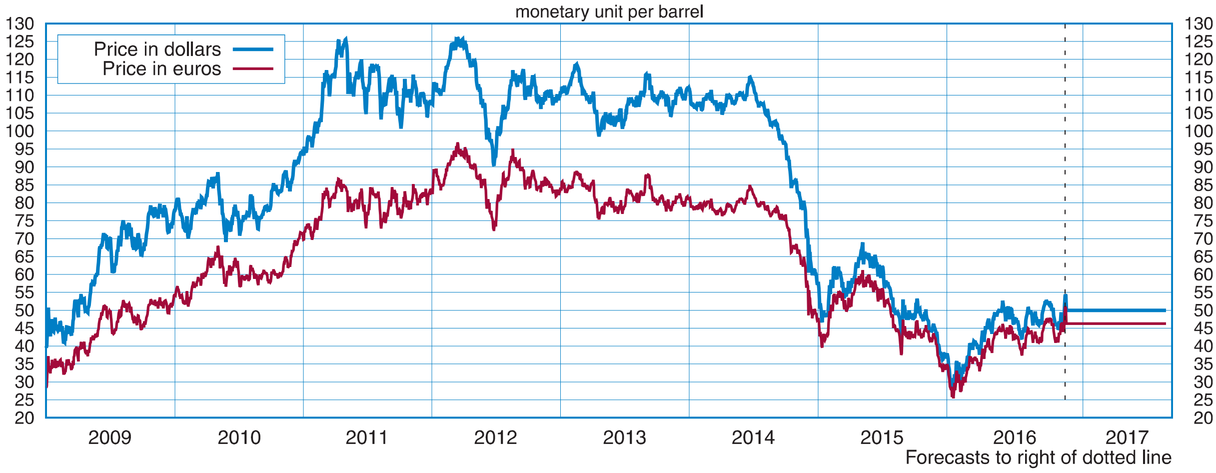
Supply should stabilise through to mid-2017 if OPEC manages to curb production

In Q3 2016, oil supply rebounded strongly (+0.8 million barrels per day - Mbpd) after two quarters of sharp decline (*Graph 2*). This rebound was due mainly to record production by OPEC (+0.6 Mbpd): Saudi Arabia produced 10.6 Mbpd and Iraq 4.4 Mbpd, their highest levels since 2007. In addition, production in Iran continued to rise (+0.7 Mbpd since January 2016), returning to its pre-embargo level.

In Q4, production is likely to decline moderately in Saudi Arabia. In Libya, output is expected to increase with the end of the blockade on the terminals and should reach 0.4 Mbpd. Production in Iran and Iraq should continue to increase. In H1 2017, assuming that the agreement announced by OPEC and Russia at the end of November is respected, production by Saudi Arabia will probably decline by an average of 0.3 Mbpd compared with H2 2016. However, production by Libya, Iran and Nigeria is likely to continue to increase, so that overall, OPEC's output should stabilise.

In America, supply from OECD member countries is expected to stabilise globally. In the United States, the new rig count was higher in Q3 2016. However, output looks set to continue its decline, given the collapse of the rig count since the end of 2014. Supply in Canada, however, looks set to pick up considerably after the Fort McMurray fire. All in all, world production seems likely to virtually stabilise through to mid-2017.

1 - Price of Brent in euros and in dollars



Source: Macrobond

Demand should continue to increase at its trend pace

In Q3 2016 global demand for oil returned to its trend growth (+0.4 Mbpd), after weakening slightly in the previous quarter. It was better sustained by non-OECD countries, including China, and by OECD member countries in the Americas. In Q4 2016 demand is expected to remain vigorous, mainly driven by the emerging economies. As an annual average for 2016, demand should increase by 1.2 Mbpd, a smaller increase than in 2015 (+1.9 Mbpd) but similar to that of 2014 (+1.1 Mbpd). In H1 2017, demand looks set to continue to rise at its trend pace, once again driven by demand from China and the other emerging countries.

The high stock level should curb the rise in prices

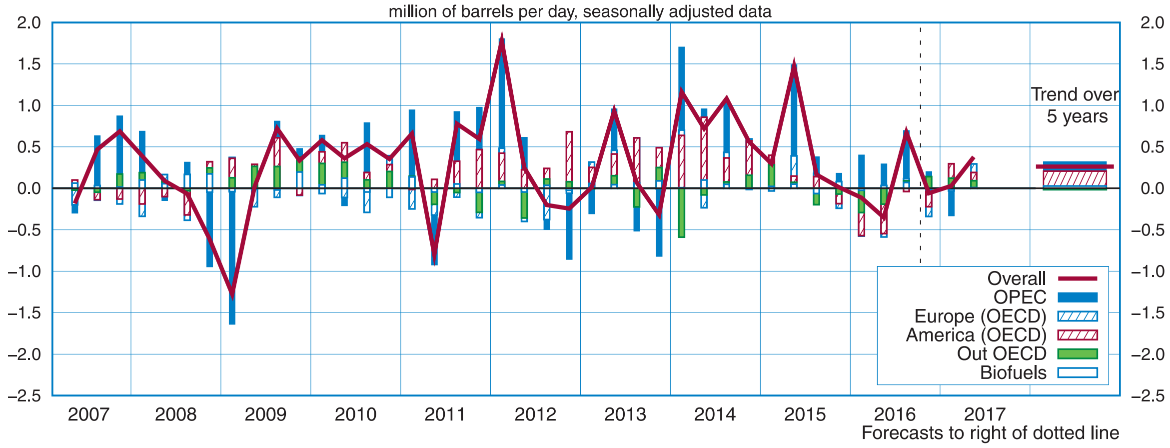
Surplus supply, which was still substantial at the end of 2015, has tended to diminish since the start of 2016, mainly because of the decline in American supply (*Graph 3*).

In the United States, stocks of crude declined in Q3 (–4.0%) after reaching the record level of 539.8 million barrels at the end of April. However, these commercial reserves are still very much higher than the average level between 2010 and 2014, and may therefore limit any price rise that could be generated by a tightening of the physical market (*Graph 4*). Similarly, the rebound potential of oil production in North America should prices recover is likely to limit the upward pressure on prices.[1]

Two uncertainties overshadow the supply scenario. First, the stabilisation of production by OPEC following the reduction agreement at the end of November is by no means a certainty. If, ultimately, production by the cartel declined, this would encourage a price rise; but if, on the contrary, the agreement were not respected, the physical market

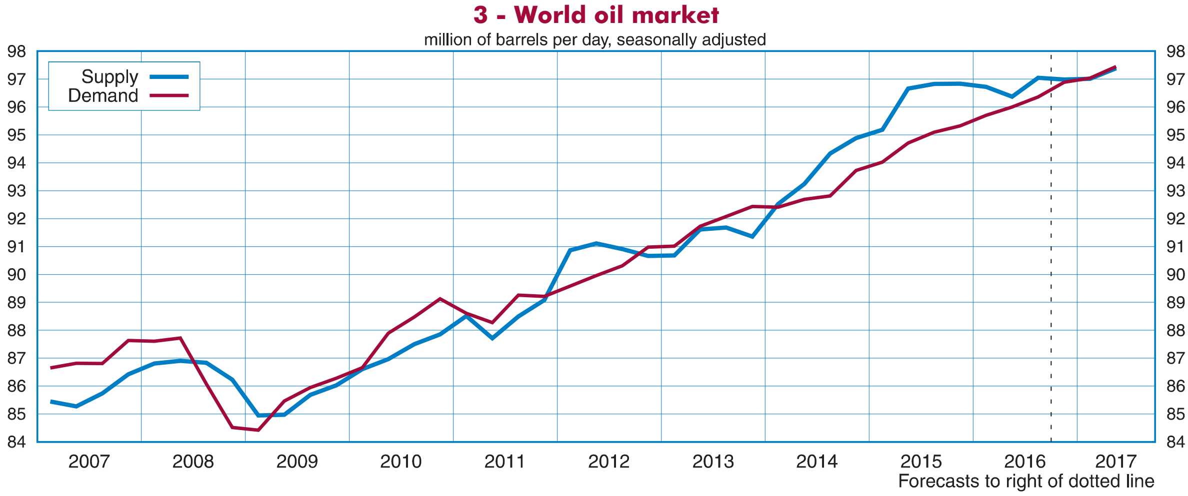
1. See Focus "A sharp downturn in American oil production expected by the end of 2016", *Conjoncture in France*, June 2016.

2 - Principal contributing factors to the variation in global oil supply



Source: IEA, INSEE

3 - World oil market



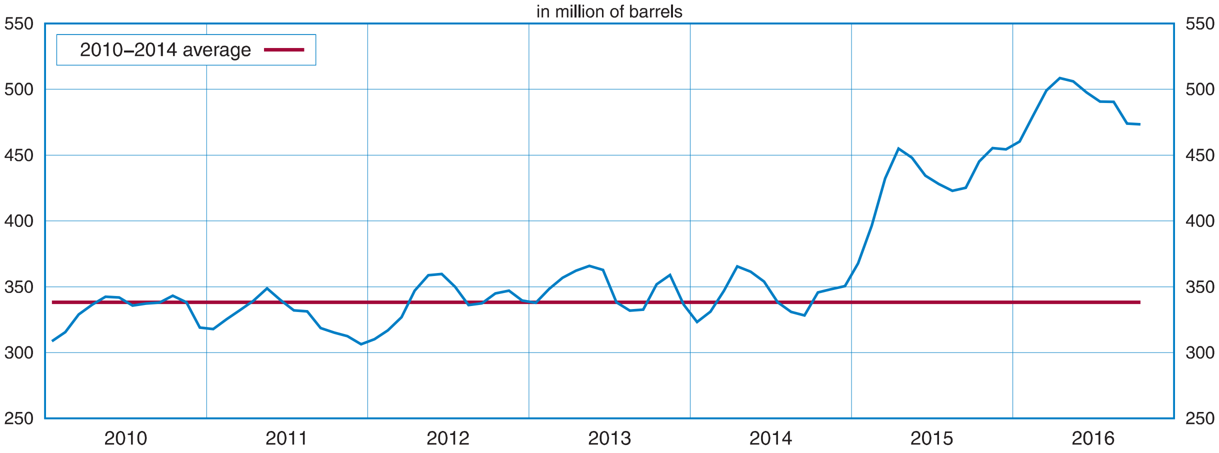
Source: IEA, INSEE

would remain in surplus, curbing prices. Second, although US production is expected to fall according to this scenario, forecasts by the International Energy Agency (IEA) and the US Department of Energy (DoE) suggest an earlier rebound, from Q2 2017, which in this case would affect prices.

Prices of other commodities increased moderately

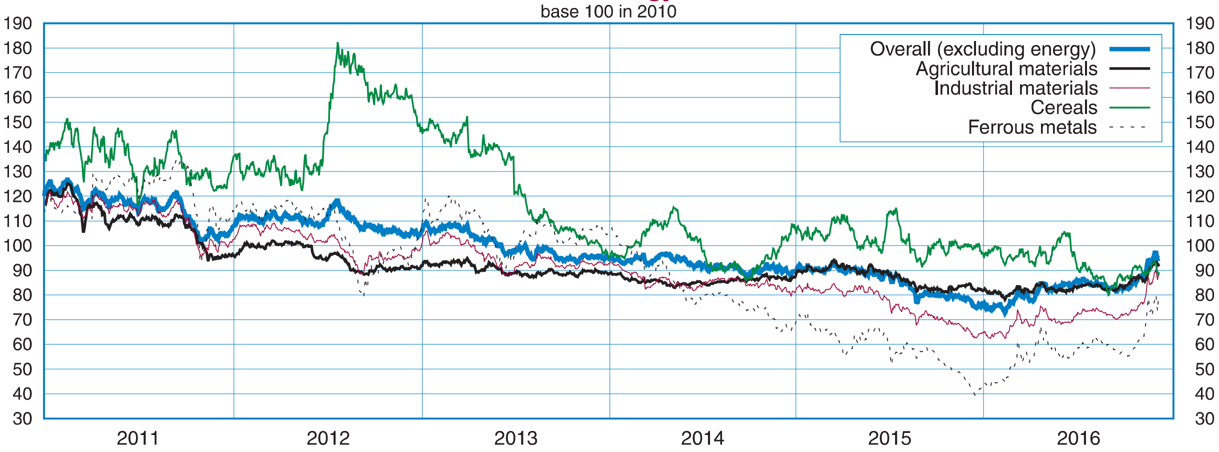
In Q3 2016, prices in Euros of commodities excluding energy rose slightly (+1.4%), but they remained lower than at the beginning of 2015 (*Graph 5*). Cereal prices plummeted in the summer (–11.3%) due to the effect of abundant harvests, especially in Eastern Europe and the United States. However, the price of industrial commodities continued to rise in Q3 (+3.3%). ■

4 - U.S. crude oil inventories
in million of barrels



Source: DoE

5 - Prices of non-energy commodities
base 100 in 2010



Source: HWWI

Financial markets

Financial markets stand up to political uncertainties

By mid-2017, monetary policy orientations are expected to continue to diverge on either side of the Atlantic. On the one hand, the American Federal Reserve is likely to gradually raise its base interest rates once again, bolstered by the prospects of US inflation rising above the 2% target and a labour market that is still moving in the right direction. On the other hand, inflation remains very low in the Eurozone and the ECB is pursuing its accommodating monetary policy. It is expected to extend its programme of asset purchases beyond March 2017. The Eurozone credit market continues to improve, although situations differ from country to country. Outstanding loans to businesses are growing solidly in France and Germany, while they are still decreasing in Spain and Italy. For the end of the year, the European banks are still expecting a rise in the demand for credit and plan to relax their conditions slightly once again. After falling back following the Brexit referendum, European sovereign yields are recovering slightly in anticipation of the increase in American base rates and the prospects of increased US debt after the result of the presidential election; at the beginning of December they were still at relatively low levels. The consequences of the pro-Brexit vote then the American presidential election have taken their toll on the foreign exchange market: in Q3, the pound depreciated against the other currencies, especially the Euro, which itself depreciated against the yen and the emerging currencies; in Q4, the dollar appreciated against the Euro. The real effective exchange rate has varied little overall since March 2016 and should remain almost stable over the forecasting period. For the purposes of this forecast, the Euro exchange rate is set at 1.06 dollars, 0.85 pounds sterling and 120 yen.

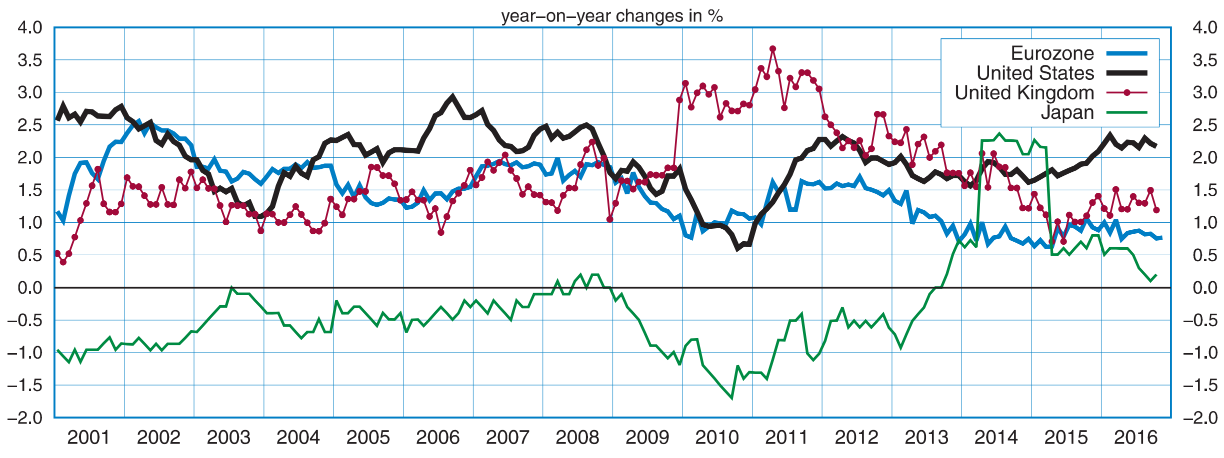
The Fed is likely to raise its base rates slightly once again

After raising its base interest rates in December 2015 for the first time in ten years, the American Federal Reserve (Fed) has not adjusted them since. However, the unemployment rate remains low (4.6% in November) and American core inflation has stayed firmly above the 2% threshold since January 2016 (*Graph 1*), so the Fed seems likely to tighten its monetary policy by gradually raising its base interest rates.

The ECB seems set to pursue its accommodating monetary policy

For its part, the European Central Bank (ECB) confirmed in October 2016 that it was extending its accommodating policy, as core inflation remains low, at less than 1% since the beginning of the year. Base interest rates are being kept at a historic low: the deposit facility rate has been held at –0.4% since March 2016. In addition, the ECB is continuing its asset purchase programme in the secondary market at a rate of 80 billion Euros per month; this programme is supposed to end in March 2017 but the ECB has hinted that it could be extended beyond that date.

1 - Core inflation in the world



Source: Eurostat, BLS, JSB, ONS

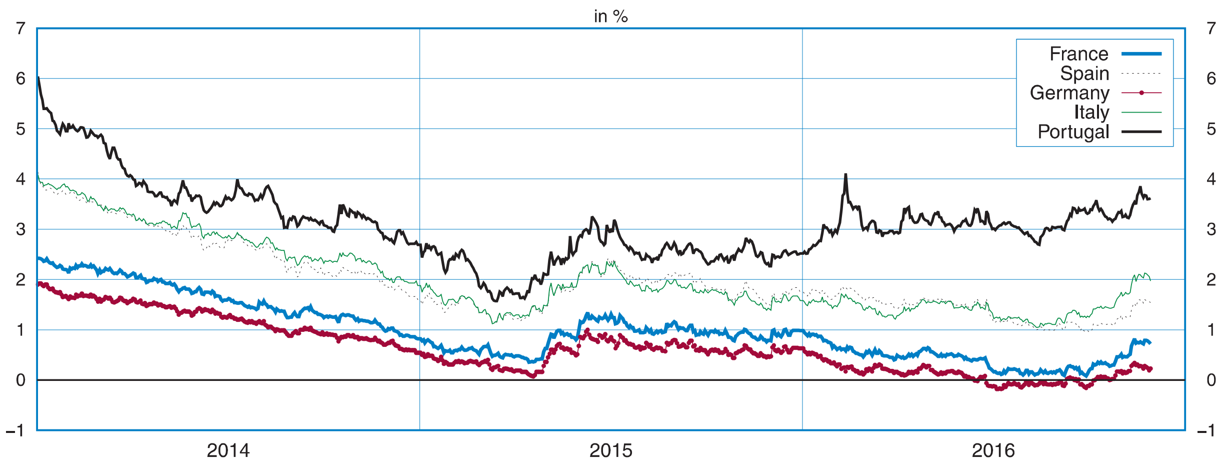
European sovereign yields are rising again

Sovereign yields in the advanced economies weakened after the result of the Brexit vote on 23 June, reaching historic lows, then picked up in the autumn in anticipation of the rise in US base interest rates by the Fed and the prospects of a strong increase in US debt after the presidential election. At the beginning of December, the French 10-year bond yield settled at around 0.8% after falling to an all-time low of 0.2% in July 2016. The German 10-year yield became negative in July 2016, then climbed again to settle at around 0.3% at the start of December (*Graph 2*). The Spanish and Italian 10-year yields also fell substantially to a low of around 1%, then recovered, with the Italian yield even rising back over the 2% threshold.

Outstanding loans to businesses in the Eurozone increased further

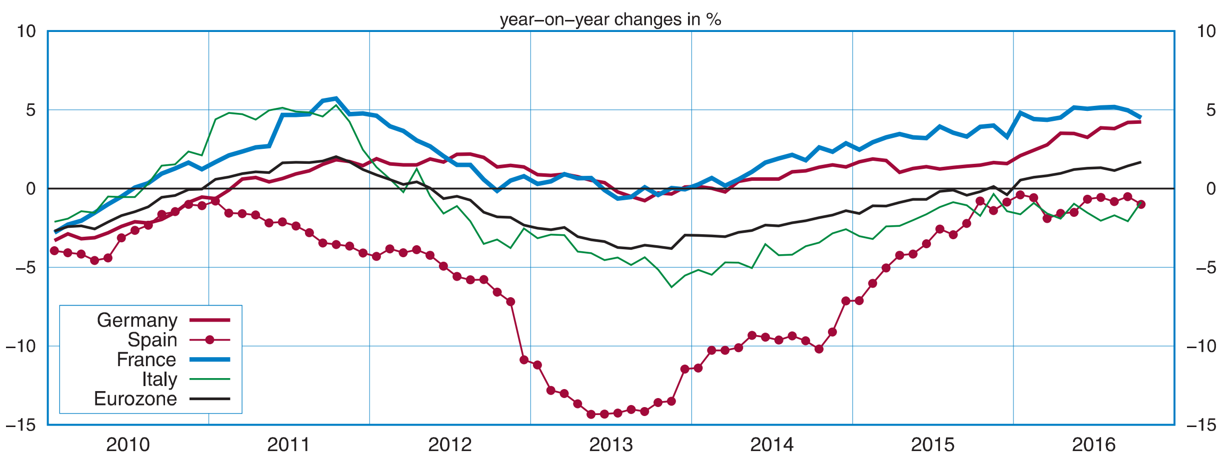
In the Eurozone, outstanding loans to non-financial corporations have increased since the beginning of 2016, maintaining the upturn that got underway in early 2014: in October 2016, they had increased by 1.7% year on year – growth that has been unprecedented since 2011 (*Graph 3*). Outstanding loans are buoyant in France (+4.5% year on year) and Germany (+4.2%), but are still falling in Italy and Spain. However, before the recent rise in sovereign yields in Italy, interest rates for new loans had converged between the main Eurozone countries (between 1.4% and 2.1%).

2 - Ten-year sovereign yields



Source: Macrobond

3 - Annual growth rate of outstanding loans in the Eurozone



Source: European Central Bank

International developments

Stock market indices have returned to their pre-Brexit referendum level

After taking a brief tumble in the aftermath of the British referendum results on 23 June, the main stock market indices in the advanced countries rebounded sharply in July and August. Despite the surprise US election result, they continued to improve in November. In addition, their volatility remains lower than the levels reached just after the Brexit result, which themselves were relatively low when set against previous shocks (*Graph 4*).

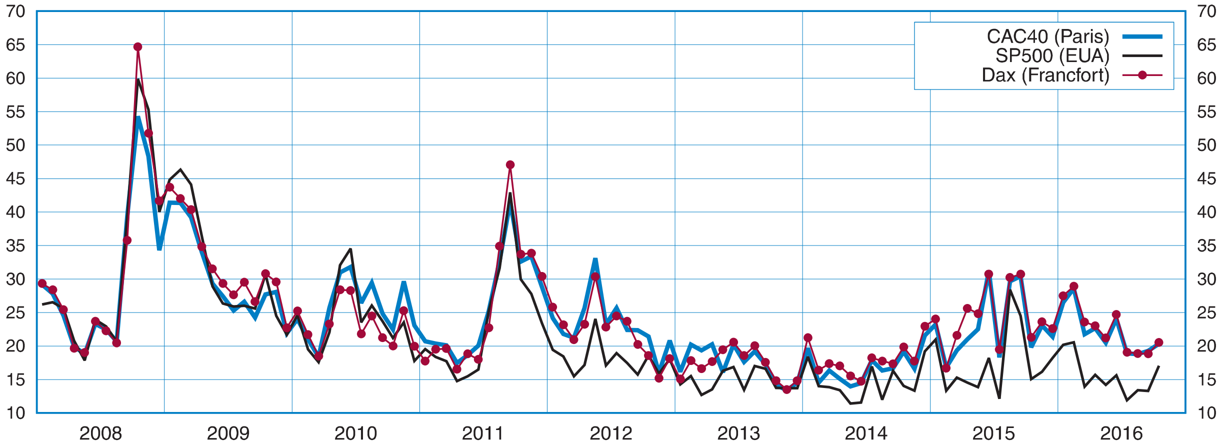
For their part, stock market indices in the emerging countries have been rising overall since February 2016, to a large extent wiping out the declines of summer 2015 and January 2016.

The Euro exchange rate is withstanding political uncertainties

After falling substantially in 2014 and early 2015, especially against the dollar, the Euro exchange rate has remained almost unchanged since mid-2015 (*Graph 5*). Since the beginning of 2016, although the Euro has appreciated against the pound, both before and after the Brexit vote, this appreciation has been offset overall by a depreciation against the yen and the emerging currencies, especially in Q3. As for the dollar, it appreciated to $1.06 to the Euro at the start of December, with the expectation of an increase in base rates by the Fed and the prospects of a rise in US debt.

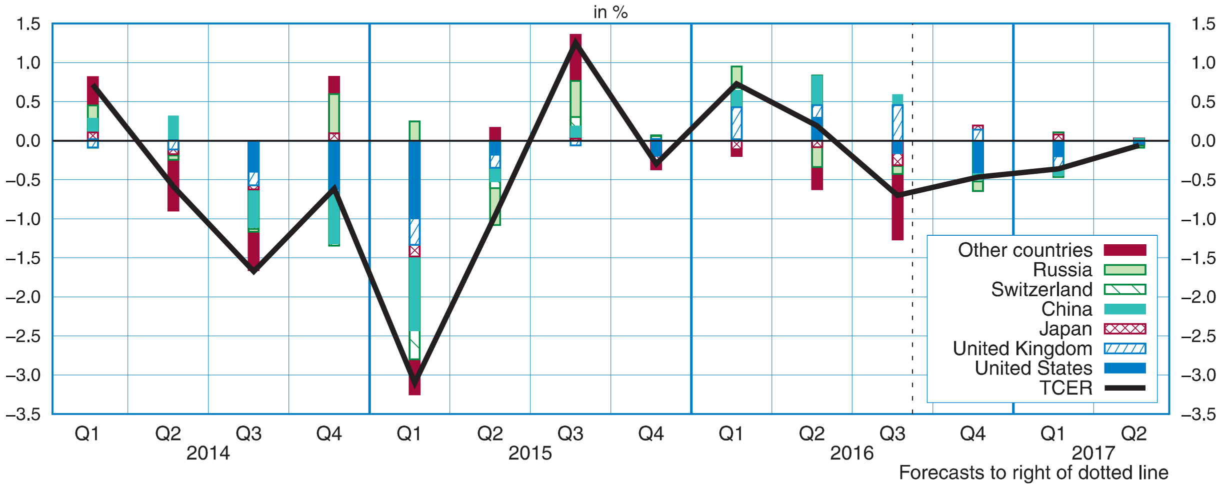
By convention, the Euro exchange rate is fixed at its last recorded level of early December (1.06 dollars, 0.85 pounds sterling and 120 yen) for this forecasting period. ■

4 - Monthly average volatility of stock market indices of the advanced countries



Source: Macrobond

5 - Quarterly change in real effective exchange rate (REER) and its contributing components



Source: DG Trésor, INSEE forecast

Eurozone

Residential investment and consumption driving growth

After increasing by 0.3% in Q3 2016, activity is expected to pick up slightly in the Eurozone to +0.4% through to mid-2017. Despite greater political uncertainties, the business climate remains positive and actually improved in the autumn. Due to its energy component, inflation is likely to rise to +1.1% year on year in Q2 2017, after two years of virtual price stability. However, the negative impact of this upturn in inflation on the improvement of purchasing power is likely to be partly offset by the rise in employment and wages, especially in Germany. In addition, households have saved a large proportion of their purchasing power gains from previous quarters and their propensity to save should remain virtually stable (12.0% mid-2017). All in all, household consumption is likely to increase steadily again (+0.4% per quarter).

Investment should enjoy renewed vitality; construction in particular is accelerating in all Eurozone countries. Finally, foreign demand is likely to gather pace moderately in early 2017: the recovery of demand in the United States and emerging countries should more than offset the drop in British demand.

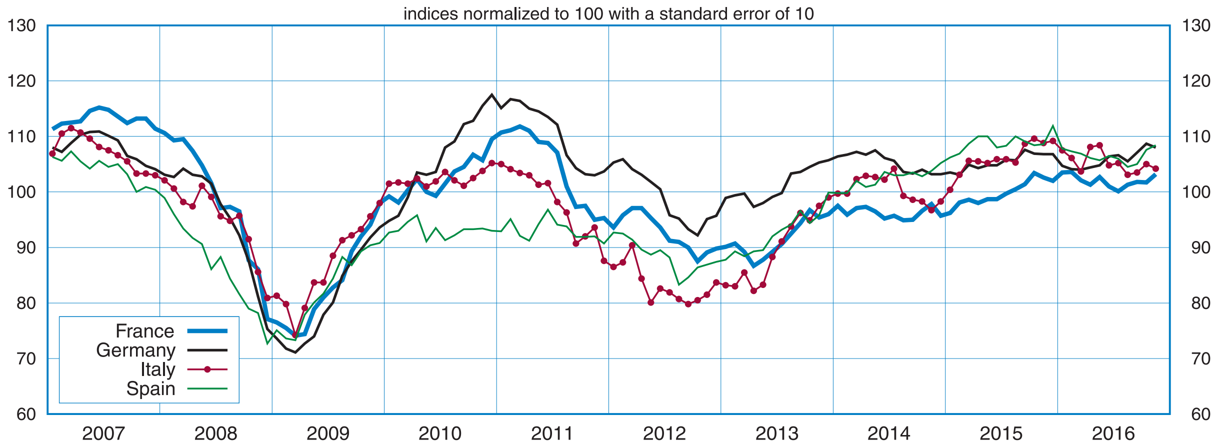
Growth is expected to remain robust

In Q3 2016 the economic activity of the Eurozone grew by 0.3%, as in Q2. It is set to pick up slightly to +0.4% in Q4, and should then maintain this pace throughout H1 2017. The business climate improved in the autumn (*Graph 1*), despite the rising political uncertainties caused in particular by the results of the British and Italian referendums and the American presidential election. The business climate thus remains clearly above its long-term average, especially in Spain and Germany.

Spain is expected to slow, while Germany should accelerate

The growth rates of Eurozone countries converged to a certain extent in Q3. Activity, although still buoyant, slowed slightly in Spain (+0.7% after +0.8%) while it accelerated in Italy (+0.3% after +0.1%) and grew modestly in Germany and France (+0.2%). Through to mid-2017, activity should rise in Germany (+0.5% per quarter in late 2016 and in H1 2017), driven by household spending in particular. In Spain, the catch-up effect is expected to run out of steam and growth should gradually weaken, down to +0.5% in Q2 2017.

1 - Business climate in the Eurozone



Source: European Commission (DG ECFIN)

In Italy, activity is likely to suffer from the wait-and-see attitude caused by the uncertainty surrounding the constitutional referendum in Q4 (+0.1%). If the business climate does not suffer from the political uncertainties generated by the winning "No" vote, it should improve moderately in H1 (+0.2% per quarter).

Purchasing power is likely to slacken due to the upturn in inflation

Assuming that oil prices level out at $50 per barrel of Brent crude, headline inflation should rise to an average of +1.1% in Q2 2017 after 0.0% in 2015 and +0.2% in 2016. This upturn should be driven primarily by energy prices, which are gradually picking up. Core inflation, i.e. excluding energy and food products, is expected to rise modestly from +0.8% in November 2016 to +0.9% in mid-2017, with the effects of the previous drop in commodity prices continuing to spread. However, employment should continue to grow strongly and wages are set to accelerate, especially in Germany and in Spain where the minimum wage will be raised in January. All in all, purchasing power looks likely to increase year-on-year by approximately +1.5% in H1 2017, compared to +2.0% on average in 2016.

Consumption should hold firm, buoyed by German household expenditure

Thanks to the good performance of purchasing power (*Graph 2*), private consumption should pick up slightly again, to +0.4% per quarter through to mid-2017 (after +0.3% in Q3 and +0.2% in Q2). This acceleration should originate primarily from Germany, where households are benefiting from a favourable labour market and new increases in social benefits. The savings ratio should remain virtually stable, levelling out at 12.0% in mid-2017, after increasing significantly between mid-2015 (11.6%) and mid-2016 (12.1%).

Construction gathers pace

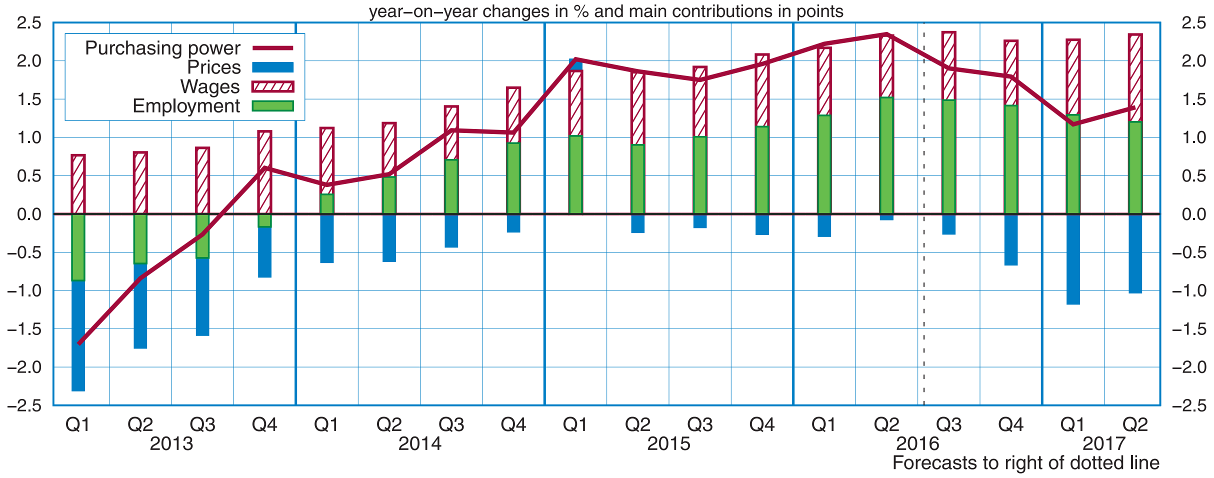
Investment in capital goods came to a standstill in the summer of 2016 but is expected to pick up to +1.0% per quarter in H1 2017. Indeed, the production capacity utilisation rate has continued to rise, reaching its highest level in eight years in late 2016; in addition, financing terms remain very favourable despite a slight rise in interest rates. Investment in construction, which accelerated in the summer, should continue to grow strongly between now and mid-2017 (+0.6% on average per quarter), as suggested by the upward trend in building permits; throughout 2016 as a whole, it should return to growth in France and Italy while remaining vigorous in Spain and Germany.

Exports are expected to benefit from the recovery of demand from the United States and emerging countries

After remaining almost unchanged in Q3 (+0.1%), Eurozone exports should accelerate through to mid-2017 (+0.8% per quarter), in line with world demand for the region's products: the drop in British demand, against a backdrop of an anticipated investment slowdown and a depreciating pound, should be more than offset by the renewed vigour of demand from the United States and emerging countries. Imports are also likely to be robust (on average +1.0% per quarter), driven by domestic demand, with the result that foreign trade should make a neutral contribution to the economic activity of the Eurozone from late 2016 to mid-2017. ■

2 – Households' purchasing power in the Eurozone

year-on-year changes in % and main contributions in points



Source: Eurostat, INSEE calculations

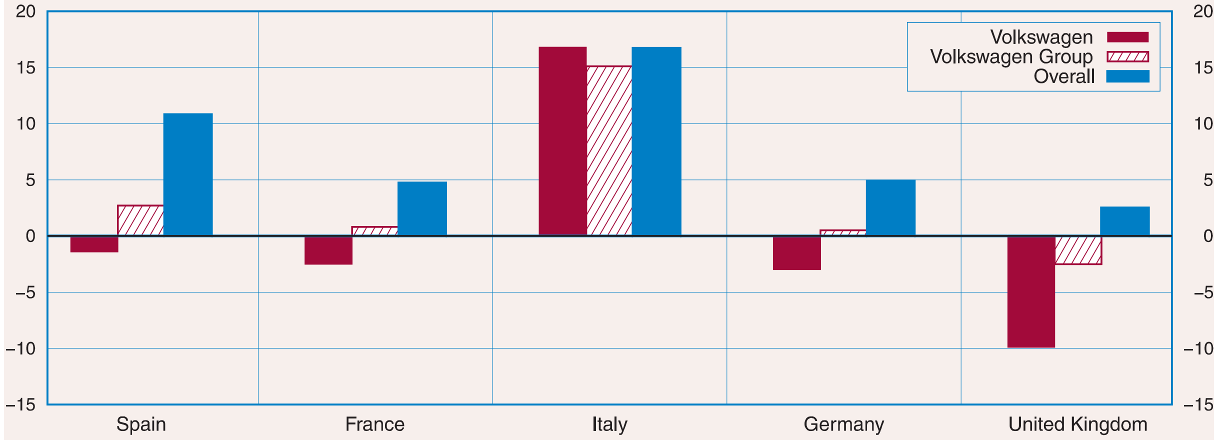
Since the exposure of its diesel engine fraud, the Volkswagen Group has been losing European market share to other carmakers based in Germany and Spain

In September 2015 the American Environmental Protection Agency revealed that the Volkswagen Group had used technologies to fraudulently reduce pollutant emissions during monitoring tests. This announcement led to the filing of numerous complaints against the German group, which estimates the cost of damages at up to $20 billion.

Since September 2015, the Volkswagen Group's Europe market share has dropped by one point

While passenger car sales have been picking up sharply for all manufacturers since autumn 2015, a marked slowdown has been observed in the number of registrations of vehicles manufactured by the Volkswagen Group (which, in addition to the eponymous marque, also includes Audi, Seat, Skoda, and others). In Western Europe, new vehicle registrations for the group and for Volkswagen alone have fallen, unlike those of other carmakers (*Graphs 1* and *2*). This is particularly true in Spain, Germany, France and the United Kingdom. In Italy, however, registrations have increased at the same rate as for the other automotive brands.

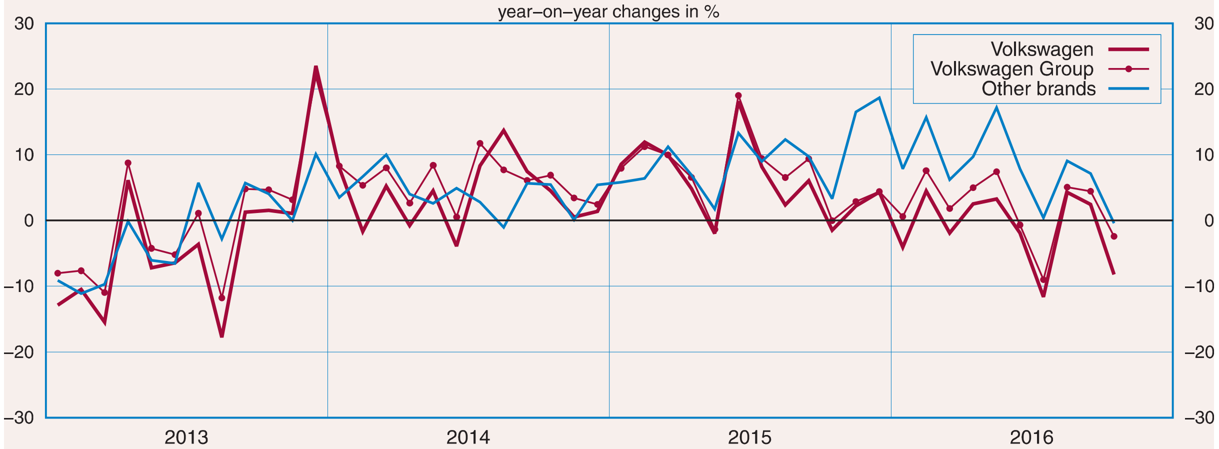
1 - Changes in Volkswagen group registrations and registrations of all automotive brands in 2016



Source: European Automobile Manufacturers Association

2 - Registrations in Western Europe

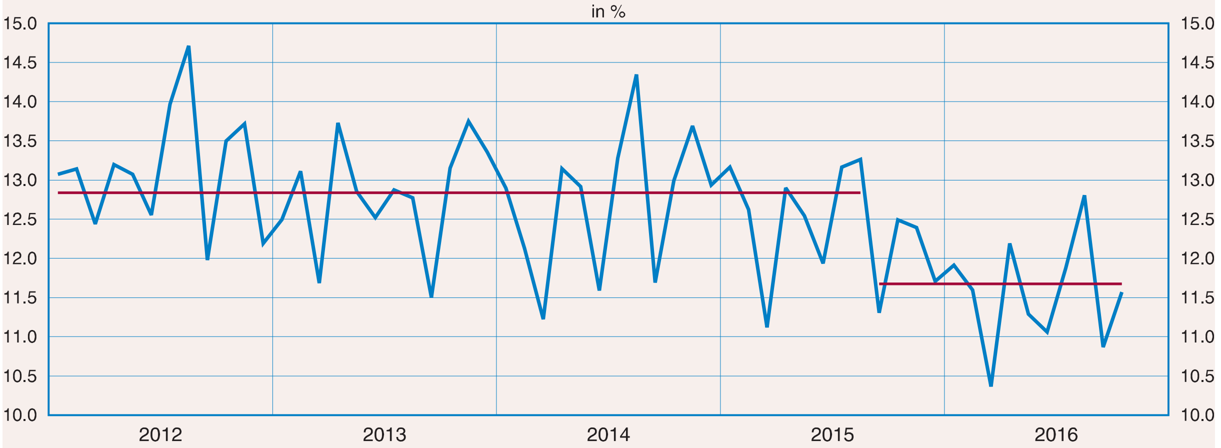
year–on–year changes in %



Source: European Automobile Manufacturers Association

As a result, the Volkswagen Group's Europe market share has dropped by one point on average since September 2015 against its average since 2011, with sales of Volkswagen's own cars accounting for the majority of this decline (*Graph 3*). However, it remains Europe's leading carmaker.

3 - Market shares of the Volkswagen brand in Europe



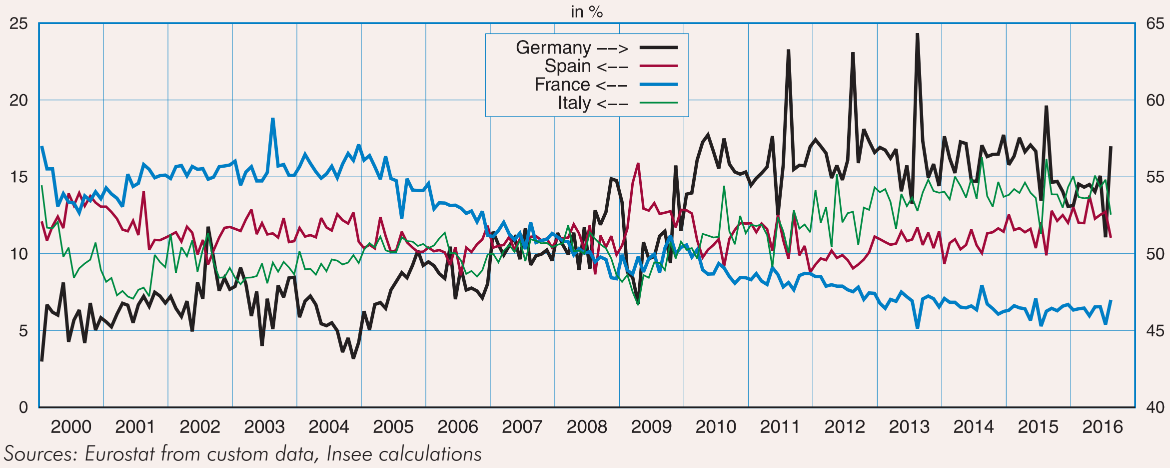
Source: European Automobile Manufacturers Association

A moderate impact on the German economy and a positive one for Spain

The Volkswagen Group's poor performance is partly reflected in German exports: the share of German passenger vehicle exports in those of the Eurozone dropped slightly (54% for the first nine months of 2016 compared to an average of 56% between 2010 and 2015), mainly to the benefit of Spain (*Graph 4*).

However, the impact on the German economy appears to be quite moderate: the country still has a clearly positive trade balance which surpassed that of its Eurozone partners in H1 2016, as only a quarter of the Volkswagen group's vehicles are produced in Germany. In addition, its competitors whose production is based mainly in Germany appear to have benefited from the damage to the Group's image: a sharp rise has been recorded in registrations of new Opel, BMW and Mercedes cars since September 2015. ■

4 - The country's share of passenger vehicle exports in Eurozone exports of passenger vehicles



Sources: Eurostat from custom data, Insee calculations