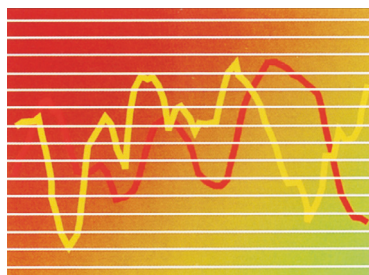


# CONJONCTURE IN FRANCE



OCTOBER 2014

## Postponed recovery

**T**he advanced economies posted a sluggish growth in Q2. While GDP rebounded in the United States and remained dynamic in the United Kingdom, activity disappointed once again in the Eurozone, where it stagnated, and in Japan, where the fall in activity caused by the rise in VAT on 1<sup>st</sup> April was greater than expected.

The emerging economies, meanwhile, have remained at a relatively modest growth rate in Q2. Information on the outlook over the summer suggests that activity is likely to continue growing at a similar rate in H2. In the advanced economies, growth should be a little livelier in H2, although the decoupling is likely to remain between the English-speaking countries on the one-hand, and the Eurozone and Japan on the other. In the United States and the United Kingdom, growth should remain relatively sustained, driven by dynamic private demand. On the one hand, household spending is likely to remain strong, favoured by a positive trend on the labour market, while corporate investment should remain buoyant, on the other. In the Eurozone, growth should remain very moderate, according to the business tendency surveys. Divergences are likely to remain between Germany and Spain, on the one hand, where activity should progress distinctly, and the Italian and French economies on the other, which are still unlikely to see a real upturn.

The French economy should barely grow in Q3 and Q4 (+0.1%), bringing growth over the year as a whole to +0.4% in 2014, as in 2012 and 2013. Growth in exports should admittedly be somewhat more sustained than in H1, thanks in particular to the recent fall in the value of the Euro, but without any real drive, as foreign demand remains sluggish. The factors preventing domestic demand from starting up again still remain. Household

consumption is likely to grow little through to the end of the year, as the purchasing power of income accelerates moderately (+0.8% over the year as a whole, after 0.0% in 2013), and household investment in housing is likely to continue falling. Corporate investment, which is suffering from continuing weak prospects, is likely to fall back once again.

Sluggish growth in France is likely to lead to slow growth in employment. Although job losses in the market sectors are likely to be softened by the low level of productivity gains, they are still likely to come to -52,000 in H2, after -12,000 in H1. A larger number of subsidised jobs in the non-market sectors should mean that overall employment would be stable, however. As the active population is increasing slightly, the unemployment rate should increase by 0.1 points in H2 to 10.3% at the end of the year, which is to say the same level as in summer 2013.

The uncertainties in this scenario mainly concern the behaviour of corporate demand in France and the Eurozone. In the scenario taken here, companies are likely to remain little disposed to spend through to the end of the year. If the downturn in the business climate over the summer is accentuated in the autumn, their wait-and-see attitude might hold domestic demand back even more. In particular, the uncertainties caused by the various geopolitical crises, especially in Ukraine, could lead to decisions on investments being more pushed back in the Eurozone. On the other hand, if the recent fall in the Euro should continue, European companies might revise their demand expectations upwards. Likewise, the resolute attitude of the monetary authorities to avoid any risk of deflation might encourage companies to increase their level of expenditure a little more. ■

## The world economy accelerated only slightly in Q2 2014

*Activity progressed moderately in the both advanced and emerging economies*

In Q2 2014, activity progressed moderately in the advanced economies (+0.3% after +0.2%). In the United States, activity showed a marked upturn (+1.1% after -0.5%), driven in particular by a backlash effect after the harsh winter. In Japan, domestic demand contracted sharply, hit by the 3-point rise in VAT on 1<sup>st</sup> April. The emerging economies have continued to grow moderately: +1.1% after +1.2% in Q1 and +1.7% on average between 2000 and 2008.

*The Eurozone stagnated*

In Q2 2014, activity in the Eurozone stagnated (0.0%, after +0.2%). This was lower than expected (+0.3%) due to weaker corporate demand (investment and inventory change). Growth disappointed in most of the major economies in the Zone, with activity contracting in Germany and Italy (-0.2%) and stagnating in France.

## In France, activity stagnated again in Q2 2014

Activity stagnated in France in Q2, as in Q1 2014, when a return to moderate growth (+0.3%) was expected in *Conjoncture in France* last June. Manufacturing output fell back much more sharply than suggested by the business tendency surveys (-0.9% against a forecast of +0.4%). The trends in corporate investment and exports were particularly disappointing.

## The short-term climate should remain positive in the advanced economies through to the end of 2014

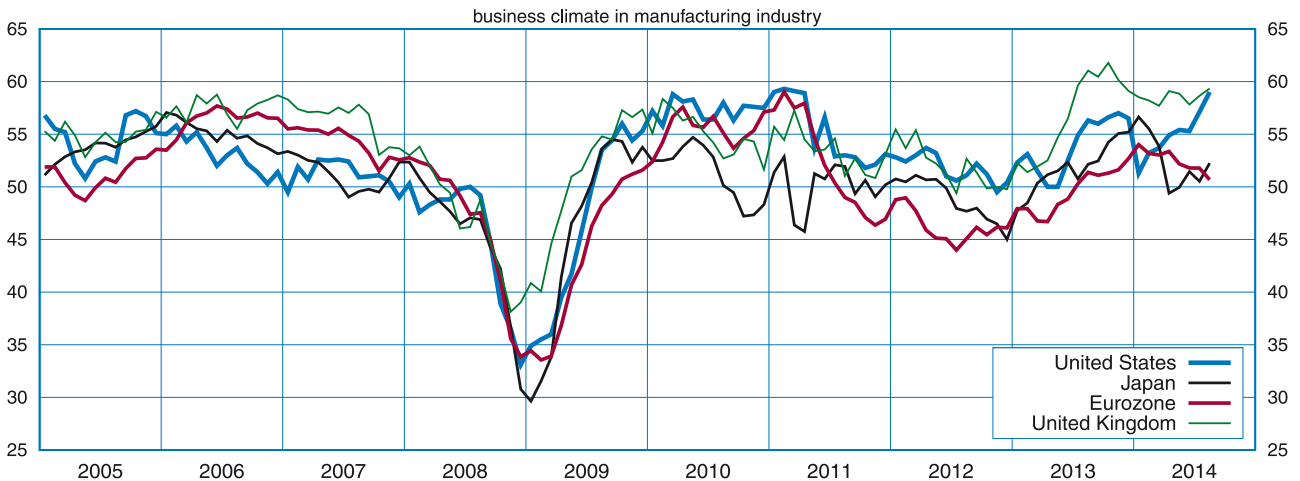
*Activity in the emerging economies should remain at a slower rate*

In the emerging countries, the business tendency surveys have shown an upturn on the whole since the start of the year, but remain at a low level, suggesting that activity is likely to be slow again, around +1% per quarter. Domestic demand should be bridled once again by past tightening of monetary and fiscal policies and imports are therefore likely to grow at a distinctly slower rate than prior to the crisis (+1.1% in Q3 then +1.2% in Q4, against +2.4% on average between 2000 and 2008).

*The advanced economies should accelerate in H2*

In the advanced economies, after showing a marked upturn in summer 2013, the business climate remains at a satisfactory level on the whole in September 2014. Activity is therefore likely to accelerate there in H2 (+0.6% per quarter), but with a growing disconnect between the English-speaking countries and the Eurozone (*Graph 1*). In the United States, growth should remain sustained (+0.8% then +0.7%), notably growth in consumption, thanks to the fall in unemployment and signs of dynamism in wages. In the United Kingdom, the upturn should continue strongly (+0.7% then +0.6%), although domestic demand is likely to slow down slightly. In Japan, as the effects of the rise in VAT fade out, activity should start up slowly in Q3 and Q4 2014 (+0.4% then +0.5%), after the upturn in the business climate in summer.

### 1 - English-speaking countries - Eurozone: the activity divergence widens



Sources: Markit, ISM

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## In H2 2014, Eurozone activity likely to grow modestly

*Monetary policy at the crossroads in the advanced economies*

Although still accommodating, the monetary policies of the English-speaking countries are gradually diverging from that of the European Central Bank. Due to the strength of the recovery and buoyant labour markets, the Federal Reserve will be cutting its securities purchases further. Likewise, the further fall in UK unemployment (to 6.4% in Q2) suggests that the end is near for the Bank of England's policy of keeping interest rates down to the same level. Faced with the present fall in inflation that is expected to continue in the medium term, meanwhile, the ECB cut its rates again at the beginning of September 2014, to 0.05% for its main base rate. It also announced several securities purchasing operations in addition to the very long term refinancing operations decided in June.

*Despite signs of improvement, the interbank market remains fragmented in the Eurozone*

Despite an improvement on the monetary market, access of banks in the peripheral countries is still not back to normal. At the same time, debt reductions among companies in the Eurozone - characterised by a fall in outstanding credit which was particularly pronounced in Italy and Spain - continued through summer 2014, although there was a slight rise in outstanding credit in France.

*Eurozone activity should show modest growth*

After improving sharply from mid-2013 through to the end of 2013 and then levelling out, the business climate in the Eurozone deteriorated slightly over the summer and growth in the Eurozone should be moderate in H2 (+0.2% per quarter).

*European households likely to increase their consumer spending*

In the Eurozone, the purchasing power of household disposable income should show an upturn in 2014 (+0.7% as an annual average), under the combined effect of the fall in inflation, the easing of fiscal consolidation and growth in wage income. In H2 2014, households should therefore continue to increase their consumer spending at a rate close to that in H1 (+0.2% then +0.3%).

*Investment in equipment set to be dynamic in the Eurozone*

After progressing in Q2 2014 (+2.2%), investment in equipment should remained dynamic in the Eurozone, especially in Germany and Spain. This upturn is the result of the progressive improvement in financing terms, as well as of the need to replace equipment after a phase of adjustment. In construction, the fall in investment is likely to continue at a more moderate rate (-0.3% then -0.2% in H2 after -2.1%), with the relative strength of Germany only partially offsetting the continuing falls in the other major countries.

*World trade should progress in H2, although without accelerating*

In Q2 2014, world trade rebounded (+1.0% after -0.6%). Trade showed an upturn in the advanced countries, except for Japan, and exports were dynamic in Asia. The business tendency indicators for export orders and available Customs data suggest that world trade is likely to remain at the same rate in Q3 (+1.1%).

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## French exports likely to progress once again

*The recovery in the other advanced economies and the depreciation of the euro should sustain French exports*

After stagnating in Q2 2014 - unexpectedly given the growth in world trade - French exports should rebound in H2 (+0.7% then +0.5%), while the trend towards loss of market share should be offset somewhat by the depreciation of the euro.

## The French economy should barely grow through to the end of the year

*The France business climate has deteriorated in all sectors*

After a significant rebound in all sectors in summer 2013, the business climate in France remained virtually stable until May 2014, below its long-term average (100). This summer it declined once again, standing at 91 in September. This deterioration has affected all sectors (Graph 2), particularly retail trade and the building industry.

*Manufacturing output virtually stable in H2 2014*

However, manufacturing output should pick up a little in H2 (+0.2% per quarter in H2), as the fall in production in Q2 was partly due to one-off factors (most notably the numerous long weekends in May and the Euro 6 standard for purchases of trucks).

*French growth close to zero through to the end of the year*

Similarly, after a sharp drop in H1 (-1.5% then -1.7%) caused by an accumulation of unfavourable factors, activity in the construction industry should continue to contract in H2, although the decline should ease (-0.7% then -0.5%). All in all, the French economy should barely grow through to the end of the year (+0.1% per quarter).

*Very modest growth in 2014, with +0.4% as in 2012 and 2013*

In 2014, GDP growth as an annual average is likely to remain modest (+0.4%), like in 2012 and 2013: the improvement in the manufacturing industry (+0.1%, after -0.6% in 2013 and -2.1% in 2012) should be offset by the sharp decline in construction where production is set to slide (-3.6%) for the third consecutive year.

## The unemployment rate should rise slightly by the end of the year

*Market-sector employment set to decline more sharply in H2 2014 than in H1*

Employment in the non-agricultural market sectors picked up slightly in Q2 2014 (+8,000 jobs after -20,000), thanks to the rebound in temporary work. Excluding temporary work, market-sector employment has remained almost stable (-5,000 jobs per quarter). Given the sluggish activity levels, market-sector employment is likely to fall back once again in H2 2014 (an average of -26,000 per quarter).

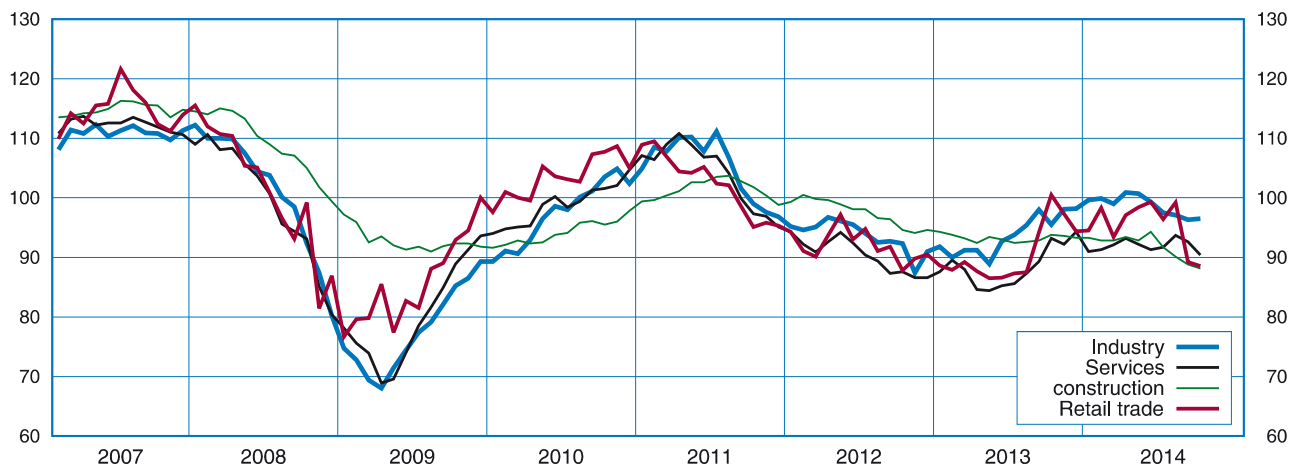
*Total employment virtually stable in H2*

In 2014 the further ramp-up of the «emplois d'avenir» is likely to be cancelled out by the greater number of people leaving "integration" contracts («CUI-contrats uniques d'insertion»). Nevertheless, the support from subsidised contracts should offset the decline in market-sector employment and hence total employment should remain virtually stable in H2.

*Unemployment set to rise slightly through to the year end*

In Q2 2014 the unemployment rate increased slightly, to 10.2% of the labour force in France on average (9.7% in Metropolitan France). In H2 it is likely to rise slightly again, to 10.3% at the end of the year (9.9% in Metropolitan France).

### 2 - In summer the business climate deteriorated in all sectors in France



Source: INSEE

## Core inflation almost nil by the end of the year

*Core inflation likely to slide further by the end of 2014*

Year-on-year growth in consumer prices, which was over 2% at the start of 2012, has declined sharply since and stood at just +0.4% in August 2014. This slump is partly the result of the fall in core inflation, due to the persistent worldwide supply surplus, as well as the easing of the prices of imported commodities. Core inflation, which was only just positive in summer, should fall further and stand almost at zero at the end of 2014 (*Graph 3*). However, assuming that the price of Brent remains stable at around \$97 and the exchange rate keeps to \$1.28/€, energy inflation should pick up, to -0.1% in December 2014 after -1.5% in August. In that case the year-on-year growth in prices, close to zero in September, would rise to +0.4% by December.

## Purchasing power recovering in 2014

*Growth in real wages likely to be sustained in 2014*

After strong progress at the start of the year, the average wage per head in the non-agricultural market sector remained fairly dynamic in Q2 2014 (+0.4% after +0.6%). In the wake of the drop in inflation, the average wage per head should slow down slightly in H2 (+0.3% per quarter). On average in 2014, real wages per head are likely to accelerate (+1.2% after +0.9% in 2013), mainly because inflation has declined more sharply than expected.

*Recovery of purchasing power in 2014*

In 2014 the purchasing power of households' gross disposable income should pick up (+0.8% after 0.0%), most notably thanks to less dynamic taxes and contributions (+2.7% after +4.2% in 2013) and the slight recovery of earned income (+1.3% after +0.9%). The quarterly profile of disposable income should follow that of taxes, as new measures are implemented.

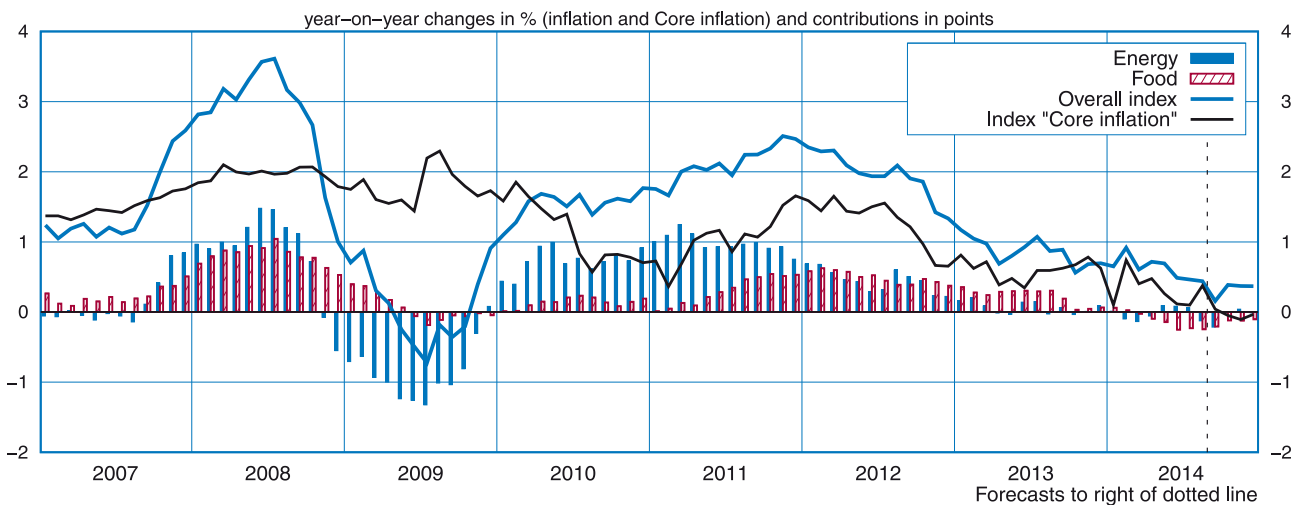
## Household consumption set to slow in H2

*Household consumption should grow only slightly in H2*

After a sharp decline at the start of the year (-0.6%), household consumption rebounded in Q2 (+0.4%). In H2 household consumption is likely to return to a rhythm more in line with the purchasing power trend (+0.2% per quarter). Energy consumption should progress further (+1.0%), while expenditure on manufactured goods is likely to increase moderately (+0.2%).

The quarterly profile of the savings ratio is likely to be uneven, due to the unusual profile of taxes on the one hand and the ups and downs of automobile and energy consumption on the other. So after reaching a high level in H1 (15.9%), the savings ratio is likely to fall gradually in H2 in reaction to the drop in the purchasing power of income. But by the end of 2014, the savings ratio should once again stand at 15.0%, against 14.6% at end 2013.

### 3 - Core inflation should be virtually nil through to the end of the year



Source: INSEE

## In 2014 government consumption should rise again and public investment decline

*A further increase in government consumption in volume*

In volume, government consumption should rise by 0.3% per quarter through to the end of 2014; on average, growth in 2014 should stay at the same rate (+1.8%) as in previous years (+1.7% in 2012 and +1.9% in 2013). Indeed, while government expenditures have slowed in value (+2.0% after +2.5% in 2013), the scale of this slowdown is the same as that of their prices. As for public investment, it has entered the unfavourable phase of the municipal election cycle. It declined in H1 (+0.1% then -0.7%) and should continue to do so in H2 (-0.4% then -0.3%).

## Private investment down again

*The fall in household investment set to ease in H2*

In Q2 2014 household investment fell back sharply once again (-2.5% after -2.7%), declining for the tenth consecutive quarter. Bearing in mind the recent time series for building permits, the decline should ease in H2 (-0.8% then -0.6%). As an average for 2014, it is likely to fall sharply (-7.4%) and by the end of 2014 should stand at its lowest level since 1998.

*Corporate investment falling once again in H2*

Corporate investment once again shrank in Q2 2014 (-0.7% after -0.6%), most notably companies' investment in construction (-1.4%) and in manufactured goods (-1.0%): the entry into force of new antipollution standards on 1<sup>st</sup> January 2014 took its toll on trucks registrations. Due to the persistent sluggishness of demand, corporate investment should decline further in H2, although more moderately (-0.3% then -0.2%).

## Uncertainties: inflation and corporate investment in the Eurozone

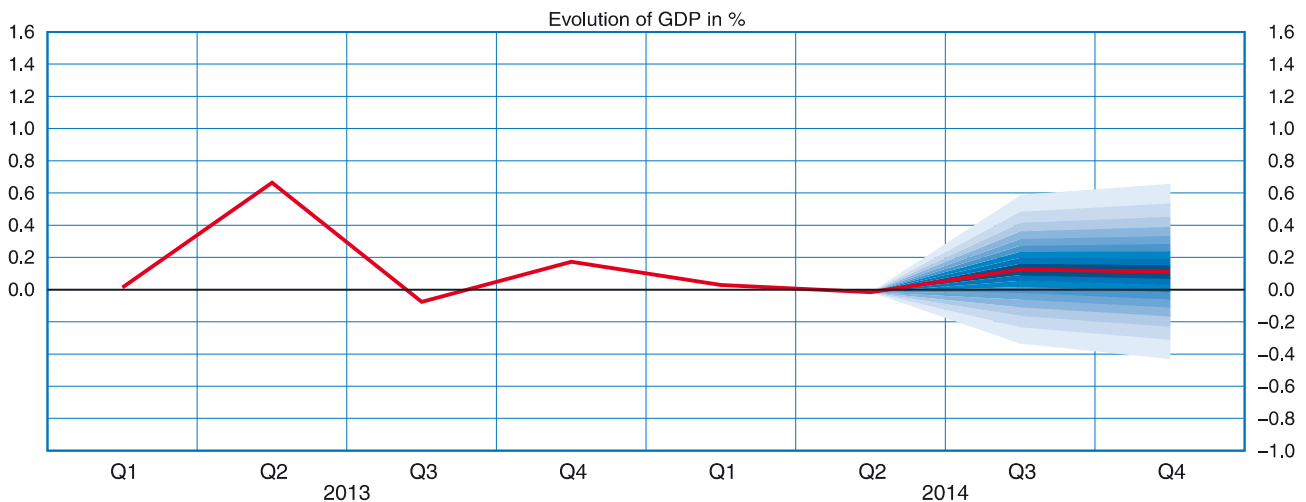
*Uncertainties and monetary policy*

The turning point noted in the summer business tendency surveys suggests that the wait-and-see attitude among businesses has become more widespread, and this could weigh more heavily on activity than our scenario suggests. Conversely, monetary policy and the depreciation of the euro could sustain growth.

*Ukrainian crisis and corporate investment in the Eurozone*

In our scenario, investment in equipment is predicted to regain momentum in Germany and Spain and remain virtually stable in France and Italy. However, the uncertainties surrounding the economic impact of the Ukrainian crisis (particularly in terms of medium-term export outlets) could postpone investment decisions in the Eurozone. Conversely, the easing of geopolitical tensions might strengthen the investment dynamic after a marked adjustment phase. ■

## 4 - Fan chart for Conjoncture in France



How to read it: the fan chart plots 90% of the likely scenarios around the baseline forecast of the changes in GDP (red 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 Conjoncture in France, INSEE, June 2008, pages 15 to 18). It can therefore be estimated that the first result for Q3 2014 has a 50% chance of being between -0.1% (lower limit of the fifth band from the bottom) and +0.3% (upper limit of the fifth band from the top). Likewise, it has a 90% chance of being between -0.3% and +0.6%. In Q4 2014, the 90% confidence interval is [-0.4% ; +0.7%].

Source: INSEE