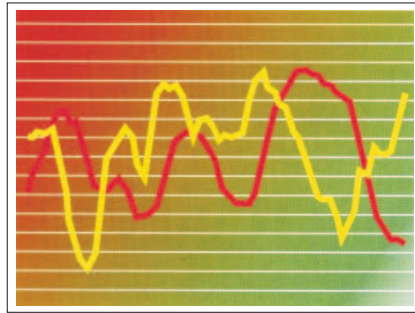


# CONJONCTURE IN FRANCE



OCTOBER 2012

## At a standstill

As predicted in the June 2012 issue of *Conjoncture in France*, the advanced economies experienced a slowdown in Q2, with a growth rate close to zero (+0.1% after +0.4% in Q1). Activity slowed sharply in Japan after the rebound in Q1, and slipped back in the Eurozone (-0.2%).

The economic data collected in summer point to globally sluggish growth in the advanced economies in H2. Activity in these economies is likely to be held back by the fiscal consolidation measures underway and by the slowdown observed in the emerging countries. Additionally, the price of oil suddenly picked up, mainly under the effect of geopolitical tensions in the Middle East. The business climate therefore deteriorated further and is now at a low level. Only the United States, driven by relatively strong private demand, is likely to maintain a fairly sustained growth rate (approximately +0.5% per quarter), albeit still below its pre-2008 trend. Activity in Japan should stabilise with the expiration of the government stimulus measures. The United Kingdom should see a rebound in Q3, although only transitory, following the after-effects of the Jubilee celebrations in June.

In Europe, the Eurozone should go into recession in Q3 2012, with negative growth once again (-0.2%). Its member countries' foreign trade is set to suffer due to the appreciation of the euro since summer, but also the weak demand for Eurozone products. Domestic demand should also continue to slip back under the combined effect of the fiscal consolidation measures underway in several countries, a sustained rate of energy inflation, and

the worsening labour market. Lastly, corporate investment will likely be affected by both a scarcity of outlets and globally low margin rates.

The French economy is likely to remain at a standstill, with zero growth in Q3 and Q4. Exports have been revised downwards from predictions in the June issue because of the slowdown in world demand combined with the appreciation of the euro since the summer.

Job losses in the market sectors should be offset somewhat by the unusually low gains in productivity, but should nonetheless reach 67,000 in H2. The unemployment rate should continue to grow, standing at 10.6% at the end of the year.

Household consumption is likely to be penalised by the drop in the purchasing power of income. Purchasing power is set to suffer a triple blow: job losses, the increase in the tax burden, and the rise in oil prices, keeping inflation at 1.9% year-on-year. However, thanks to a drop in the savings ratio of households, consumption should remain virtually stable.

Various uncertainties surround this scenario. First, the business tendency surveys give a more pessimistic view than the available data. In terms of domestic demand the main uncertainty surrounds the saving behaviour of households: if the cut in the savings ratio were to only partly offset the drop in purchasing power, household expenditure and hence activity would be weakened. Conversely, in terms of foreign demand, the growth in the emerging countries could be stronger than expected if their previous monetary easing measures were to bear fruit. ■

## Activity declined in Europe in Q2 2012

Activity grew in the United States and Japan in Q2 2012...

Activity slowed sharply in Q2 2012 in the advanced economies: +0.1% after +0.4%. However, there were divergences across the different zones. The American economy progressed at a similar rate to that of the previous quarter (+0.3% after +0.5%), sustained by strong private domestic demand and exports. In Japan activity also continued to grow, albeit at a slower pace than in the previous quarter (+0.2% after +1.3%); household consumption had seen an exceptional growth rate in Q1 thanks to the implementation of a vehicle purchasing grant.

... but slipped back in Europe

However, the European economies weakened further. Because of the sharp downturn in domestic demand, activity declined in the Eurozone (-0.2% after +0.0%) and in the United Kingdom (-0.4% after -0.3%). There were also major divergences within the Eurozone: activity progressed in Germany (+0.3%) and remained stable in France (+0.0%), while the recession deepened in Spain (-0.4%) and in Italy (-0.8%).

## World trade set to contract in H2

Slowdown in world trade in H2

World trade marked time in Q2 2012 (+0.3% after +0.8%) and is set to weaken further in H2. The export orders tracked by the Purchasing Managers Index (PMI) surveys have indeed declined sharply since June and the growth overhang for world trade for Q3 was slightly negative at the end of July. World trade is therefore likely to slip back in Q3 and stabilise in Q4.

The rebound in the emerging economies long overdue

The weakening of trade should be particularly marked in the emerging economies: at the end of July the growth overhang for exports in these countries was clearly negative (-1.6%). More specifically, despite the implementation of monetary easing measures, the Chinese economy is showing no signs of picking up: over the rest of the year it is likely to be penalised by the fall in demand from the European Union, its number one client.

Oil prices on the rise despite the weakness of activity worldwide

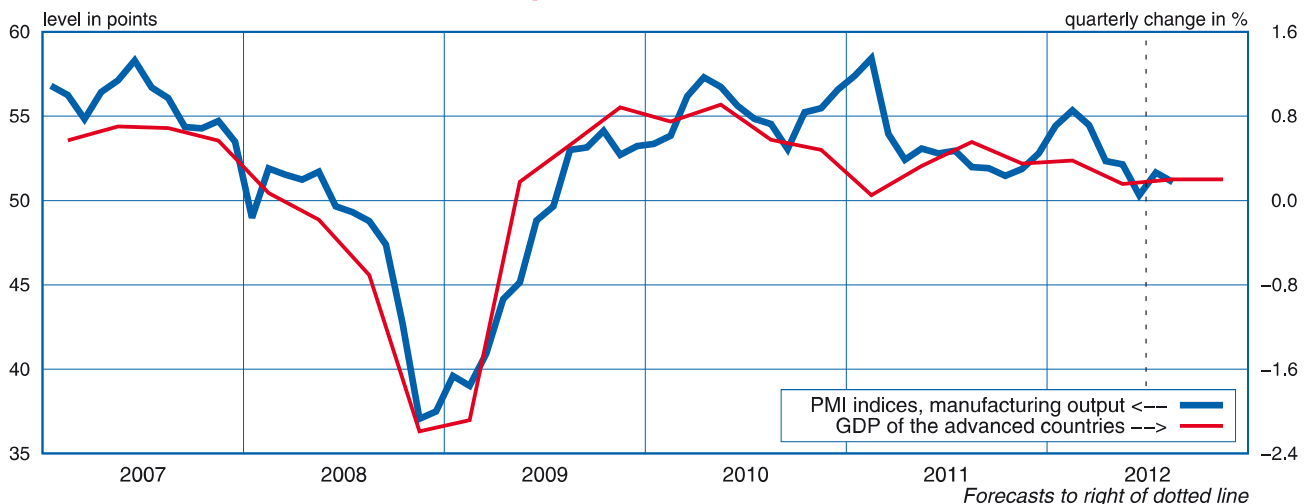
Despite weak activity worldwide, oil prices in dollars grew sharply throughout the summer: +6% in July and +10% in August. The price of the Brent barrel should hover around \$110 through to the end of the year. The hike in oil prices in Q3 is likely to have adverse effects on the world economy: consumer prices are set to grow at a sustained pace in H2 in the advanced economies, thereby weakening the purchasing power of households.

## Low growth levels for the advanced economies through to the end of the year

The advanced economies idling

The world business climate has deteriorated since the summer (see Graph 1), but still remains in the growth zone. The advanced economies should therefore continue to grow at a modest rate in H2 (+0.2% per quarter), although divergen-

1 - Activity in the advanced economies



Source: Markit, INSEE calculations

ces are likely to remain marked. The American economy should grow by 0.4% in Q3 and 0.5% in Q4. In the United Kingdom activity should rebound sharply in Q3 (+0.6%), boosted by the after-effect of the extra bank holidays in June for the Queen's Jubilee celebrations, but then stagnate in Q4 (-0.1%). In Japan activity should be stable, with the decrease in fiscal support measures. The Eurozone is set to go into recession (-0.2% in Q3 then -0.1% in Q4).

#### *The American economy served by internal relays*

The American economy is likely to be driven by strong private domestic demand in H2. Since the start of the year a favourable dynamic has been set in motion: employment has progressed while productivity gains have been maintained, allowing American companies to keep a high margin rate and provide employees with real wage gains. So investment should continue to grow at a sustained pace and, although inflation is on the rise, the purchasing power of households should rise. Households are likely to increase their consumption expenditure whilst stabilising their savings ratio. Through to the end of the year the increase in the proportion of taxes in household income should remain limited. However, the decline in government expenditure is likely to slow activity.

#### **Activity set to decline in the Eurozone over the forecasting period**

#### *The European Central Bank has announced the launch of a programme of sovereign bond purchases*

The persisting financial tensions in the Eurozone are weakening the transmission of fiscal policy and making credit conditions more difficult in certain countries. Faced with these tensions, the European Council of June 28th and 29th decided on a "compact for growth and jobs" and a common banking supervision. Moreover, the European Central Bank has decided to step up its non-standard measures, announcing the launch of a programme of sovereign bond purchases. The announcement of this programme immediately had a positive effect on the credit conditions of Spain and Italy and allayed fears concerning the sustainability of their government finances. If it were to be confirmed, this drop in sovereign yields would have favourable effects on the financing costs of private agents in these countries.

#### *Highly restrictive European fiscal policies*

Confronted for several months with these pressures on sovereign yields, and in line with their commitments, a number of European states are implementing extensive measures to bring down their public spending deficits (VAT rises in Spain and Italy, civil service wage cuts in Spain, creation of a land tax in Italy, etc.). The measures announced for 2012 represent in the order of 3.5 GDP points in Spain and 2.5 GDP points in Italy.

#### *Domestic demand set to fall back sharply*

The measures implemented to control government deficits, the upsurge in inflation and the deterioration of the labour market are all likely to take their toll on the purchasing power of European households. In spite of a drop in the savings ratio, households are likely to continue to bring down their expenditure. Given the poor business prospects and still-difficult credit terms in certain countries, the drop in corporate investment is set to continue as well.

#### *The recession deepening in Italy and Spain*

Divergences within the Eurozone are set to widen in H2. In Germany activity should continue to progress slightly (+0.1% per quarter), with household consumption holding firm. However, German exports, which grew sharply at the start of the year, are likely to grind to a halt. Spain (-0.6% then -0.8%) and Italy (-0.4% then -0.4%) should remain in recession. In both these countries domestic demand is set to fall further while exports, penalised by the decline in world trade and the recent appreciation of the euro, are likely to grow only slightly.

#### **In France, activity should remain stable through to the end of the year**

#### *Sluggish activity in Q2*

Activity was stable in France in Q2 2012 (+0.0% after +0.0%). It declined sharply in the manufacturing industry (-1.0% after -1.0%) and was sluggish in market services (+0.2% after +0.4%). However, the low temperatures in April helped sustain heating expenditure, so much so that energy output grew strongly (+2.1%

after +1.7%). Lastly, activity rebounded in construction (+0.4% after -0.1%), most notably in civil engineering, thanks to the leap in activity to catch up with the deficit caused by the cold weather in February.

*Business tendency surveys at a low in September*

Since June 2012, the business climate has declined in services (87 in September after 88 in June) and fallen even more sharply in building (94 after 97 in June). In industry, the fall in the business climate has been restricted (90 after 91 in June), although industrialists' assessment of their past activity is far more negative in September than it was in June. In spite of this poor business climate, industrial output rebounded in July and its growth overhang for Q3 is positive (+0.5%).

*Stable activity in Q3*

The decline in manufacturing output should therefore be less marked in Q3 than in the previous quarter (-0.1% after -1.0%). Activity in services is likely to be subdued (+0.0% after +0.2%). Energy output should no longer be sustained by exceptional weather factors and should fall back sharply (-1.4% after +2.1%). However, activity in construction (+0.2% after +0.4%) should continue to be driven by the catch-up effect in civil engineering. All in all, activity is set to be sluggish in Q3 (+0.0% after +0.0%).

*Growth of 0.2% in 2012*

GDP should be stable once again in Q4, in line with the low level of business prospects. Over the year as a whole growth should stand at 0.2%.

### Employment set to decline in H2

*The decline in market-sector employment gathering pace*

Due to the weak level of activity over the last three quarters, employment in the non-agricultural market sectors slipped back sharply in Q2 (-22,000). As adjustments to employment always lag behind fluctuations in activity, and since activity is set to be subdued once again in H2, the drop in employment should intensify. The non-agricultural market sectors are set to shed 67,000 jobs by the end of the year. The decline in employment should however be limited when set against the low levels of activity (see Graph 2).

*The unemployment rate set to hit 10.6% in Q4*

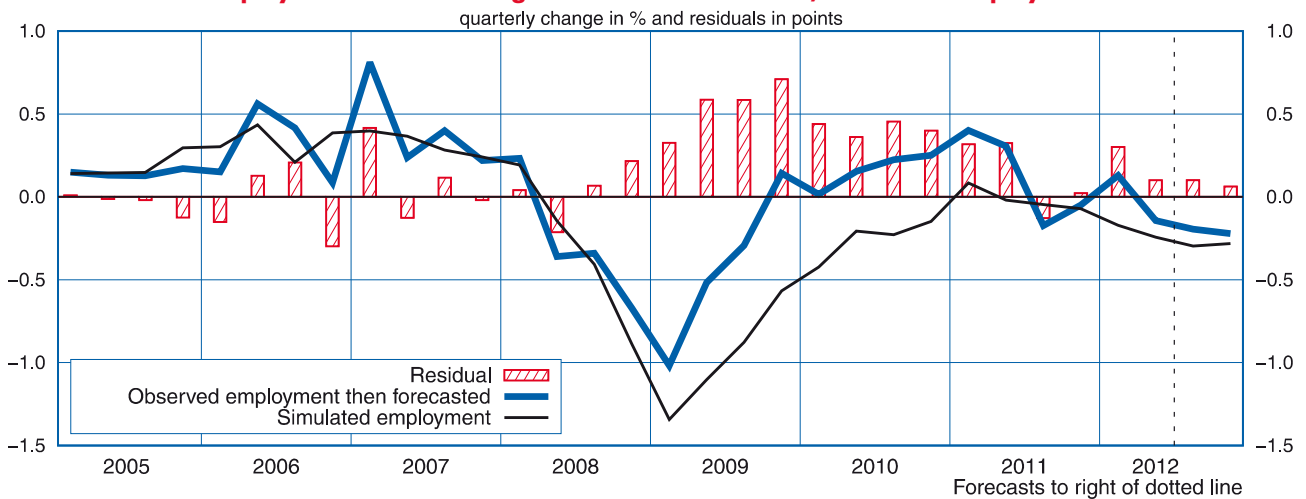
The unemployment rate stood at 10.2% (9.7% in Metropolitan France) of the active population in Q2 2012. It should continue to rise in H2. It is likely to stand at 10.4% (10.0% in Metropolitan France) in Q3 and 10.6% (10.2% in Metropolitan France) in Q4.

### Inflation close to 2.0%

*Energy inflation remaining at a high level*

Despite the high unemployment rate and the low production capacity utilisation rate, both of which restrict inflationary pressure, the drop in headline inflation should be limited. It should stand at 1.9% in December, after 2.1% in August.

## 2 - Observed employment in the non-agricultural market sector, simulated employment and residual



Indeed, due to the upsurge in oil prices in July and August, year-on-year energy prices are set to remain high (+5.3% in December). As for core inflation, it should be moderate: +1.2% in December against +1.3% in August.

### Purchasing power on the decline in 2012

*Real wages unlikely to grow in H2*

Nominal wages should be sustained by the increase in the minimum wage brought in on 1st July 2012. But the deteriorating labour market is taking its toll on wage negotiations and the upsurge in inflation in H2 is likely to restrict the progress of real wages. Over one year, wage rises should thus remain modest (+0.2% year-on-year in Q4).

*Decline in purchasing power*

Household purchasing power should decline in 2012 (-0.5% as an annual average). This drop should mostly be concentrated in H2, when purchasing power is likely to be hit hard by energy inflation, a slowdown in earned income, and higher income and property taxes. The measures voted in for 2012 for the initial finance law and the amending finance law have led to tax rises in the order of 1 household income point over the year. About half of these measures, most notably those concerning income and wealth taxes, are likely to affect household income in H2.

### Household consumption unlikely to progress

*Household consumption holds steady thanks to a drop in the savings ratio*

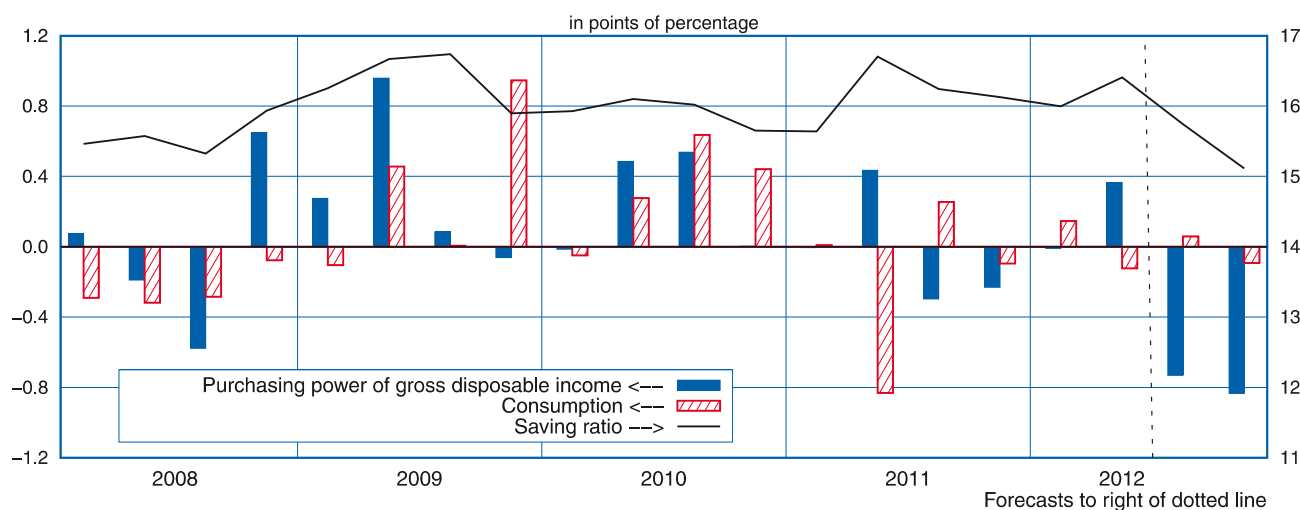
The new measures to raise the tax burden, most notably those concerning capital income, should affect incomes which are usually spared in the short term. Households are thus likely to soften the blow to their consumption expenditure caused by the drop in their purchasing power in H2 2012 by bringing down their savings ratio (see Graph 3). Household consumption should therefore hold steady in H2 (+0.1% in Q3 then -0.1% in Q4). In Q3, household consumption of manufactured goods, particularly clothing, should rebound slightly (+0.4%). But expenditure on market services should be stable (+0.0%) and that on energy is unlikely to remain at the exceptional level of Q2 (-3.5%).

### Investment declining through to the end of the year

*Corporate investment falling back*

Corporate investment progressed slightly in Q2 (+0.6%), but should slip back in H2 (-0.4% in Q3 and -0.7% in Q4), mainly due to a scarcity of outlets. The low level of margins should also have an adverse effect, although the conditions for granting credit have been stable in France for several months and interest rates for loans taken out by companies have fallen.

## 3 - Household savings and consumption



Source: INSEE

## Exports grinding to a halt, because of the contraction in world trade

### Fall in world demand for French products

Like world trade, world demand for French products should decline in H2. Additionally, exports are likely to be slowed by the appreciation of the euro since July. As a result, they should fall back in Q3 (-0.3%) and then rebound slightly in Q4 (+0.2%).

## Uncertainties: world trade and household savings

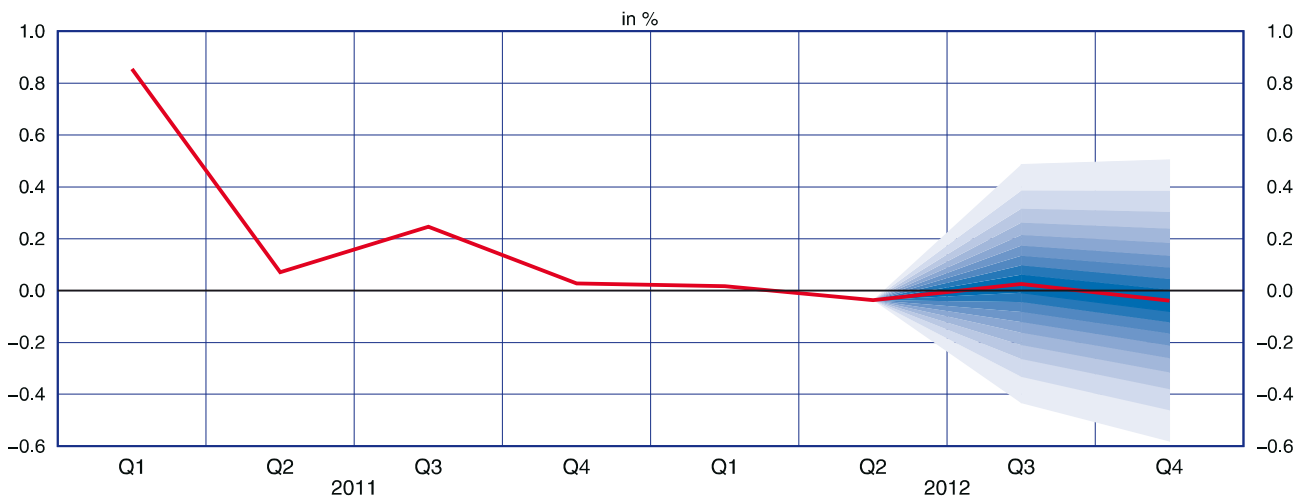
### World trade

In our scenario, world trade is expected to stabilise in Q4, after declining in the previous quarter. The emerging economies could however pick up more sharply than forecast if the extensive monetary easing measures implemented in recent months, particularly in China and Brazil, were to boost their domestic demand quickly.

### Household savings

This forecast assumes that households are likely to reduce their savings ratio in order to soften the blow of the decline in their earned income and the tax rises. If the drop in the savings ratio were to only partially offset the decline in purchasing power, household expenditure and hence activity in France would be weakened. ■

4 - Fan chart for Conjoncture in France



Methodological note: see Conjoncture in France, INSEE, June 2008  
Source: INSEE