International economic outlook and detailed forecasts for France

Inflationary tensions persist throughout the world, despite the recent decline in some commodity prices

Imbalances between production capacities and buoyancy in demand after the lockdowns have driven inflation to high levels around the world (► **Figure 1** left). These inflationary tensions were reinforced in particular by the outbreak of war in Ukraine in February, but also by China's continuing "zero-Covid" strategy in the spring and by the intense heat waves which affected some harvests this summer and slowed the river traffic of goods.

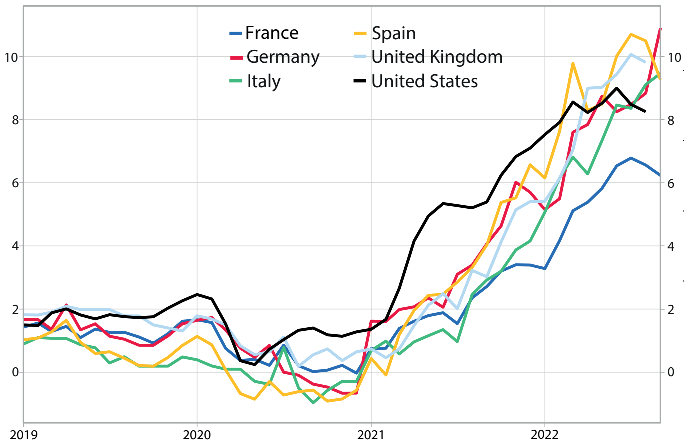
While concerns over energy supply chains are keeping gas and electricity spot prices at a high level in Europe, in contrast some world commodity prices have recently fallen considerably (► **Figure 2**), notably cereals and industrial commodities. However, these declines have generally not yet been passed on to consumer prices, except for oil prices, where fluctuations are passed on almost immediately to petrol prices. In general, it takes several quarters for commodity price movements to be transmitted to production prices then ultimately to consumer prices. Contrary to oil prices, gas spot prices reached new heights in August, following the interruptions to gas deliveries to Europe by Russia which exacerbated the risk of shortages.

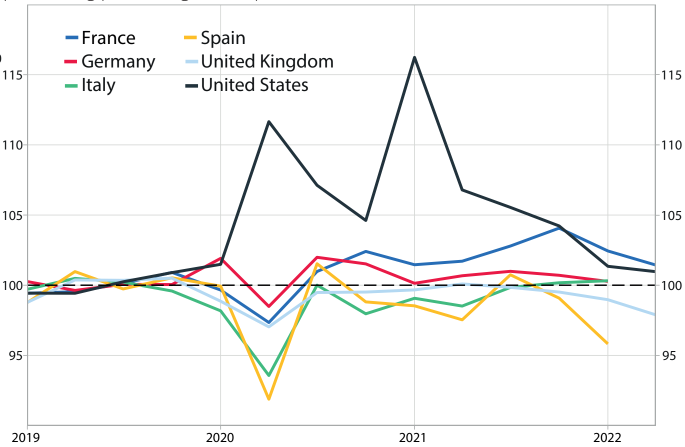
Inflation is not exactly the same in all countries (► **Focus**). In the United States, the general increase in prices, coupled with a dynamic labour market, is now leading to substantial wage rises, which in turn are likely to increase inflation. In the Eurozone, core inflation is not so high at this stage: price rises are still driven partly by energy products, but they are nevertheless gradually spreading to food, manufactured goods and some services.

Monetary policies are tightening, while volatility is increasing in financial markets

Faced with these increases in inflation, the western central banks have started on a cycle of monetary tightening with the aim of preventing any destabilisation of expectations. Increases in their rates have consequences on the foreign exchange market: the euro has depreciated since the start of monetary tightening by the US Federal Reserve, thus raising the price of European energy imports, which are often quoted in dollars. Over the forecasting period (end of 2022), technical assumptions regarding the €/$ exchange rate and also the price of Brent are close to the values observed at the end of September (i.e. \$0.95 per euro and the price of Brent at around \$90 per barrel).

► 1. Inflation is high around the world and is hampering household purchasing power





Note: Eurostat produces the Harmonised Index of Consumer Prices (HICP) covering countries in the European Union. For the United Kingdom, for which data in the Eurostat databases are available only to the end of 2020, an HICP was estimated from CPI data published by the UK ONS and by adapting them to the scope of the HIPC. For the United States, the index shown is the CPI provided by the BLS. Purchasing power is the gross disposable income (GDI) of households and non-profit institutions serving households (NPISH), compared to the deflator of household consumption. For France, it may differ from the figure published on the INSEE website, where the scope is only households.
How to read it: September 2022 for year-on-year consumer prices, except for the United States and the United Kingdom (August 2022); Q1 or Q2 2022 (depending on the country) for the purchasing power of household GDI (depending on the availability of data on the Eurostat website on 4 October 2022).
Source: INSEE, Eurostat, BLS, BEA, ONS, INSEE calculations

In this context, also marked by increased geopolitical uncertainties in Europe (changes of government in the United Kingdom and Italy), volatility has recently increased on the financial markets and sovereign yield spreads between countries have grown. The real estate market is also exposed to several threats: in China, where the strengthening of prudential measures led to a strong slowdown in the sector, which was nevertheless important for Chinese growth; also in countries where the effect of variable interest loans could become substantially greater, as in Spain, Italy or the United Kingdom, for example.

Residual catch-up effects and budget support measures are probably insufficient to avoid further shrinkage in some European economies

Prospects for growth at the end of 2022 appear somewhat clouded by difficulties in production on a global scale, by inflation which is hampering households' gross disposable income purchasing power (►**Figure 1** right) and by monetary tightening, which is likely to constrain credit and investment. However, with the fiscal support measures put in place, the loss of purchasing power is mitigated. In addition, some sections of western economies, such as consumption of services, are still benefitting from a catch-up effect: in the spring, international tourism had not yet returned to its pre-crisis level and would appear to have made a positive contribution to world growth in the summer. Some countries are expected to benefit more from these effects, like Spain, where household consumption too is still well below its pre-Covid level (►**Figure 3**).

In H2, demand is expected to be fairly sluggish in the main economies, including China, in contrast to the rebound after the 2008 crisis when it was Chinese growth that drove the recovery. As a result, it is likely that world trade will continue to slow in Q3 (+0.7% forecast in Q3 after +1.6% and +0.8% in Q1 and Q2) despite the improvements observed in global supply chains, reflected in lower freight prices and improved input delivery times.

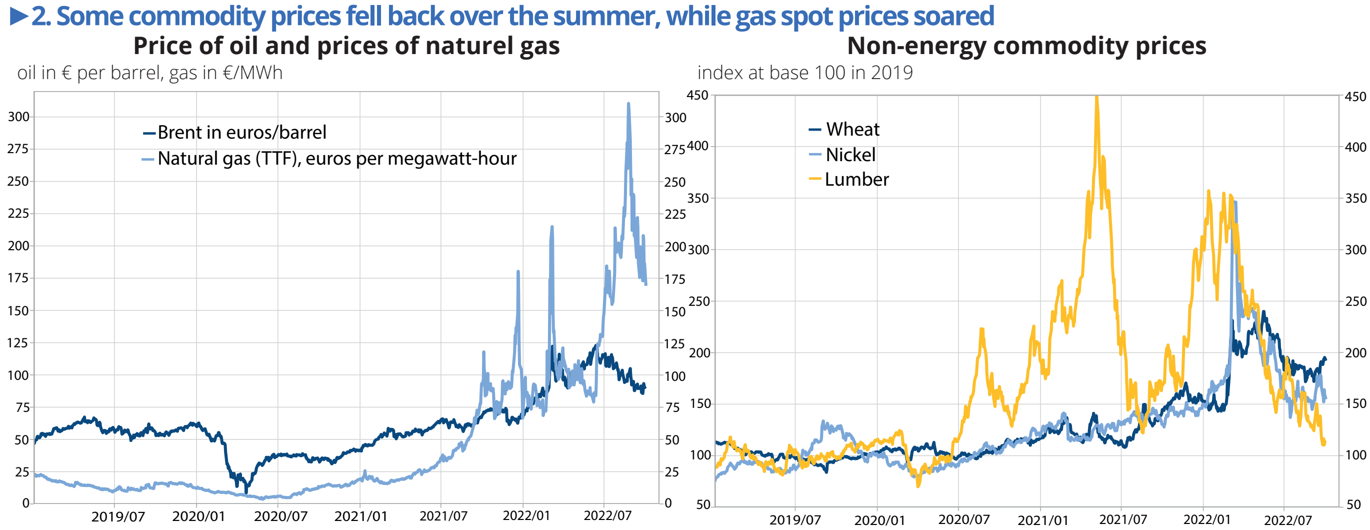
In China, economic activity would appear to have rebounded in Q3 (+3.0%), after the lockdowns in Q2, especially in Shanghai, and thanks to investment policies in infrastructure and strategic sectors. However, the recovery appears to have been dampened by heat waves disrupting industrial production and by weak domestic consumption. The real estate crisis or possibly another series of strict lockdowns could once again significantly hamper the Chinese economy at the end of the year.

In the United States, the employment market is expected to remain dynamic, enabling the economy to avoid recession. GDP is expected to slow down markedly, however, in Q4 (+0.2% after +0.5% in Q3). In fact, if inflation were to stabilise at a high level this would inhibit household consumption, while the FED's monetary tightening is likely to adversely affect investment, especially residential investment.

In the United Kingdom, inflation has also reached particularly high levels and is expected to continue to increase at the end of the year. However, it is likely to be mitigated by the energy bill freeze decided by the new government. As a result of loss of purchasing power, major strikes and calls for wage increases disrupted the functioning of the UK economy during the summer. Tensions mounted in the financial markets following recent fiscal policy announcements. The United Kingdom is expected to enter recession in H2 (-0.2% forecast per quarter after +0.2% in Q2).

In H2, it is likely that activity in the Eurozone, which is more exposed to the consequences of the war in Ukraine, will suffer the repercussions of this

►2. Some commodity prices fell back over the summer, while gas spot prices soared



Source: Commodity Research Bureau, ICE Futures Europe, Euronext Paris, London Metal Exchange, Chicago Mercantile Exchange deteriorating economic context. The effects of high inflation are expected to be reflected in economic behaviour, despite the fiscal policies introduced to limit price rises or support incomes. In Germany, a country highly vulnerable to supplies coming from Russia, price rises and energy supply difficulties are likely to hold back household consumption and production by companies with rationing a possibility. All this despite strong fiscal support and a very significant increase in the minimum wage. German GDP is likely to contract in Q3 and in Q4 (-0.2% then -0.5% forecast). Similarly in Italy, also very exposed to Russian gas imports, household consumption is expected to decline in the face of rising inflation. In an uncertain political context following the September elections, investment and exports are no longer expected to be able to drive growth in economic activity: GDP would appear to have slowed in Q3 (+0.2% after +1.1%) then looks set to decline at the end of the year (-0.2%). Economic activity in Spain looks set to be more resilient to international difficulties (+0.3% then +0.2% forecast in Q3 and Q4), due to a greater catch-up potential and the disconnection of the Iberian peninsula from the European gas market, making it possible to mitigate the rise in gas and especially electricity prices. High inflation and the rise in interest rates are nevertheless likely to hamper household consumption and investment, both of which are expected to slow at the end of the year. All in all, economic activity in the Eurozone appears to have increased modestly in Q3, then could slip back at the end of the year.

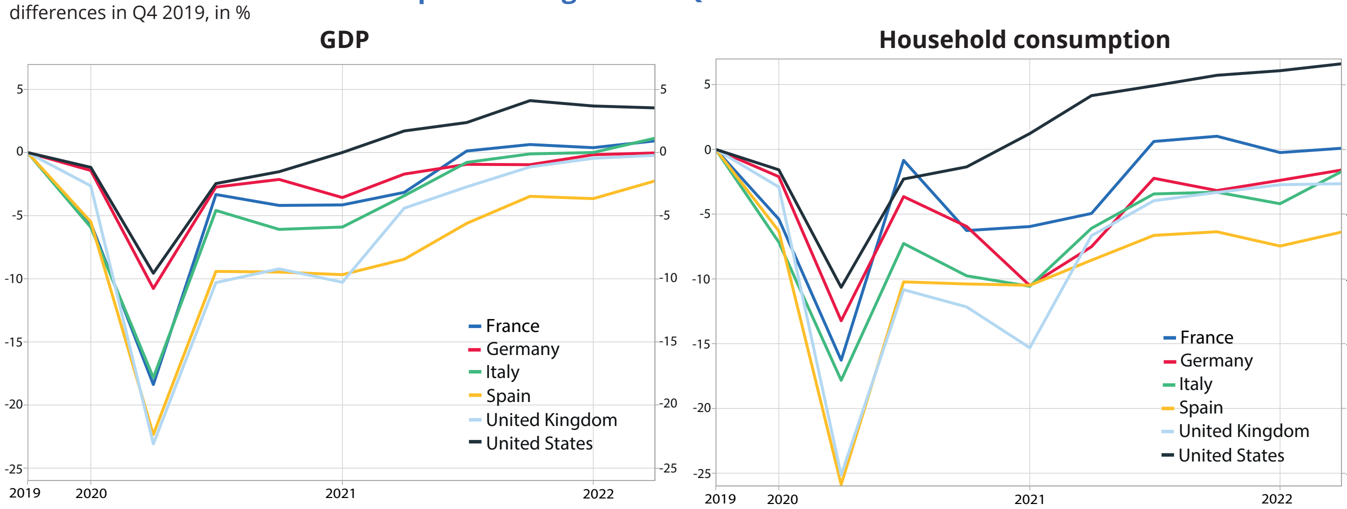
In France, activity is expected to be at a standstill at the end of the year, due to a downturn forecast in industry and a slowdown expected in services

Since the *Economic Outlook* of 7 September, the business tendency surveys published at the end of September have confirmed the darkening of the business climate in France. The forecast of a slowdown in activity in Q3 is thus maintained (+0.2% after the moderate rebound of +0.5% the previous quarter). At the end of the year, in an even more uncertain context, activity is expected to come to a standstill (0.0% forecast in Q4 2022).

The slowdown in activity over the summer would appear to have affected both services and the manufacturing industry, with the major contribution coming from services. In fact, in Q2, the rebound in activity was mainly due to services that had suffered at the beginning of the year from the deteriorating health situation (accommodation-catering, transport services and services to households). In Q3 however, it would appear that activity in services changed only moderately from month to month (the production index for July even suggests a downturn in activity compared to June ► **Figure 4**). Its quarterly change would therefore appear to have benefitted above all from the strong "carry-over effect" as a resulting of the catch-up observed in the spring.

Meanwhile, the manufacturing industry would appear to have improved slightly. Although supply constraints remained significant overall, supply chain difficulties

► 3. GDP and household consumption: changes since Q4 2019
differences in Q4 2019, in %



Last point : Q2 2022
Source: INSEE, Destatis, Istat, INE, ONS, BEA

ceased to deteriorate a few months ago, according to the business tendency surveys, especially problems related to the war in Ukraine (▶Focus). In this respect, manufacturing output rebounded significantly in August (+2.7% after -1.6% in July) in all branches, reaching its highest point since the start of the health crisis.

In Q4 2022, services are expected to slow once again, and the manufacturing industry looks set for a downturn. In industry, the surveys published at the end of September do indeed indicate a further deterioration in the business climate (▶Figure 5) and in particular a clouding of the opinion of business leaders as to their order books and their personal expectations for production, probably linked to the mood of uncertainty surrounding the geopolitical and energy situation. In addition, they consider that in the case of inventories of finished products levels still remain high. The associated balance of opinion reached a high point in August (except in agri-food), suggesting reduced production margins for the end of the year. However, the downturn in manufacturing activity is likely to mask sectoral disparities: the decline is expected to affect mainly "other industrial branches" (chemicals, metallurgy, rubber and plastics, etc.), in line with the greater use of energy in these sectors (▶Focus). Services are less exposed to the uncertainties affecting the industrial branches and should once again improve at the end of the year, but catch-up effects are unlikely to be more than residual.

Employment should continue to grow, although less briskly than in H1

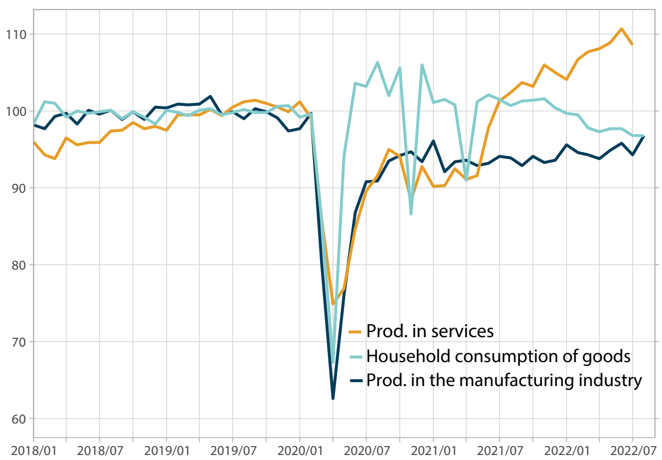
In H1 2022, payroll employment continued to be buoyant, although less so than in the previous half-year (+187,000 payroll jobs created between the end of 2021 and the end of June 2022, or only half as many as between the end of June and the end of 2021). Hiring difficulties, which are still at a high level in the business tendency surveys, partly reflect this dynamism in employment because a considerable proportion of the companies experiencing these problems also report that they have recently increased their workforce or they expect to do so in the near future (▶Focus). Thus in mid-2022, payroll employment was substantially higher than at the end of 2019 (+3.2%, and this was when activity in Q2 2022 was 0.9% above its Q4 2019 level). About a third of this increase was due to the dynamism of sandwich contracts, and especially apprenticeship contracts.

In H2 2022, the dynamics of payroll employment are expected to continue to slow (+58,000 net job creations forecast between the end of June and the end of December). The increase in sandwich contracts is expected to continue, while the other types of job creation look set to slow significantly, in line with activity. The majority of job creations are likely to remain concentrated in the market tertiary sector, while payroll employment is expected to remain virtually stable in industry, construction and the non-market tertiary. All in all, and taking into account a slight slowdown in self-employment in 2022, employment (payroll employment and self-employment) is expected to increase by 305,000 jobs in 2022, after the sizeable catch-up in 2021 (+971,000 payroll jobs).

The unemployment rate remained broadly stable in H1 (▶Figure 6). In addition to the robustness of employment, the active population increased substantially, with the labour force participation rate of 15-64 year-olds reaching a new historic high point

▶4. Monthly production indices in the manufacturing industry and services, and monthly household consumption of goods

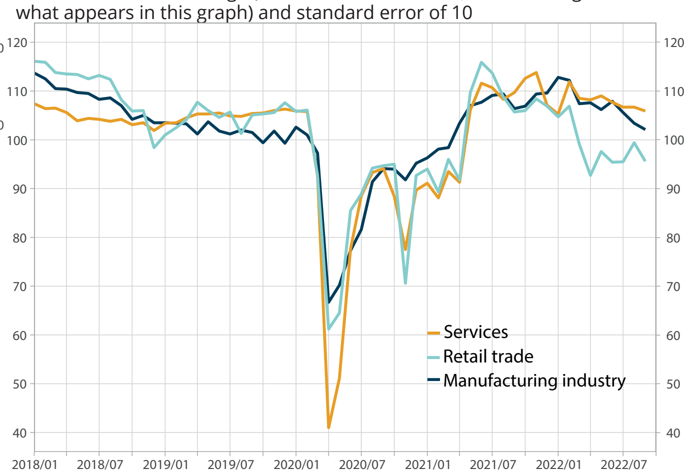
base 100 in 2019



Last point: August 2022 for production indices in industry and household consumption of goods, July 2022 for the production index in services.
Source: INSEE

▶5. Business climate in the manufacturing industry, services and retail trade

normalised to 100 average (across the whole series, which is longer than what appears in this graph) and standard error of 10



Last point : September 2022
Source: INSEE, business surveys

(73.5%). In H2 2022, the active population is expected to slow significantly, returning to a dynamic closer to its trend rate. Given that a slowdown in employment is also expected, the unemployment rate should remain at 7.4% of the active population until the end of 2022.

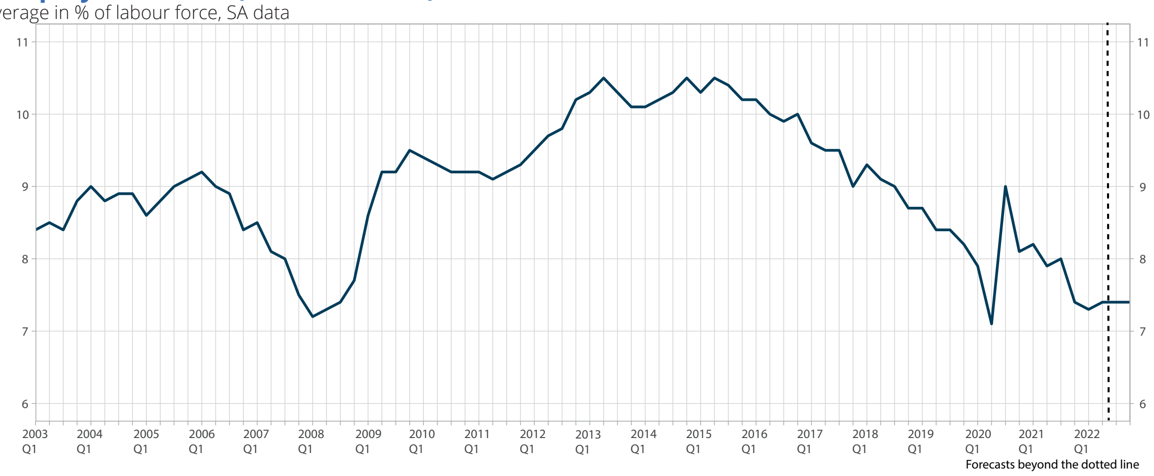
After a few months of relative stability, inflation is expected to rise again at the end of the year to reach around 6.4% year-on-year at the end of 2022

Inflation reached 5.6% year-on-year in September, according to the provisional forecast, after 5.9% in August (►**Figure 7**). This second consecutive monthly drop in inflation contrasts with the sharp and continuing increases in H1. Energy inflation has declined since June: fuel prices fell with the reduction in oil prices (and in September with the increase in the reduction at the pump), while gas and electricity prices were still kept in check by the tariff shield. At the same time inflation continued to rise in food and manufactured goods, as a result of earlier sharp increases in production prices.

By the end of the year, assuming that the price of oil remains fixed at €95 per barrel, inflation is expected to decline slightly in October then move upwards once again, reaching 6.4% year-on-year in December. It is likely that this profile will mainly reflect that of energy inflation, with the reduction at the pump being cut back from November and a "base effect" driving up the year-on-year increase in energy prices at the end of the year (because oil prices fell at the end of 2021, with the emergence of the Omicron variant). Inflation is expected to continue to increase in food, reaching almost 12% year-on-year by the end of the year, the largest contribution to headline inflation, and in manufactured goods (5% year-on-year in December). In services, inflation is expected to remain contained, with the abolition of the television and radio licence fee bringing prices down under the heading "Television and radio licence fees, subscriptions".

►6. Unemployment rate (ILO definition)

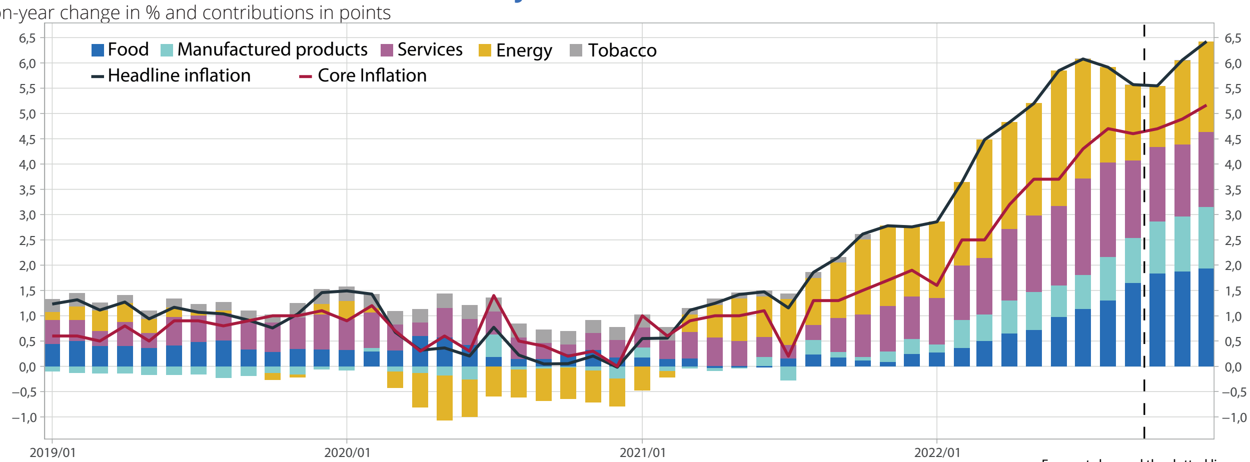
quarterly average in % of labour force, SA data



Scope: France (excluding Mayotte), persons aged 15 or over living in ordinary housing
Source: INSEE

►7. Headline inflation and contributions by item

year-on-year change in % and contributions in points



Note: for September 2022, headline inflation is a provisional estimate, core inflation a forecast.
Source: INSEE

Core inflation does not take into account changes in the most volatile prices or tax measures such as the abolition of the TV licence fee, and it is therefore expected to increase slightly at the end of the year, driven mainly by the prices of manufactured products and food (excluding fresh). It is therefore likely to be 5.2% at the end of the year, after 4.7% in August.

Despite the dynamics of consumer prices, household purchasing power is likely to rebound sharply in H2, sustained by measures voted during the summer

Household purchasing power fell back during H1 2022 (-1.8% per consumption unit in Q1 then -1.2% in Q2), penalised by the brisk acceleration in consumer prices (►**Figure 8**). It is expected to pick up significantly in H2, due to the dynamism of nominal income and, to a lesser degree, to the slowdown in prices.

It is likely that earned income will be driven by a significant acceleration in wages, linked to the recent increases in the minimum wage and the fact that inflation is taken into account in wage negotiations. Also because of the value sharing bonus (PPV, successor to the extraordinary purchasing power bonus), and the increase in the civil service index point in Q3. Meanwhile, social benefits and other income transfers are expected to increase substantially in Q3 then in Q4, sustained by the measures voted during the summer (increases in many social benefits and the back-to-school bonus in Q3, exceptional energy cheque at the end of the year). Lastly, taxes and social contributions should fall in Q4, notably due to the continuing reduction in the housing tax and the abolition of the television and radio licence fee (in the national accounts this abolition is not counted in the household consumption deflator but instead in their income).

All in all for 2022, households' gross disposable income (GDI) is expected to increase by 4.7%, of which about 1.3 points is due to support measures voted during the summer or announced since then. The purchasing power of GDI is likely to remain stable overall in 2022 and decline by 0.6% per consumption unit (►**Figure 9**).

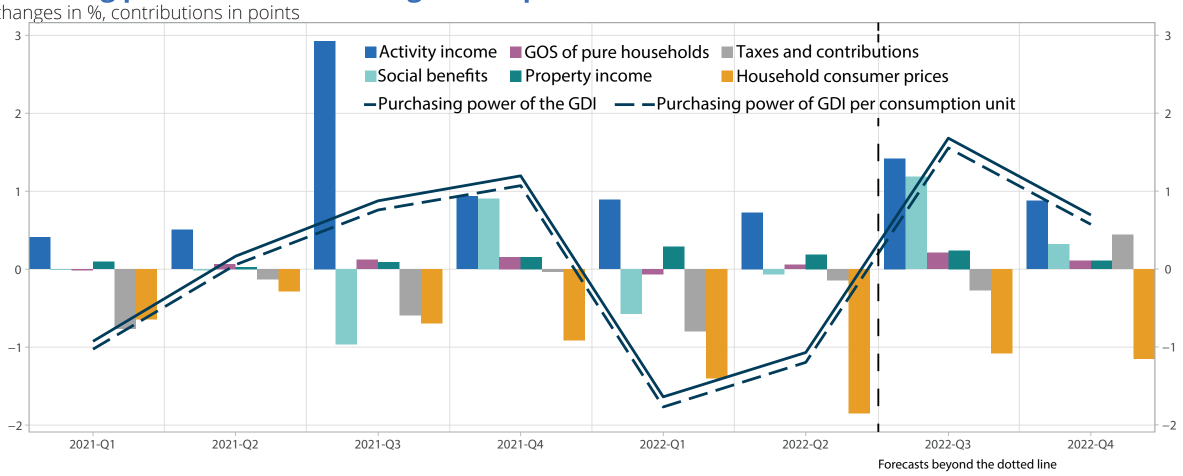
Household consumption is expected to be sluggish in H2, leading to an upturn in their savings ratio

In Q2, household consumption rebounded slightly, driven by an upswing in services (►**Figure 10**). Spending on accommodation-catering, transport services and leisure activities benefitted from the improved health situation. However, inflation hampered the consumption of goods: spending on agri-food products and on fuel declined once again, also purchases of vehicles.

Consumption would appear to have continued to improve in Q3, driven by the ongoing recovery in services, albeit reduced compared to the previous quarter, especially in accommodation-catering. After their marked downturn in July, purchases of goods stabilised in August (►**Figure 4**): they would appear to have fallen back once again across the quarter as a whole, although less markedly than in the previous quarter. The inflationary context would appear to have affected spending on food products in particular. Spending on fuel would seem to have continued to fall, according to bank card transaction data, but less significantly than in H1, probably in line with the fall in the price of oil and the increase in the reduction at the pump in September (►**Focus**). Car purchases would appear to have increased. Purchases of capital goods, which have been above their pre-crisis level since H2 2020, would appear to have continued their return to trend.

►8. Purchasing power of households gross disposable income

quarterly changes in %, contributions in points



Note: the contribution of social benefits also includes other transfers.
Source: INSEE

n Q4, household consumption is expected to increase only very moderately. The latest economic indicators point to a downturn in household confidence in September, reaching a historic low point, as was the case in July, while the business climate in retail trade deteriorated (►Figure 5). The consumption of goods is therefore unlikely to improve, as the context of high inflation continues to temper households' purchasing decisions. In services, the catch-up effects in play in Q2 and Q3 are expected to fade out, giving way to a more trend-based rate of increase.

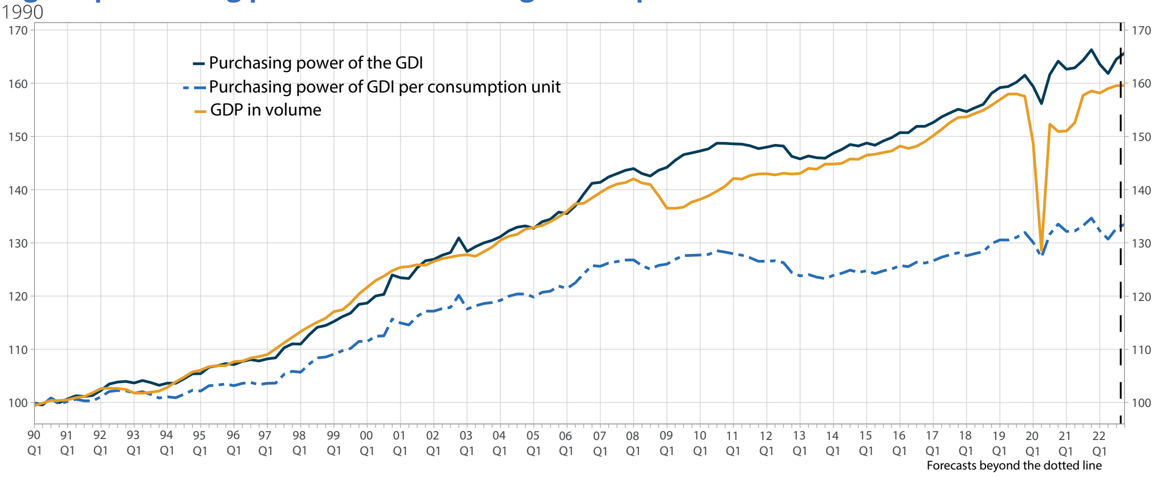
Given the momentum forecast for household purchasing power in H2, their savings ratio should pick up considerably, exceeding 17% at the end of the year, despite having reached a low point in Q2 (15.5%, slightly higher than the 2019 level nevertheless ►Figure 11). This increase in households' savings ratio would probably reflect a smoothing behaviour on their part regarding purchasing decisions in a context of quarterly variations in their purchasing power.

Corporate investment is likely to slow by the end of the year

There was a moderate increase in corporate investment in H1, held back notably by a continuing decline in investment in manufactured goods (and more particularly in transport equipment, which has been falling for five consecutive quarters). The rebound in new vehicle registrations in July and August suggests a turnaround in purchases of transport equipment by companies in Q3, leading to a marked acceleration in their investment this quarter in our scenario. At the end of the year, however, the expected decline in manufacturing activity, the slowdown of activity in services and, more generally, the context of both geopolitical and energy uncertainty and the rise in interest rates are expected to result in a marked slowdown in corporate investment.

►9. Change in purchasing power of household gross disposable income and of GDP since 1990

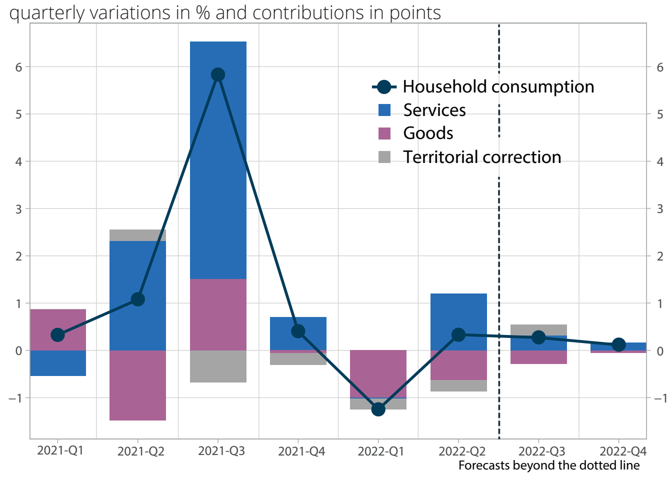
base 100 in 1990



Source: INSEE

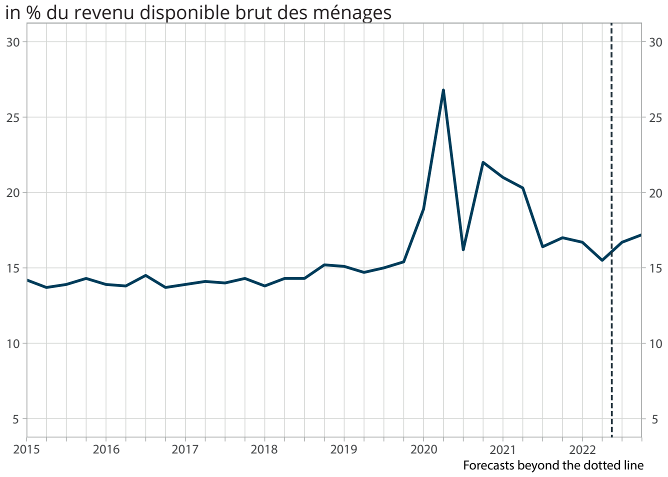
►10.Household consumption

quarterly variations in % and contributions in points



►11. Household saving rate

in % du revenu disponible brut des ménages



Source: INSEE

Economic outlook

The buoyancy of wages in H2, combined with a slightly stronger increase in employment than in activity, is likely to affect companies' margin rate, despite the support it is expected to receive through subsidies paid as part of the economic and social resilience plan. Thus the margin rate of non-financial corporations is expected to reach 32.0% of their value added in Q4 2022. On average over the year, it is also expected to be 32.0%, down considerably compared to 2021 when it had been particularly well supported by emergency aid linked to the health crisis, but higher than in 2018 (31.5%). The rise in energy prices could also damage the gross operating surplus of those companies that depend most on this factor of production and thus increase diversity between branches.

The reopening of tourism is stimulating exports and also imports of services

In Q2 2022, foreign trade supported GDP growth: exports continued to grow (+0.9%), driven mainly by the continued return of foreign tourists to France, whereas imports were at a standstill.

Exports are likely to be less dynamic in H2 (+0.6% forecast in Q3 then +0.5% at the end of the year). The slowdown in world trade is expected to affect world demand for French products and the catch-up effects associated with the return of foreign tourists is likely to be less than in the previous half-year. However, some major aeronautical deliveries should sustain exports, especially at the end of the year.

Meanwhile, imports would appear to have been vigorous in Q3, due to the significant catch-up in purchases by French tourists abroad. However, they are likely to slow considerably at the end of the year, in line with these diminishing catch-up effects and the sluggishness of domestic demand.

Domestic demand appears to have accelerated slightly in Q3, but was accompanied by dynamic imports, and is expected to come to a virtual standstill at the end of the year

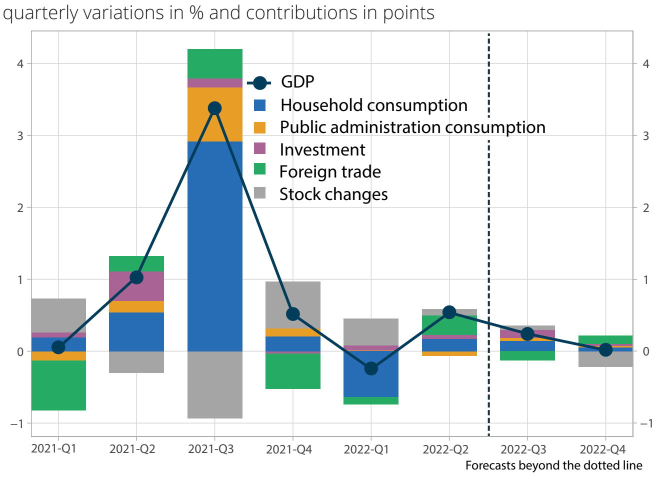
All in all, activity in Q3 would appear to have been sustained by a slight acceleration in domestic demand compared to the spring, mainly as a result of corporate investment, but tempered by dynamic imports, and as a result foreign trade hampered quarterly change in GDP. At the end of the year, domestic demand is expected to slow significantly. However, this slowdown is likely to be less than that in activity itself, resulting in a destocking movement heightened by exports of aeronautical equipment.

Across 2022 as a whole, growth is expected to be 2.6%. The growth overhang for 2023 (i.e. annual growth that year if quarterly GDP remained at the level reached at the end of 2022, in each quarter) is likely to be modest, at around +0.2%.

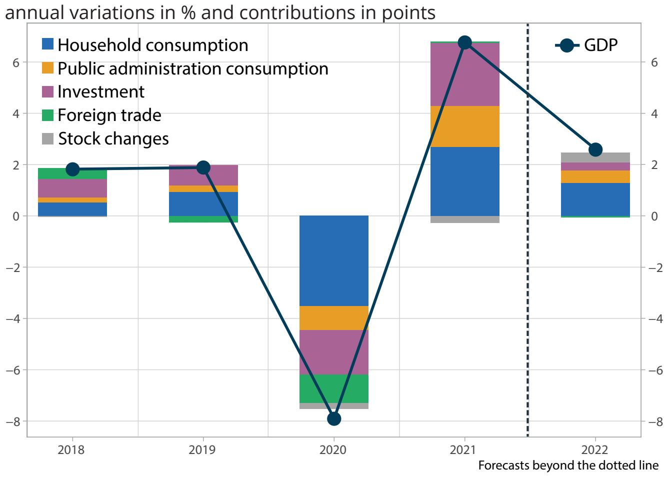
There are several uncertainties that could affect this scenario. A possible worsening of the energy crisis in Europe could cause activity to fall back at the end of the year, due to the economic consequences of this crisis on France's main partners but also the possible introduction of restrictions on energy consumption. A deterioration in the health situation could also affect activity, like the Omicron wave right at the beginning of 2022. Finally, the volatility of the financial markets remains a point to be watched.

►12. GDP and its main contributions

quarterly variations in % and contributions in points



annual variations in % and contributions in points



Source: INSEE