

# France's international environment

Between now and the end of 2009, the advanced economies are likely to continue shrinking, but at an increasingly moderate pace, as suggested by the gradual improvement in the business tendency indicators. After a fall of 2.1% in Q1, their GDP should decline by 0.8% in Q2, then 0.5% and 0.2% in Q3 and Q4. World demand for French products is likely to follow the same trend, falling by 4.2% in Q2 2009, then by 2.4% in Q3 and 1.3% in Q4. The exact scale of the impact of the fiscal and monetary stimulus is the key unknown in this forecast.

## The sharp decline in activity in Q1 2009...

In Q1 2009, the advanced economies shrank sharply again: -2.1% after -1.9% in Q4 2008. In particular, investment and inventory levels fell sharply (see table). On the one hand, households scaled back their housing investment expenditure, as financing conditions have remained tight, they fear a drop in their income due to rising unemployment, and property prices are falling, thereby removing any prospects of capital gains. On the other hand, businesses have sharply reduced their investment expenditure: their markets appear uncertain, they have substantial excess

production capacities and they are still having difficulties getting financing. Furthermore, they have started bringing their inventory levels down in line with lower demand levels that look set to remain that way: the contribution of inventory to growth was negative overall (-0.6 points).

In contrast, household consumption in the advanced economies was buoyed up in Q1 by three factors: lower taxes, higher benefits and the decline in consumer prices in the wake of the slide in oil prices. In the United States in particular, household purchasing power grew by 1.6% in Q1. In the United Kingdom, the fall in prices was accentuated by the VAT cut. And in Germany and France, among others, consumption was boosted by incentives to replace old vehicles.

Nevertheless, demand declined sharply leading to a further slide in world trade in Q1: -11.3% after -5.8% in Q4 2008. Germany and Japan, whose growth is highly dependent on foreign trade, were once again particularly hard hit: German GDP dropped by 3.8% in Q1 2009, after a fall of 2.2% in Q4 2008, and Japanese GDP was down 3.8% in Q1, after a fall of 3.6%. Activity in the major emerging countries, in particular China and the newly industrialised countries of South-East Asia, was also hit by the sharp drop in their exports.

Table 1

## Industrialized countries: consolidated supply and use table

in real terms

	Quarterly changes, %												Annual changes, %		
	2007				2008				2009				2007	2008	2009
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
<b>GDP</b>	0.5	0.7	0.8	0.3	0.4	0.1	-0.3	-1.9	-2.1	-0.8	-0.5	-0.2	2.4	0.6	-4.6
Private consumption	0.5	0.5	0.4	0.3	0.4	-0.1	-0.4	-0.8	-0.2	-0.2	-0.4	-0.5	2.1	0.4	-1.5
Public consumption	0.5	0.8	0.6	0.5	0.4	0.7	0.8	0.6	-0.4	1.1	1.1	1.1	2.1	2.3	2.4
Investment	0.5	-0.1	0.1	-0.3	-0.5	-1.0	-1.5	-4.8	-7.6	-5.6	-3.7	-2.0	0.8	-3.3	-17.4
Exports	0.6	1.7	3.5	1.0	1.5	1.0	0.3	-7.7	-10.5	-1.5	-1.1	-0.5	6.6	3.4	-17.0
Imports	1.4	-0.1	1.3	-0.2	0.6	-1.8	0.2	-3.8	-9.4	-2.4	-2.1	-1.8	2.8	-1.2	-15.3
<b>Contributions to GDP growth</b>															
Domestic demand excluding inventories	0.5	0.4	0.4	0.2	0.2	-0.1	-0.4	-1.3	-1.4	-0.8	-0.7	-0.4	2.0	0.2	-3.6
Inventories	0.1	0.0	0.2	-0.2	0.0	-0.2	0.2	0.0	-0.6	-0.1	0.0	0.0	-0.1	-0.1	-0.7
Net exports	-0.2	0.3	0.2	0.2	0.2	0.4	-0.1	-0.7	0.0	0.1	0.2	0.3	0.4	0.6	-0.2

Forecasts

Sources: national statistical institutes; IMF; INSEE estimates

### ... should moderate gradually from now until the end of 2009

In the period covered by this forecast, the advanced economies are likely to continue shrinking, but at an increasingly moderate pace. In Q1, the overall business climate improved from its low in December 2008 (see *Graph 1*): in May, purchasing managers are still reporting a fall in activity, but much less sharp than at the beginning of the year. At the same time, world trade should drop back less and less sharply, as shown by the "export orders" component of the purchasing managers' index, which increased markedly in May. The rise in the Baltic Dry Index would appear to confirm this, although its ability to predict trends in world trade appears slight on close examination (see *Focus "The Baltic Dry Index is not a reliable lead indicator of world trade"*).

Households in the advanced economies should continue to reduce their demand through to the end of 2009. Their earnings are likely to continue falling, due to the rapid fall in employment and the sharp slowdown in wages. On top of this, their access to credit should remain difficult, and all the more so as banks find themselves facing a rise in default rates on consumer loans. Admittedly, in Q2, household consumption will be somewhat sustained by the gain in purchasing power brought about by low inflation and the stimulus measures, in particular in the United States and in Spain, but in H2, consumption looks set to fall more sharply.

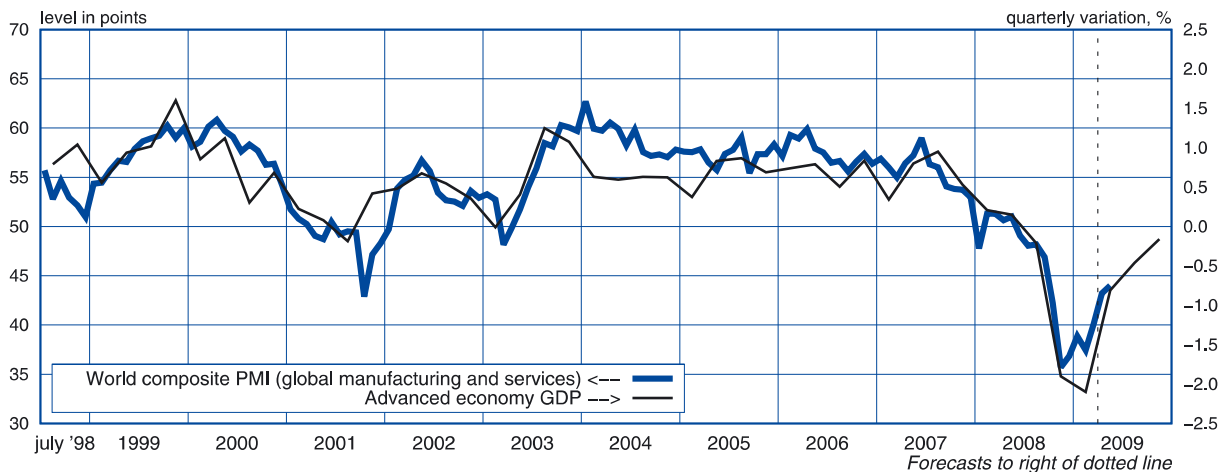
Businesses are likely to continue cutting back their investment expenditure in the face of gloomy, uncertain demand forecasts, and large overcapacity in production. However, these reductions in investments should gradually ease,

with sales prospects improving little by little, notably thanks to the public investment expenditure scheduled in the national stimulus plans.

Inflation in the advanced economies fell to +0.2% in March, year on year, in the wake of the slide in oil prices in H2 2008. It should remain moderate through to the end of 2009, as falling activity continues to put the brakes on prices and wages. It is likely to particularly affect oil prices. Their sharp rise since April should run out of steam by the end of Q2; it was driven jointly by reductions in output by OPEC and anticipated tensions on the oil market; the slowdown should be driven by the decline in consumption in developed countries and high stock levels. Over the period covered by the forecast, the market should be close to equilibrium and the price of a barrel of Brent should fluctuate around \$60 (see "*Oil*" note). The fall in activity is also likely to keep wages down via the rise in unemployment: core inflation in the advanced economies therefore looks set to fall gradually.

All in all, GDP of the advanced economies should fall by 0.8% in Q2 2009, then in a less pronounced manner in H2: -0.5% in Q3 then -0.2% in Q4. These results assume that financial markets carry on their return to normal started in recent months, and that the stimulus measures announced by the governments do sustain household and corporate demand. In the period concerned by our forecast, activity should accelerate gradually in China under the combined effects of the national stimulus plan and a slight increase in exports to advanced economies. This upturn in the Chinese economy, combined with less degraded business in the advanced economies, should also boost growth in the rest of the South-East Asia zone.

**1 - Activity deteriorated in an increasingly moderate pace**



Sources: *GlobalInsight, DataInsight, IMF, INSEE calculations*

### Financing terms for households and companies remain unfavourable

In Q1 2009, action by the public authorities eased tensions on interbank markets, bringing the risk premiums demanded by banks before lending each other money to the levels of August 2007. This fall reflects the easing of fears over bank balance sheets. Their financial situation is less critical than in the previous quarter, as their losses are less.

However, banks in the advanced economies are still demanding strict financing terms of households and companies: surveys of the banks report a tightening of these conditions, although to a lesser extent. Also, default rates have increased, reaching all-time highs in the United States, and this could lead the banks to carry on tightening their conditions.

Additionally, bond financing of non-financial enterprises remains very costly. For example, the spread between long-term rates and public securities is only just down, and remains much higher than the levels observed before the Lehman Brothers bankruptcy, notably in Germany and the United States.

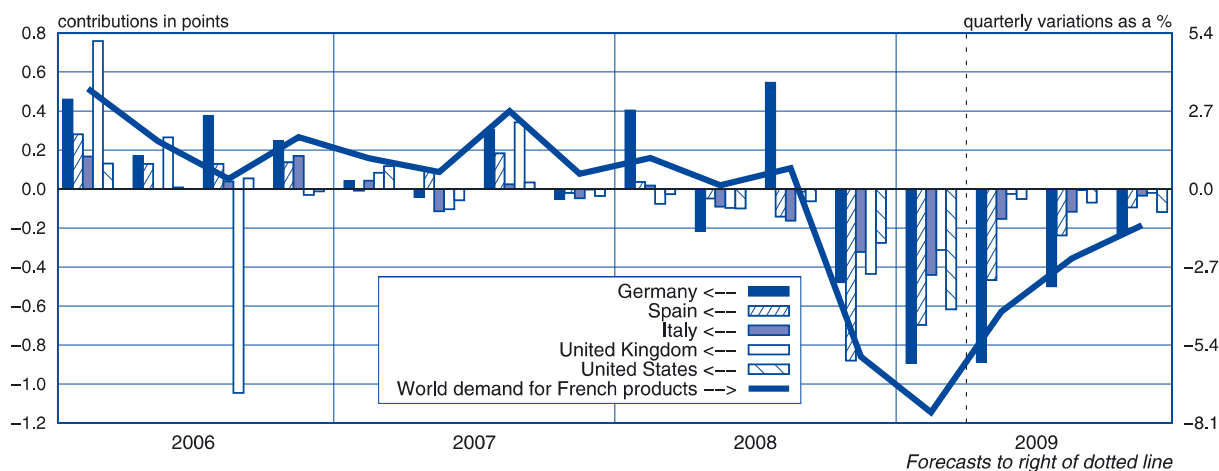
All in all, financing for private agents remains difficult and costly, although it has improved noticeably since the height of the tensions in the wake of the Lehman Brothers bankruptcy.

### Monetary and budgetary stimulus policies are beginning to bear fruit

Faced with the sharp drop in activity, the public authorities in the advanced economies and major emerging countries have introduced substantial stimulus plans to boost demand. These plans include measures to support private, household and corporate demand, and public expenditure programmes. However, with the exception of China where the first expenditure was made at the end of 2008, only the measures targeting households and companies look set to have a notable impact on activity in the period covered by this forecast.

Most of the household demand stimulus measures aim to increase their purchasing power by acting either on consumer prices or on income. For example, the incentives to replace old vehicles introduced in a large number of countries specifically reduce the purchase price of new vehicles, while the VAT cut in the United Kingdom affects a wider range of consumer goods. Household disposable income is increased via three channels: by tax cuts or lower social contributions (Germany, Spain and the United States, among others); by increasing benefits, and in particular unemployment benefit (Germany and the United States); or by one-off stimuli (United States, Japan and Italy). Certain other measures seek to ease the conditions of access to loans by households or to ease the burden of their interest payments. In the United States, in particular, direct buyouts of mortgage securities by the Fed have significantly reduced the rates on offer to households.

## 2 - Fall in the imports of France's main trading partners should moderate



Note: the curve represents the quarterly variation in world demand for French products. The bars represent the variations in the countries' imports in volume, weighted by their share in French exports (the total weight of these five countries represents almost half of French exports).

Sources: DataInsight, DGTPE, INSEE calculations

Companies in the advanced economies are benefiting from measures destined mainly to scale back their costs in order to reduce the number of bankruptcies and layoffs and to stimulate their investment expenditure. For example, cash flow measures such as early refunds of any excess amounts of tax paid and extended payment times for payment of future taxes aim to ease the financing difficulties companies are facing. In Germany, the reduction in health insurance contributions and the payment by the State of part of the cost of temporary lay-offs also lighten the cost burden on companies. Finally, most countries have introduced tax rebates to support corporate investment expenditure.

All in all, the implementation of State stimulus plans should attenuate the decline in demand in the advanced economies from Q2 2009. The impact on activity, however, remains difficult to assess due

to lingering tensions on financial markets and the high level of household debt. In particular, faced with rising unemployment, households are likely to save a large part of the additional income from the temporary stimuli.

### **Export outlets for France should fall more moderately through to the end of 2009**

France should benefit from the more moderate decline in world trade in H2 2009. "World demand" for French products, meaning the imports of our trading partners weighted by the proportion of our exports they represent, should thus fall, but gradually less sharply through to end 2009: -4.2% in Q2, then -2.4% and -1.3% respectively in Q3 and Q4 (see *Graph 2*). ■

## Focus - The Baltic Dry Index is not a reliable lead indicator of world trade

In Q1 2009, world trade fell back by 11.3% after a drop of 5.8% in Q4 2008.<sup>(1)</sup> These two consecutive falls are the biggest recorded since the Second World War. Also, between May and November 2008, the index of maritime freight prices for dry raw materials (Baltic Dry Index) lost 80% of its value, ahead of the downturn in trade. The fall in the Baltic Dry Index would seem to have been an advance signal. However, despite this striking example, the Baltic Dry Index is not a reliable lead indicator of world trade: the signals supplied by the indicator regarding world trade can prove to be wrong and any econometric link between the two is difficult to demonstrate and unstable.

### The Baltic Dry Index: a market "price"...

The Baltic Dry Index (BDI) is an index of the price of maritime freight of bulk dry materials (ore, metals, coal, cereals, etc.). It is calculated by British company London Baltic Exchange and is a daily average of the prices practiced on the world's twenty-four main maritime routes. These prices result from the match between supply and demand for ships transporting bulk materials (bulk carriers) among dry materials forwarders and charterers.<sup>(2)</sup> Changes in the BDI are often interpreted as an indicator of future economic activity, and in particular of world trade.

### ...upstream from the production process and trade

Since 1992, the phases of positive and negative growth in world trade have been accompanied by movements in the same direction of the Baltic Dry Index, aside from the very great volatility of this index (see graph). In particular, the sharp contraction in world trade in 2001 and in 2008 can be seen in the trends of the BDI. For these two periods, the fall in

(1) According to the Dutch Centraal Planbureau (CPB). The OECD, meanwhile, published a figure of -6.7% in Q4 2008.

(2) The Baltic Dry Index is also available as sub-indices according to the load capacities of the ships.

the Baltic Dry Index even seems to have come a few months ahead of that in world trade. For example, in 2000, the BDI began to fall from October, while the downturn in world trade only came at the beginning of 2001; in November 2008, the BDI had already lost 80% of its value when world trade suddenly deteriorated (-6.8%).

In theory, the BDI can be interpreted as a market price upstream from production and international trade. In fact:

- As cargo supply is inelastic in the short term, the BDI can provide information on world demand for dry materials.
- This demand is said to reflect expectations of production, in particular industrial production, via the use of dry materials as inputs into the production process.

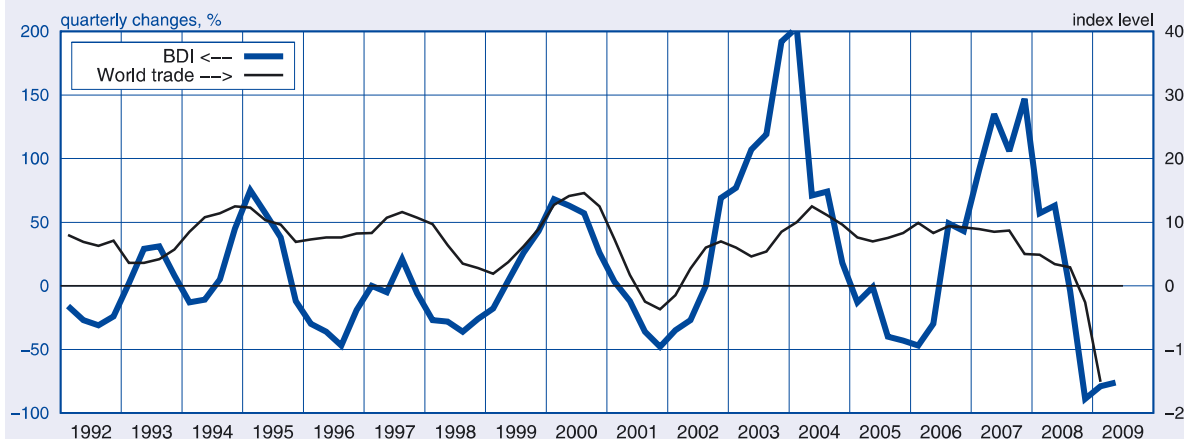
Therefore, when companies foresee a rise in activity, they increase their raw materials orders for their production and future exports. As the world fleet does not adapt immediately to the increase in maritime traffic volumes, this pushes the Baltic Dry Index upwards. Conversely, the BDI would be dragged downwards by an anticipated drop in production and world trade. Therefore, trends in the Baltic Dry Index are thought to reflect growth and world trade trends.

Also, the BDI has the twofold advantage of being published daily and never being revised. Studying its movements as part of a world trade forecasting exercise would therefore allow real-time analysis, given that the first monthly world trade trends are only published by the Dutch Centraal Planbureau about two and a half months late. It would therefore also provide complementary information to that in the surveys (balances of opinion, order books, etc.).

### The link between the BDI and world trade proves difficult to establish

However, the Baltic Dry Index does not always give clear signals as to developments in world trade. Certain movements of the BDI, on a scale and at a pace similar to

### Baltic Dry Index (BDI) and world trade



Sources: Baltic Exchange, CPB

those of 2001 or 2008, have not been followed by marked movements in world trade (see *Graph*). Also, volatility of the BDI has increased sharply since 2000, while the same cannot be said of world trade, at least until 2008. In 2005-2006 in particular, the BDI began by falling sharply and then soared by 135% in 2007, while world trade at the same time continued to grow at a sustained rate. Also, between 1992 and 2008, the index lost over 30% of its value in less than a year on six occasions, while world trade has taken a downturn only twice. Statistical analysis of the turning points<sup>(3)</sup> of the BDI and in world trade confirms that the BDI had more cycles than world trade over this period. This should not be seen as a surprise: the BDI can respond to many factors that do not necessarily affect world trade. It can be affected by geopolitical tensions or by oil prices, due to the fuel used for cargo ships. As the BDI is a market price, anticipation of its movements can also play a role in the volatility of the index.

The absence of an automatic link between the BDI and world trade is confirmed by econometric analysis: use of the BDI in simple models does not give satisfactory results. On the one hand, the relation between the BDI and world trade is not

stable statistically. Depending on the period of estimation, the link between the two variables is weak or even non-existent. Up to the end of the 1990, trends in the BDI do not explain those in world trade; since then, the link between BDI and world trade is not proven if we end the estimation period prior to 2008.<sup>(4)</sup> Additionally, statistical analysis shows something of a parallel relationship (when there is one) rather than providing a lead indicator, even at cycle turning points.<sup>(5)</sup>

The use of the BDI for the purposes of forecasting world trade is therefore not conclusive. While the index may give an advance signal in some cases (when the whole economy is affected, as at the end of 2008 for example), it also sends out incorrect messages on foreign trade. To forecast such trade, other lead indicators, such as the export orders in the Purchasing Managers' Index survey<sup>(6)</sup> can be easier to interpret and have greater explanatory value in statistical models. Those readers interested in such matters may refer to the Focus on "Understanding trends in foreign trade per country by world trade forecasts" in the March 2009 *Conjoncture in France*. ■

(3) Procedure of Bry and Boshan (cf. Bry G. et Boshan C. (1971), "Cyclical Analysis of Time Series: Selected Procedures and Computer Programs", NBER Technical Paper, National Bureau of Economic Research).

(4) The coefficient of the BDI is not significant to the standard statistical thresholds (1%, 5% or even 10 %).

$$\dot{W}T_t = 0,01 + 0,01 \dot{B}D_t + 0,5 \dot{W}T_{t-1} + 0,4 \dot{W}T_{t-2} - 0,6 \dot{W}T_{t-3}$$

(+2,8)
(+1,0)
(+2,9)
(2,2)
(-3,4)

The econometric relation is as follows:

$\dot{W}T_t$ : quarterly growth rate of the world trade index calculated by the CPB.

$\dot{B}D_t$ : quarterly growth rate of the BDI.

Estimation period: 2000 Q1 - 2007 Q4; R2 adjusted = 0.46; DW = 1.8. In brackets: Student t.

(5) The Banerji test leads us to accept the hypothesis that the BDI is not ahead of world trade during phases of turning points in trade (cf. Banerji A. (1999), "The lead profile and other non-parametric tools to evaluate survey series as leading indicators", Research Paper, Economic Cycle Research Institute).

(6) The PMI survey is a monthly survey of available purchasing managers in a large number of countries on the business outlook (production, orders, employment...). The "export orders" component can be used to predict world trade.

# Consumer prices

Since summer 2008, inflation has been falling in France. This clear downward trend is due not only to the downturn in demand pushing prices down, but also to the fall in the prices of raw materials, and notably oil, gradually being passed on to other products.

These two factors should continue to push inflation down through to the end of 2009. "Core" inflation measured by taking the prices of energy, seasonal food products and public tariffs out of the overall index and neutralising the effect of variations in taxes, notably VAT, was over 2% in summer 2008. It is likely to fall back to 1.2% in December, after standing at 1.6% in May 2009.

Year on year, the overall index is likely to follow a less regular course: it should reach a low point of -0.7% in July 2009, because it was in July 2008 that oil prices had reached their peak; the overall index should then rise as the price comparison basis becomes lower for oil prices. It should therefore be back up to 0.6% in December, although this still remains a very low level compared with recent years. This time it is not energy prices that look set to pull year-on-year prices down, but the components of "core" inflation, and in particular non-energy industrial goods. The fall in the rate of VAT for

the restaurant sector should also have a similar impact.

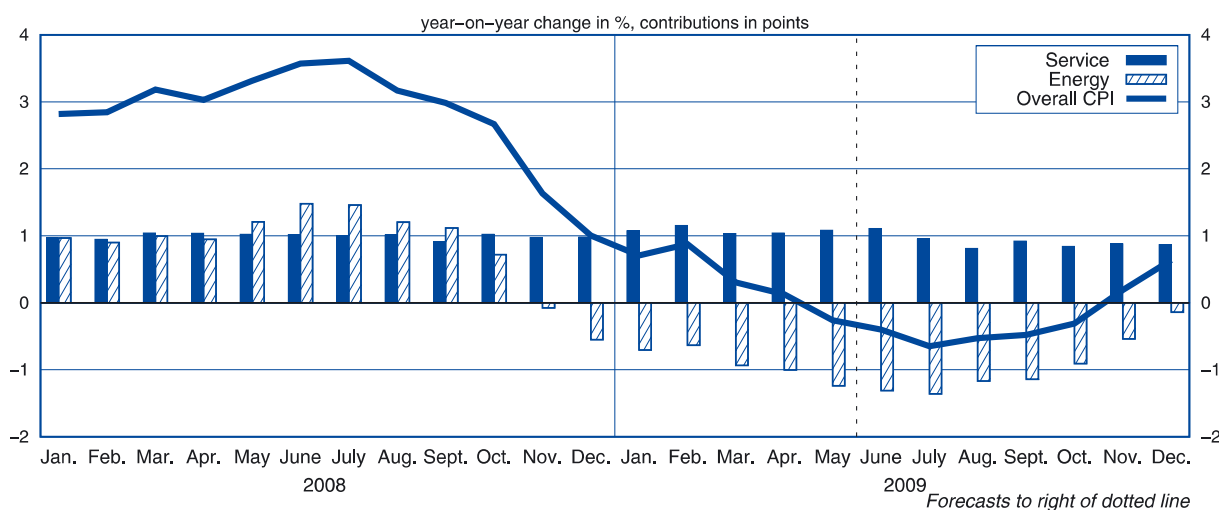
## Persistent disinflationary pressures...

In 2009, weakening demand and the gradual spread of falling raw material prices to other products look likely to exert disinflationary pressures. If we exclude from the price index the prices of volatile products, public tariffs and, from 1<sup>st</sup> July, that part of the reduction in VAT that restaurant owners pass on in their prices, year-on-year inflation should therefore drop from a high point of 2.1% in October 2008 to 1.2% in December 2009, after falling to 1.6% in May 2009 (see box).

## ... but a less regular trend in the year-on-year price figures because of oil

In July 2009, year-on-year change in consumer prices is set to reach a low of -0.7%. Two effects are combined here: the cut in VAT on restaurants and lower energy inflation (see Graph 1). One year

**1 - Inflation in France: contributions of the services and energy items**



Source: INSEE

## Consumer prices

earlier, Brent Prices had reached a peak of \$145, while it is now assumed that they are likely to remain stable in H2 2009 at around €60 per barrel (see "Oil" note). The fall in the year-on-year energy price figures should therefore be even greater than that observed in the oil counter-shock in 1986: -18.1% in June 2009 against -15.9% in 1986. At the end of the year, year-on-year inflation should be positive again at 0.6 % (see table): the price of Brent should again be higher than that at the end of last year, when it had collapsed to \$40. The rise in energy prices year on year should be greater than the two disinflationary effects at work in 2009: lower demand on the one hand, and the repercussion on consumer prices of the fall in producer prices that started in Q1 2009, on the other.

### The downturn in demand set to hold down prices of non-energy industrial goods

The prices of non-energy industrial goods have been stable on the whole through to H1 2009 but look set to rise in H2. In December 2009, they should therefore be down year on year (-0.4% against +0.1% in May). The recent fall in producer prices in industry should spread to consumer prices in H2. As well as this, demand for household equipment goods looks set to weaken, contributing

to falling prices in that sector. Finally, the drop in the prices of automobiles and imported consumer goods that started in early 2009 should also contribute to that in non-energy industrial goods (see Graph 2).

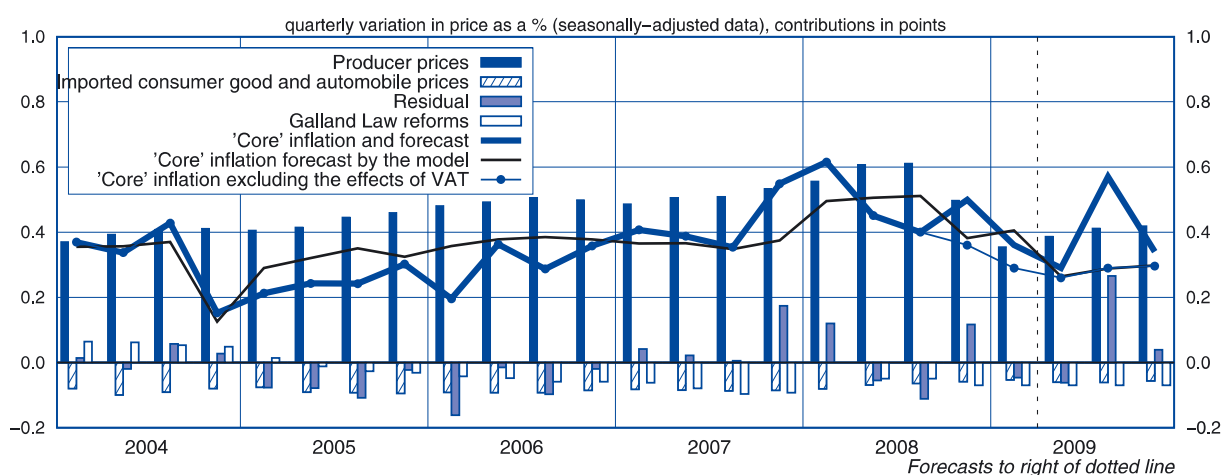
### The cut in VAT for restaurants likely to bring down service inflation

In services, inflation looks set to decline distinctly: the year-on-year change in prices should fall from 2.5% in May to 2.0% in December. This fall should be essentially due to the cut in VAT rates for sit-down restaurants, which will go from 19.6% to 5.5% on 1st July. Working on the hypothesis that 40% of the reduction in taxes is passed on to prices (see box), restaurant prices should therefore drop by 3%, those of services are likely to decline by 0.3% and the impact on the overall index should be -0.2 points.

Furthermore, specific measures are likely to bring prices down in telecommunication services.<sup>(1)</sup> The

(1) On the one hand, in September 2008 the European Commission adopted a regulation requiring mobile telephone operators to comply with a pricing cap of 4 eurocents for wholesale SMS roaming rates in summer 2009. On the other hand, the ARCEP (*Autorité de régulation des communications électroniques et des postes*) decided to bring down by around 30% the wholesale prices of mobile telephony from 1<sup>st</sup> July 2009.

## 2 - Contributions to "core" inflation



How to read the chart: the thick curve represents quarterly core inflation, which depends on the quarterly growth in producer prices in the market sector and the prices of imported consumer goods and automobiles. A supplementary variable is introduced ("Galland law reforms") in order to take into consideration the price-lowering effects caused by the successive reforms of the Galland law, initiated at the end of 2004. The relationship presented here is part of a wider model (price-wage loop) which also takes account of the role of inflation expectations in wage negotiations. The histograms represent the econometric contributions of the variables to core inflation. For example, in Q3 2007 core inflation was 0.35%; producer prices explain 0.55 point, and the "Galland law reforms" variable and the prices of imported consumer goods and automobiles contributed negatively (0.1 point each). The contribution of the residual is therefore nil for this quarter. The positive residual in Q3 2009 reflects the rise in VAT-exclusive prices in the restaurant sector.

Source: INSEE



sharp rise in urban heating prices seen in October 2008 is unlikely to be repeated and should induce a fall in year-on-year prices of the "rent-water" item from 2.9% in May to 2.4% in December. Finally, the recent downturn in demand for accommodation services could push hoteliers to keep their prices moderate in H2.

### Reduction in inflation of food products

On food products, inflation should be very low, with the year-on-year figure falling to 0.2% in December. Since August 2008 and the end of the upward pressure from the prices of imported food commodities, inflation of food products excluding

seasonal products has fallen back distinctly and was only 0.2% by Q1 2009. Measured over a year, inflation has therefore fallen continuously as the sharp rises of the second half of 2007 and the first months of 2008 disappeared from the calculation of the year-on-year figures (for an evaluation of the effects of fluctuations in food commodity prices, see *Focus*). Also contributing to the moderation of food product inflation are the effects of the Law on the Modernisation of the Economy, leading to moderation in the prices of the leading brands.<sup>(2)</sup> ■

(2) Since last summer, the Law on the Modernisation of the Economy has authorised the negotiation of tariffs between distributors and suppliers. Negotiations started in autumn 2008 and ended last March, and covered the prices of products marketed from Q2 2009. As a result, the effects of the law will not be visible in Q1 but should be felt in Q2.

Consumer prices													
changes as a % and contributions in points													
CPI* groups (2009 weightings)	June 2008		December 2008		May 2009		June 2009		December 2009		Annual averages		
	ga	cga	ga	cga	ga	cga	ga	cga	ga	cga	2007	2008	2009
<b>Food (16.5%)</b>	5.5	0.9	3.2	0.5	0.4	0.1	0.2	0.0	0.2	0.0	1.4	4.9	0.7
<b>Tobacco (1.7%)</b>	6.2	0.1	0.6	0.0	0.8	0.0	0.8	0.0	0.2	0.0	2.6	3.9	0.5
<b>Non energy industrial goods (31.5%)</b>	0.2	0.1	0.1	0.0	0.1	0.0	0.1	0.0	-0.4	-0.1	0.0	0.3	0.0
<b>Energy (7.2%)</b>	18.8	1.5	-7.0	-0.6	-17.1	-1.2	-18.1	-1.3	-1.9	-0.1	1.7	10.8	-13.0
including: oil products (4.2%)	28.0	1.4	-14.9	-0.7	-26.1	-1.1	-27.1	-1.1	-0.7	0.0	1.5	14.8	-20.5
<b>Services (43.0%)</b>	2.4	1.0	2.3	1.0	2.5	1.1	2.6	1.1	2.0	0.9	2.6	2.4	2.3
including: rent-water (7.4%)	2.3	0.2	2.5	0.2	2.9	0.2	2.9	0.2	2.4	0.2	3.5	2.5	2.7
health services (5.1%)	1.9	0.1	0.8	0.0	1.0	0.1	0.8	0.0	0.8	0.0	2.4	1.4	0.8
transport-communications (5.2%)	2.0	0.1	1.4	0.1	1.9	0.1	2.9	0.2	2.4	0.1	0.6	1.6	2.5
other services (25.2%)	2.7	0.6	2.8	0.7	2.8	0.7	2.8	0.7	2.1	0.5	2.7	2.7	2.4
<b>All (100%)</b>	3.6	3.6	1.0	1.0	-0.3	-0.3	-0.4	-0.4	0.6	0.6	1.5	2.8	0.0
All excluding energy (92.8%)	2.3	2.1	1.7	1.6	1.3	1.2	1.3	1.2	0.8	0.8	1.5	2.1	1.2
All excluding tobacco (98.3%)	3.5	3.5	1.0	1.0	-0.3	-0.3	-0.4	-0.4	0.6	0.6	1.5	2.8	0.0
<b>"Core" inflation (61.9%)<sup>(1)</sup></b>	2.0	1.2	1.9	1.1	1.6	1.0	1.5	1.0	1.6	1.0	1.5	2.0	1.6
<b>"Core" inflation excluding the effects of VAT<sup>(2)</sup></b>	2.0	1.2	1.9	1.1	1.6	1.0	1.5	1.0	1.2	0.8	1.5	2.0	1.5
<b>All HCPI*</b>	4.0	4.0	1.2	1.2	-0.3	-0.3	-0.5	-0.5	0.5	0.5	1.6	3.2	0.0

Forecast

ga : year on year cga : contribution to the year on year value of the overall index

\* Consumer price index (CPI) and harmonised consumer price index (HICP)

(1) Index excludes public tariffs and products with volatile prices, corrected for tax measures and seasonal variations (as calculated and published each month by INSEE).

(2) Index excluding public tariffs and products with volatile prices, calculated neutralising the effect of changes to tax rates.

Source: INSEE

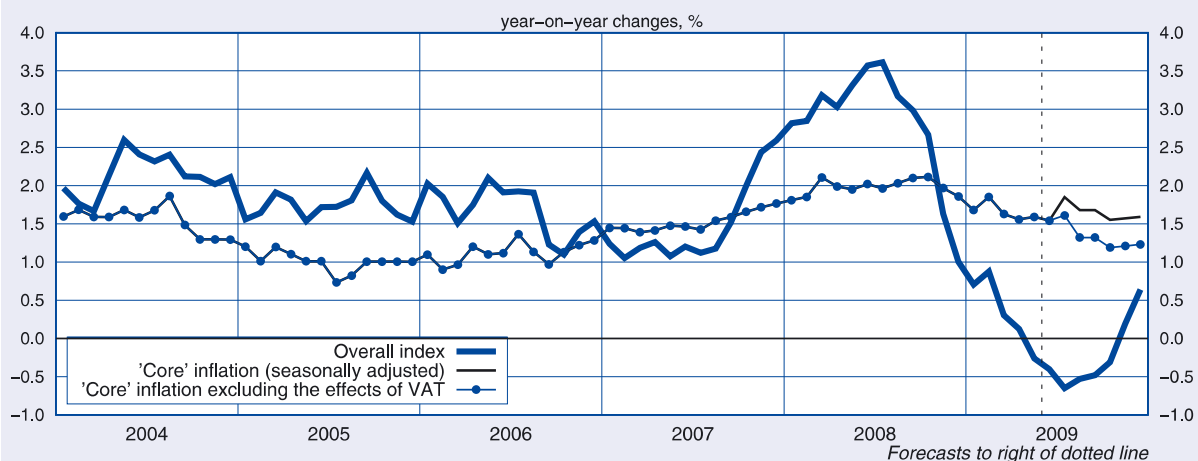
## Box - Measuring "core" inflation: with or without modifications to taxes

"Core" inflation as it is calculated and published each month by INSEE would not show the same downward trend in H2 as the one we estimate in this note (excluding the effect of VAT, see graph): it would remain at 1.6% in December (see table). In fact the "core" inflation that is published is the result of a statistical definition and not of an estimate like the one we have made in this *Conjoncture in France*. It is calculated on prices inclusive of VAT, to which are applied any variations in tax rates. If producers pass on the variation in tax rates in full in their sale prices, then "core" inflation is unchanged. However, if they pass on less than 100% of the variation in the rate, the price exclusive of VAT increases and so does "core" inflation. We estimate that the sector will only pass on 40% of the cut in VAT on sit-down restaurants on 1st July from 19.6% to 5.5%.<sup>(1)</sup> In 2000, on the occasion of the drop from 20.6% to 19.6% in the standard VAT rate, we were able to estimate that only half of the reduction had been passed on (see box

on the "Impact of the drop in the standard VAT rate" in *Conjoncture in France in June 2000*). Also, the drop in taxes will be accompanied this time by the suppression of the aid granted to the sector until now, meaning that the amount of the cut in VAT that is passed on should be less than 100% at all events. To compensate for the end of these measures, restaurant owners might reduce their VAT-inclusive prices proportionally slightly less than in 2000, although weak demand will have the opposite effect to some extent. All in all, we have made the hypothesis that they would pass on a little less than half of the drop in VAT. This would therefore result in a mechanical increase in prices exclusive of VAT and published "core" inflation will therefore be higher by about 0.4 points. ■

(1) This measure does not concern sales of alcohol.

### Consumer prices in France



Source: INSEE

## Focus - The rise in food commodity prices: a big impact on consumer prices, but not an abnormal one

Since early 2007, imported food commodities have been fluctuating greatly. They soared until July 2008, before heading downwards through to the end of 2008. Retail prices of transformed food products also accelerated sharply from the autumn 2007. They calmed down from mid-2008, but did not actually drop, despite the fact that raw material prices were falling.

Three hypotheses can be put forward to explain this difference:

- Food prices could be passing on the changes in food commodity prices with a time lag, so that the rises in these prices between mid-2007 and mid-2008 were still having effects, while the recent falls in prices are only being partially passed on;
- Other costs (transport, distribution, etc.) could be continuing to rise;
- Finally, margins could be increasing in the raw material transformation and finished product distribution chain.

To try to settle matters between these hypotheses, this focus uses the analysis framework that was previously used in the December 2007 Conjoncture in France. The aim at the time was to assess the impact of agricultural commodity prices. The first result is that the usual time lag explains the fact that the past rise in raw materials continued to prevail over the later fall in prices until the end of 2008. Since the beginning of 2009, this fall has prevailed and is beginning to moderate the prices of transformed food products. However, the second result is that the rise in other costs is continuing to push retail prices upwards and that it is this effect that is prevailing. Finally, the third result is that margin behaviour is contributing to moderation of prices due to the fact that the Galland Law is being brought into question, notably through the Law on the Modernisation of the Economy (LME). Excluding the effect of the LME, margin behaviour is neutral: it would appear that

there has not been an unusually sharp rise in inflation, at least in terms of prices as a whole.

### After increasing sharply, prices of food commodities collapsed at the end of 2008

From January 2007 onwards, food commodity prices soared, reaching a peak in July 2008. On the one hand, supply was down: drought has severely limited production and enthusiasm for biofuels had diverted crops that were formerly destined for food production to fuel production. On the other hand, demand in emerging countries had increased strongly.<sup>(1)</sup>

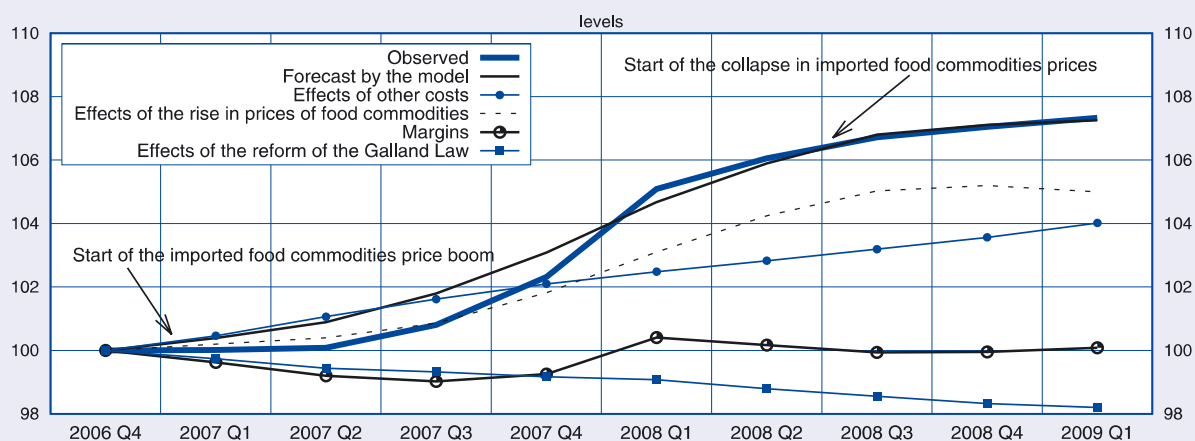
In contrast, from July to December 2008, food commodity prices fell. One explanation was that the market was rightly anticipating an excellent harvest in 2008 (+15% for wheat production, +4.9% for oilseeds) and renewed stocks. This anticipation was based on the favourable weather conditions in summer 2008 and increased sowing driven by the higher prices in H1 2008. Another was that demand for food commodities declined sharply with the economic crisis.

### Food commodity prices contributed a 5-point rise to consumer prices of food products excluding seasonal products...

The rise in food commodity prices from the start of 2007 spread throughout the supply chain and took about half a year before it was felt in consumer prices (see Graph 1). To measure this impact, we modelled the relationship between consumer prices of food excluding seasonal products and the prices of imported food commodities, via agricultural and agrifood producer prices. In these models, we also took

(1) For further details, see box on "Soaring food prices feed inflation" in Conjoncture in France, December 2007.

### Price level of food products excluding seasonal products



Source: INSEE, INSEE estimates

## Consumer prices

account of the legislative reform of the Galland Law (these models are presented in "The Galland Law and Consumer Prices" in the June 2008 *Conjoncture in France*). In relation to our model, the rise in prices was passed on with a slight time lag to consumer prices (see *Graph 1*). But this delay was fully corrected in Q1 2008. All in all, the way soaring prices seem to have been passed on to consumer prices would not appear to have been abnormal.

Despite the fall in food commodity prices since July 2008, consumer prices have continued to rise. According to the model we have estimated, the fall has been passed on correctly, but has been offset by the latest delayed effects of the previous rise in prices (see *Graph 1*). And the rise in other costs has made prices rise even more in Q1 2009.

All in all, since the start of 2007, the rise in imported food commodity prices is thought to have made a contribution of 5 points to the rise in the prices of food products other than seasonal produce (see *tables*) according to the model. Since mid-2008, the fall in prices has started to spread to retail prices, but is more than offset by the rise in other costs (see *Graph 1*): since the beginning of 2007, these other costs are

thought to have made a 4-point total contribution to the rise in retail food prices.

### ... but the increase in prices has been slightly attenuated by legislative reforms

This increase would have been even greater without the successive reforms of the Galland Law. Prior to these reforms, suppliers were allowed to pay financial compensation to distributors in exchange, for example, for promoting their products on supermarket shelves.<sup>(2)</sup> Until 1st January 2006, these merchandising and promotion fees (*marges arrière*) could not be deducted from the price of the purchase from the supplier. As of 1st January 2007, the Dutreil Law authorised the deduction of that part of these fees exceeding 15% of the purchase price. In March 2008, distributors were authorised to subtract the full amount of these fees from the purchase price. Last, the Law on the Modernisation of the Economy that came into force last August (LME Law) abolished the merchandising and promotion fees and authorized the negotiation of the price proposed by the

(2) These financial advantages were called "*marges arrière*".

### Estimated effect of fluctuations in imported food commodity prices on the consumer price index (CPI)

in points

Items in the CPI	Weight in the CPI	2007				2008				2009	Estimated total	Total forecast by the model
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1		
Food excluding seasonal products	14.5%	-0.2	-0.2	0.3	1.2	2.4	0.9	0.5	0.2	-0.1	5.0	4.9
Food	16.5%	-0.2	-0.2	0.2	1.0	2.1	0.8	0.5	0.2	-0.1	4.4	4.3
Total	100.0%	-0.03	-0.03	0.04	0.2	0.4	0.1	0.1	0.03	-0.01	0.7	0.7

How to read the table: in Q1 2008, the quarterly rate of growth in food prices excluding seasonal products was 2.4 percentage points above the level it would have had if imported food commodity prices had remained constant from Q1 2007.

Source: INSEE, INSEE estimates

### Estimated effect of the reforms of the Galland Law

in points

Items in the CPI	Weight in the CPI	2007				2008				2009	Total
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	
Food excluding seasonal products	14.5%	-0.3	-0.3	-0.1	-0.2	-0.1	-0.3	-0.3	-0.3	-0.1	-2.1
Food	16.5%	-0.3	-0.3	-0.1	-0.2	-0.1	-0.3	-0.3	-0.2	-0.1	-1.9
Total	100.0%	-0.04	-0.05	-0.02	-0.03	-0.02	-0.05	-0.04	-0.04	-0.02	-0.3

How to read the table: in Q1 2008, the quarterly rate of growth in food prices excluding seasonal products was 0.1 percentage points below the level it would have had in the absence of legislative measures.

Source: INSEE, INSEE estimates

supplier to its distributor.<sup>(3)</sup> The effects of this law should be felt mainly from Q2 2009, as the commercial negotiations that started in autumn 2008 and the start of this year mainly concern the prices of products sold from March 2009.

(3) Until now, this price was not negotiable. If the distributor was not happy with the offer, he changed suppliers. But suppliers in the same branch generally offered identical minimum prices for their sector (see the Report in the June 2008 Conjoncture in France). Henceforth, distributors can place suppliers in competition with each other to obtain lower prices.

Since the beginning of 2007, we estimate that these reforms have held back the rise in food products other than seasonal produce. Their contribution comes to -2.1 points, which represents a drop of 0.3 points of the overall index (see tables). ■

# Employment

Employment, and in particular temporary employment, started to fall in H2 2008 due to the drop in activity. This fall is expected to quicken in 2009, due to an even sharper slump in activity at the end of 2008 and the start of 2009. Non-agricultural market-sector employment should fall by almost 700,000 jobs in 2009, after -141,000 in 2008; by the end of the year it should reach its lowest level since 2000. In contrast, non market-sector employment looks set to continue increasing, but this will only slightly limit the fall in total employment, which should come to 592,000 jobs over 2009 as a whole.

With the entry of the French economy into recession, total employment turned around in 2008, with 93,000 job losses. This fall is set to become more pronounced in 2009, reaching 592,000 jobs.

## Market-sector employment: down to 2000 levels

Under the effects of the fall in activity, employment in the market sectors has been declining since Q2 2008. No improvement of the employment situation is expected in 2009. The net slide in output at the end of 2008 and start of 2009 is likely to result in further sharp falls in employment (see Graph 1) with the usual time lag. All in all, employment in the market sectors is expected to fall by 328,000 in H2 after -370,000 in H1 (see Table 1). The number of employees in the non-agricultural market sectors should therefore fall by the end of 2009 to its level at the end of 2000 (see Graph 2).

The fall in employment in the market sectors started with temporary employment, and then spread to all sectors (see Graph 3). Employment should therefore fall sharply in industry, construction and

Table 1

### Changes in employment figures

	Level of employment at the end of the period (in thousands)	Job creations over the period (in thousands) seasonally adjusted					Change in employment over the period (as %) seasonally adjusted				
		2007	2007	2008	2009	2009 H1	2009 H2	2007	2008	2009	2009 H1
<b>Mainly non-agricultural market sectors (1) including:</b>	15 960.4	287	-141	-699	-370	-328	1.8	-0.9	-4.4	-2.3	-2.1
Industry:	3 674.5	-42	-73	-243	-117	-126	-1.1	-2.0	-6.7	-3.3	-3.6
including:											
Manufacturing industry	2 889.4	-35	-69	-198	-100	-99	-1.2	-2.4	-7.0	-3.5	-3.6
Construction	1 468.6	59	13	-51	-24	-27	4.2	0.9	-3.5	-1.6	-1.9
Tertiary market sector	10 817.3	270	-81	-404	-229	-175	2.6	-0.7	-3.8	-2.1	-1.7
including											
Commerce	3 087.2	41	-13	-57	-30	-27	1.3	-0.4	-1.9	-1.0	-0.9
Market services (including temping)	5 580.5	175	-64	-254	-150	-103	3.2	-1.1	-4.6	-2.7	-1.9
<b>Agricultural employees</b>	327.1	-12	0	0	0	0	-3.6	0.0	0.0	0.0	0.0
<b>Mainly non-market service sectors</b>	7 011.6	44	33	92	40	52	0.6	0.5	1.3	0.6	0.7
<b>Self-employed</b>	2 243.2	16	15	15	8	8	0.7	0.7	0.7	0.3	0.3
<b>TOTAL EMPLOYMENT</b>	25 542.4	335	-93	-592	-323	-269	1.3	-0.4	-2.3	-1.3	-1.1

Forecast

(1) Sectors EB to EP

How to read the table: employment dropped by 141,000 in the mainly market sectors during 2008. This corresponds to a fall of 0.9%. At 31 December 2007, this sector included 15,960,400 paid employees.

Scope: Metropolitan France

Source: INSEE, employment estimates

even in the market service sector excluding temporary work, whereas this sector had been spared in previous recessions.

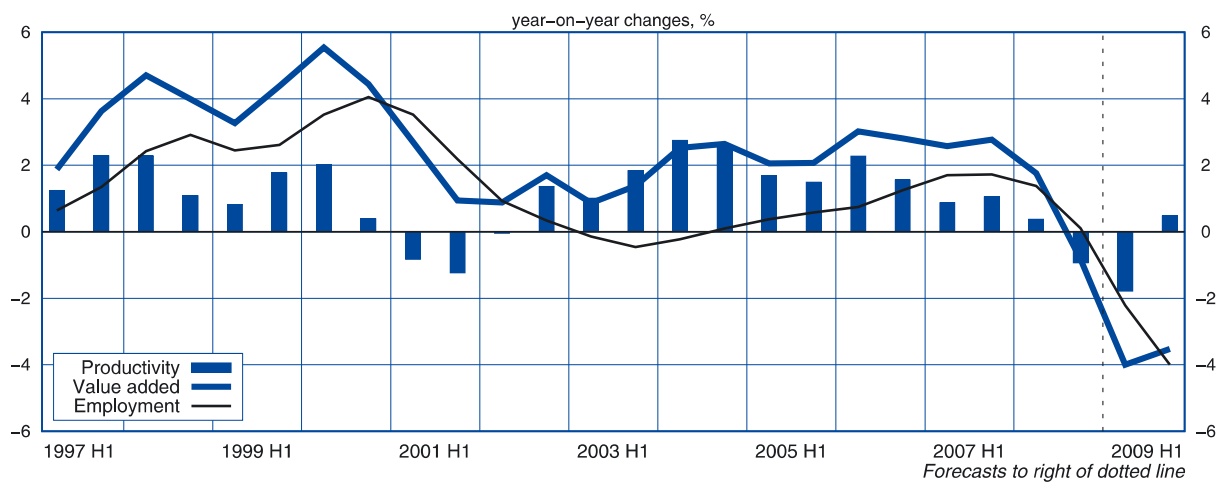
## More and more job losses in industry

In industry, employment continued its downward trend in 2008 with only a limited aggravation. Industrial companies adjusted their employment to the dip in activity, mainly by reducing the number of

temporary workers on assignments in industry, who are counted in service-sector employment: in industry, the number of temporary workers went down from 300,000 in 2007 to 200,000 in 2008, representing a drop of 33%, while the number of employees fell by "only" 2%.

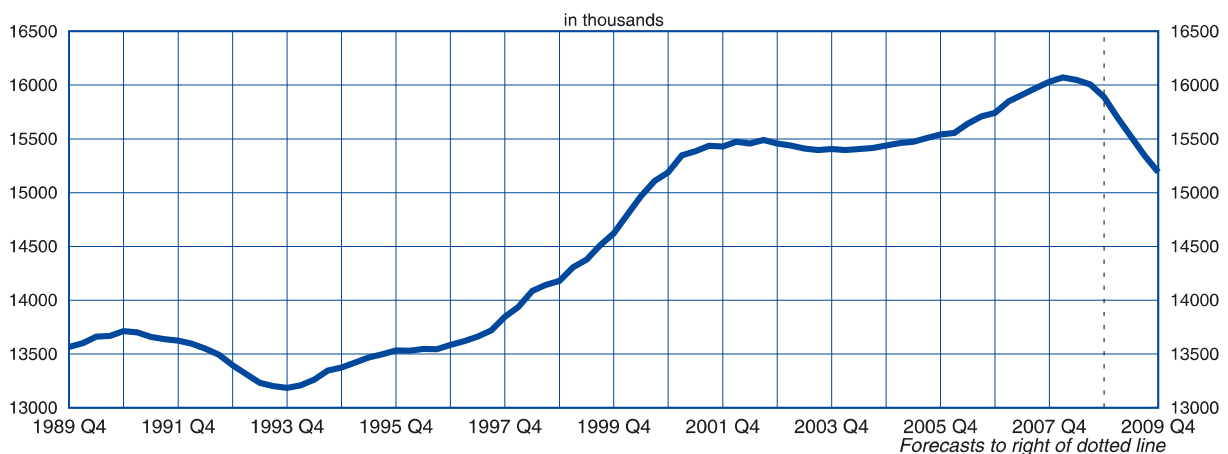
In 2009, the employment situation in industry should worsen considerably in line with the slump in activity: 243,000 jobs are expected to be lost, which is three times more than in 2008 (-73,000) and six times more than in 2007 (-42,000).

### 1 - Paid employment and value added of the non-agricultural market sectors



Scope: Metropolitan France  
Source: INSEE, quarterly accounts and employment estimates

### 2 - Non-agricultural market paid employment



Source: INSEE, employment estimates

## Employment

### Fall in employment in construction

Construction created only 13,000 jobs in 2008, after the all-time high figures in 2006 and 2007 (respectively +62,000 and +59,000 jobs). Employment started to fall in Q4 2008 and this slide is expected to continue in 2009, with the workforce declining by 51,000 in 2009.

### Gloomy prospects in 2009 for the tertiary market sector

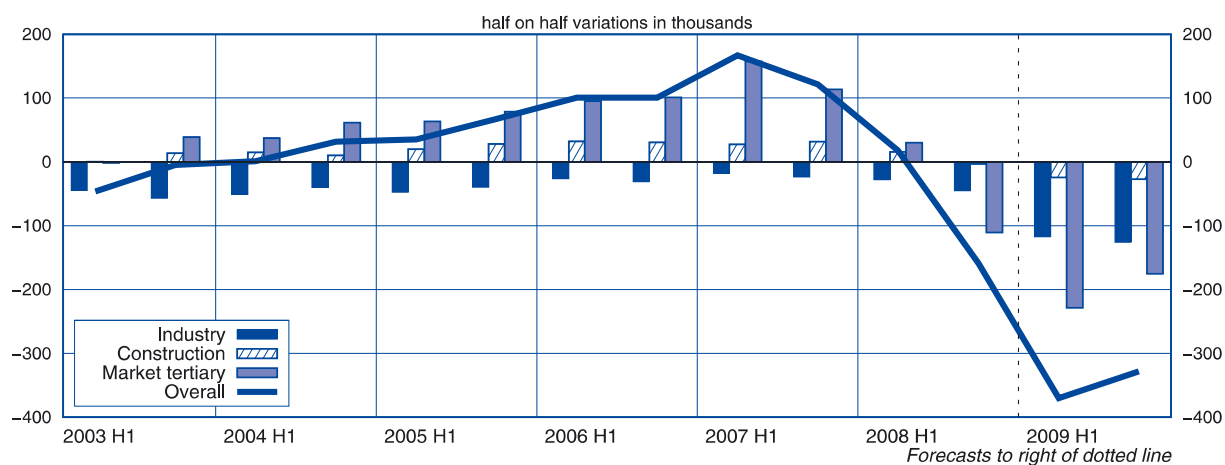
In 2008, due to the fall in activity, temporary employment suffered a very sharp fall (-21.2%), and tertiary market employment excluding temporary work grew little (+0.6%). The contrast with previous years is clear: between the end of 2004 and the end of 2007, 610,000 jobs were created in the tertiary market sector. In 2009, the slide in temporary employment is expected to continue, while the other sub-sectors of the tertiary market sector are likely to begin, in turn, to adjust

their workforces to the downturn in activity. Employment in the tertiary market sector is therefore expected to fall increasingly sharply in 2009 (-404,000 in total over the year as a whole).

### Non-market sector employment should be dynamic, however

In contrast, in the non-market sectors, employment should be dynamic in 2009: 92,000 jobs are likely to be created in these sectors, which is much more than in 2007 and 2008 (+44,000 and +33,000). The high number of subsidised contracts expected in the Social Cohesion Plan (*contrats d'accompagnement dans l'emploi* and, to a lesser extent, *contrats d'avenir*) should increase the total number of beneficiaries of such contracts, which had fallen in 2007 and in 2008 (see Table 2). Also, private employment in non-market sectors (subsidised and non-subsidised) and non-subsidised public employment are expected to continue to grow at rates close to those in 2007 and 2008. ■

### 3 - Paid job creations in the non-agricultural market sectors



Source: INSEE, employment estimates

**Table 2**  
**Variation in the number of beneficiaries of subsidised contracts in the non-market sector**

	In thousands				
	2005	2006	2007	2008	2009
Employment and solidarity contracts	-89	-21	-	-	-
Contrats emploi consolidé (CEC)	-35	-36	-19	-1	0
Contrats d'accompagnement dans l'emploi (CAE)	121	45	-17	-48	62
Contrats d'avenir	15	60	13	-10	8
Youth employment contracts	-35	-25	-19	-4	-3
Integration contracts	-1	-	-	-	-
Minimum activity income contract, non-market	-1	0	-	-	-
<b>Total</b>	<b>-25</b>	<b>23</b>	<b>-41</b>	<b>-63</b>	<b>67</b>

Forecast

Scope: Metropolitan France

Source: DARES, INSEE calculation



# Wages

In 2009, nominal wages in the non-agricultural market sector are expected to slow down clearly, due to the drop in inflation and the rise in unemployment. The basic monthly wage (SMB) should increase by 2.0%, after +3.0% in 2008. The average wage per head (SMPT) should fall (-0.4% after +2.7% in 2008), notably due to lower bonuses and less overtime. In real terms, wages should follow diverging courses: due to the sharp fall in inflation in 2009, the basic monthly wage should accelerate considerably (+2.0% after +0.2% in 2008), while the average wage per head should fall (-0.3%) after pretty much stagnating in 2008 (-0.1%).

In general government, the average wage per head should slow down clearly (+1.4% in 2009 against +3.1% in 2008). In contrast, the real average wage per head should accelerate sharply (+1.5% after +0.3% in 2008).

## The basic wage should slow down in 2009...

In 2009, the nominal basic monthly wage (SMB) is expected to be less dynamic than in 2008 (+2.0 % after +3.0 %, see *Table and Graph*). On the one hand, the continuing slide of the labour market is

likely to have an effect on wages (see "Employment" and "Unemployment" notes). On the other hand, rises should be less spectacular because of the slowdown in process observed since mid 2008 (see "Consumer prices" note).

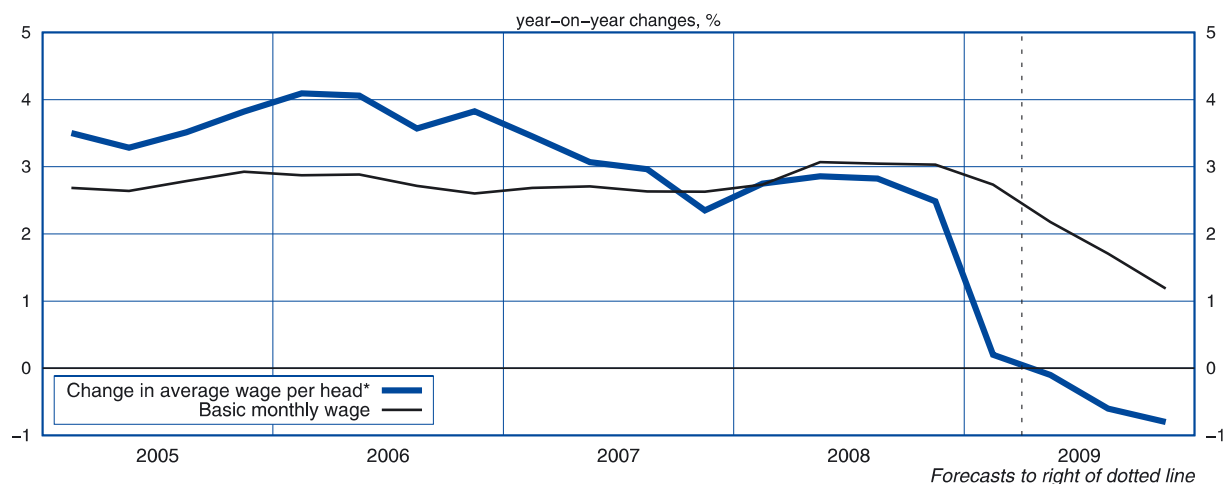
In particular, the very slight rise in prices observed over a year is likely to limit the revaluation of the minimum wage planned for 1<sup>st</sup> July. Indeed, this revaluation takes account of price changes from May to May, among other things. All in all and if no helping hand appears, the minimum wage is only likely to increase year-on-year by around 1% to 1<sup>1</sup>/<sub>4</sub>% on 1<sup>st</sup> July 2009, against 3.2 % on 1<sup>st</sup> July 2008.<sup>(1)</sup>

## ... and the average wage per head should fall

In 2009, the average wage per head (SMPT) should fall by 0.4% after a 2.7% rise in 2008. In addition to the negative effects of the rise in unemployment and falling prices holding back the average wage per head and the basic monthly wage, overtime is expected to be down, the

(1) This year-on-year rise corresponds to two one-off raises, one in May and the other in July.

Change in average wage per head\* and the basic monthly wage



\*Scope: non-agricultural market sector  
Sources: Dares, INSEE

performance-related bonuses paid out in Q1 in the tertiary sector should fall sharply and financial enterprises are thought to have paid much smaller bonuses to their executives at the start of 2009 than in past years, due to the crisis.

### The real average wage per head should fall again in 2009

In real terms, the basic wage should accelerate very sharply, from +0.2% in 2008 to +2.0% in 2009. The slowdown in prices that has been ongoing since mid 2008 should continue through the first half of 2009. Although fluctuations in inflation are generally passed on to nominal wages, this effect is only partial and delayed. For example, in 2008 the basic monthly wage accelerated due to the rise in inflation, but not as much as prices; the real basic monthly wage therefore rose little. In contrast, in 2009 the slowdown in the basic monthly wage should be less pronounced than that in inflation, and the basic monthly wage should rise again more clearly. However, this fall in inflation is unlikely to be enough to offset the sharp slide in the average wage per head. In real terms, this average wage per head should therefore fall back by 0.3%, after -0.1% in 2008.

### Wages should slow down in general government

In parallel with the increase in the minimum wage, the Civil service minimum wage index should increase by two points on 1<sup>st</sup> July 2009. Also, the Civil Service index point should be increased by +0.5% in July and then +0.3% in October. Finally, the Individual Purchasing Power Guarantee system (GIPA) should be renewed at the end of 2009.

All in all in 2009, the average wage per head in general government should grow less quickly than in 2008 (+1.4% after +3.1%); but in real terms, the dip in inflation should mean that it is accelerating (+1.5% after +0.3% in 2008). ■

### Change in basic monthly wage and average wage per head in the non-agricultural market sector and general government

change as a %

Seasonally-corrected data	Quarterly growth rates								Annual averages		
	2008				2009				2007	2008	2009
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Basic monthly wage	0.8	1.0	0.6	0.6	0.5	0.4	0.2	0.2	2.7	3.0	2.0
Average wage per head											
- in the non-agricultural market sector (NAMS)	1.1	0.5	0.5	0.7	-1.2	0.2	0.1	0.1	3.0	2.7	-0.4
- in general government (GG)	-	-	-	-	-	-	-	-	2.5	3.1	1.4
Household consumer price index	0.9	0.8	0.4	-0.3	-0.2	-0.1	0.1	0.4	1.5	2.8	0.0
Real basic monthly wage	-0.1	0.2	0.2	1.0	0.7	0.5	0.1	-0.2	1.2	0.2	2.0
Real average wage per head (NAMS)	0.2	-0.2	0.1	0.7	-1.0	0.3	0.0	-0.2	1.5	-0.1	-0.3
Real average wage per head (GG)	-	-	-	-	-	-	-	-	1.1	0.3	1.5

Forecasts – \*ovhg: overhang  
Source: INSEE

### The basic wage and the average wage per head, the two wage indicators used in *Conjoncture in France*

#### **The basic monthly wage: the constant-structure remuneration for work**

The trends in the basic monthly wage reflect the mean variation in wages, at a constant qualification structure. This index is estimated from the quarterly Acemo survey by the Dares (survey on activity and employment conditions of the labour force). This quarterly survey concerns 20,000 to 30,000 establishments or enterprises of 10 employees or more in the non-agricultural market sector. The basic monthly wage is noted for 16 professional categories. Each establishment or enterprise declares the basic wage of a work position considered as representative of a professional category. This work position is monitored throughout the surveys. The basic monthly wage excludes bonuses and incentives of any nature, as well as the remuneration of overtime.

#### **The average wage per head: the wages paid by all companies**

Trends in the average wage per head, as calculated by the national accounts, reflect those of the wages paid by all companies. This indicator is the result of a comparison of the changes in total wage bill and in the number of paid employees, both of which are measured using exhaustive sources (tax data from enterprises). Compared with the basic wage, it takes account, notably, of very small companies, and integrates structure effects (trends in qualifications, in the share of part-time work), economic situation effects (overtime level) and seasonal effects (bonuses). ■

# Household income

In 2009, the gross disposable income of households should slow down sharply. This slowdown is due to the drop in earned income and property income caused by the recession. In contrast, social benefits should remain relatively dynamic and the tax burden should be reduced due to the automatic stabilisers and the stimulus plan. Despite the slowdown in household gross disposable income, the purchasing power of household income should progress slightly (+1.1% in 2009 after +0.6% in 2008) thanks to the marked fall in inflation in 2009. Per consumption unit, purchasing power should increase by 0.4% in 2009.

## Declining earned and property income due to the recession

In 2009, earned income is expected to slip (-1.3% after +3.3% in 2008; see Table 1). The gross operating surplus (GOS) of sole proprietors<sup>(1)</sup> should also fall (-0.3% after +4.1%) as the slide in activity continues. On top of this, total wages received by households are likely to fall (-1.5% after +3.2%, see Table 2), in particular in the non-agricultural market sectors (see Graph 1). This fall is probably due to the pronounced decrease in

(1) The gross operating surplus (GOS) of sole proprietors is the balance of the operating account of sole proprietorships. It is mixed income, as it remunerates the work performed by the owner of the sole proprietorship and, where applicable, members of his family, but also contains the profit achieved as an entrepreneur.

Table 1

### Household gross disposable income

change as a %

	Half-yearly averages						Annual averages		
	2007		2008		2009		2007	2008	2009
	H1	H2	H1	H2	H1	H2			
<b>Gross disposable income (100%)</b>	2.3	2.6	1.7	0.9	0.1	0.3	5.2	3.4	0.7
including :									
Income (68%)	2.2	1.9	2.0	0.7	-1.3	-0.8	4.5	3.3	-1.3
Gross wages (58%)	2.2	1.8	1.9	0.8	-1.4	-0.9	4.4	3.2	-1.5
GOS of sole proprietors (10%)	2.2	2.8	2.6	0.2	-0.2	-0.4	4.9	4.1	-0.3
Social benefits in cash (30%)	2.0	1.6	1.5	2.2	2.5	1.4	3.6	3.5	4.4
GOS of "pure" households <sup>(1)</sup> (14%)	4.4	3.4	1.9	1.4	0.8	1.7	8.1	4.3	2.3
Property income (10%)	6.6	1.6	2.2	0.3	-1.5	0.2	3.9	3.2	-1.2
Social contribution and tax burden (-23%) <sup>(*)</sup>	4.5	-0.6	2.9	1.8	-0.9	-0.9	2.1	3.5	-0.5
Contributions by paid employees (-8%)	1.8	1.2	0.6	0.9	-0.8	-0.9	3.6	1.6	-0.8
Contributions of self-employed persons (-2%)	0.7	1.3	6.4	-6.2	-1.0	1.3	2.0	3.8	-3.5
Income and wealth tax (including CSG and CRDS) (-13%)	6.9	-1.9	3.8	3.6	-1.0	-1.2	1.3	4.6	0.1
Income before taxes	2.9	2.0	1.9	1.2	-0.1	0.1	4.7	3.6	0.6
<b>Household consumer prices (quarterly national accounts)</b>	0.9	1.5	1.7	0.6	-0.7	0.0	2.1	2.8	-0.4
<b>Purchasing power of gross disposable income</b>	1.5	1.1	-0.1	0.3	0.8	0.3	3.0	0.6	1.1

Forecast

Note: the figures in parentheses give the structure of the year 2007.

(1) Households except sole proprietors.

Source: INSEE

the number of paid jobs which looks set to continue (see "Employment" note), while wages per head are likely to fall in Q1 and then return to moderate growth (see "Wages" note).

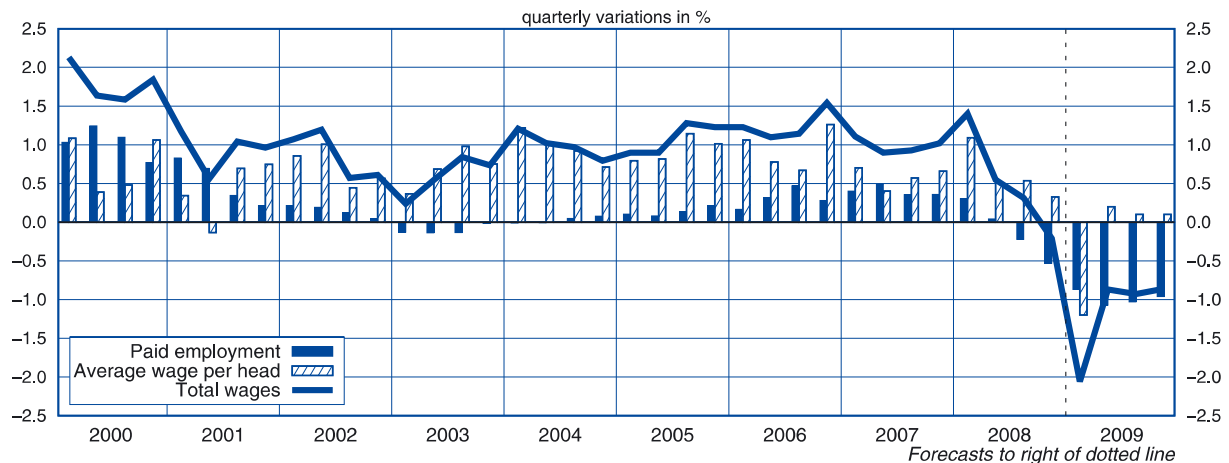
Property income is also likely to fall this year (-1.2% after +3.2%). It should slide sharply in H1 (-1.5%), with the fall in interest rates, in particular the rate of the Livret A savings plan; it should then be stable at the end of the year. At the same time, rent received by households<sup>(2)</sup> should slow down distinctly in 2009 (+2.3% after +4.3%).

(2) These rents are what is called in the national accounts the GOS of "pure" households. This corresponds to the rents that private homeowners would receive from their tenants if they put their home up for rent ("fictional" rent). The rents are corrected for property tax.

## Social benefits likely to accelerate in 2009

In 2009, social cash benefits should accelerate (+4.4% after +3.5%; see Table 3). In particular, social assistance benefits in cash should rise markedly (+7.5% after -3.5% in 2008). They should be boosted by three revaluations: that of the minimum integration income in January; that of the solidarity allowance for the elderly in April; and that of the allowance for disabled adults in April and September. Two payments should also contribute to keeping welfare benefits dynamic in H1: the active solidarity bonus paid in April, and the €150 bonus for beneficiaries of start-of-term benefit, paid in June. Finally, the launch of the active solidarity income in June should accentuate this growth even further.

### 1 - Breakdown of the total wages of households in the non-agricultural competitive sector



Source: INSEE

**Table 2**  
**From non-financial enterprise payroll to wages received by households**

change as a %

	Half-yearly averages						Annual averages		
	2007		2008		2009		2007	2008	2009
	S1	S2	S1	S2	S1	S2			
Non-financial enterprises (67%) <i>including : Average wage per head</i>	2.5	1.9	2.3	0.8	-2.2	-1.8	4.8	3.7	-2.7
Financial corporations (5%)	0.1	2.1	-0.3	-2.9	-6.4	-2.0	3.4	-0.7	-8.7
General government (23%)	1.5	1.2	1.0	1.0	1.1	1.3	2.9	2.1	2.2
Households excluding sole proprietors (2%)	4.0	3.4	2.7	3.2	2.8	1.5	7.9	6.1	5.3
<b>Total gross wages received by households (100%)</b>	<b>2.2</b>	<b>1.8</b>	<b>1.9</b>	<b>0.8</b>	<b>-1.4</b>	<b>-0.9</b>	<b>4.4</b>	<b>3.2</b>	<b>-1.5</b>
<i>including : Non-agricultural market sectors</i>	<i>2.3</i>	<i>1.9</i>	<i>2.2</i>	<i>0.5</i>	<i>-2.6</i>	<i>-1.8</i>	<i>4.6</i>	<i>3.4</i>	<i>-3.2</i>

Forecast

Nota Bene: the figures in parentheses give the structure of the year 2007

Source: INSEE

## Household income

As well as this, social security benefits should accelerate (+4.5 % after +4.2 %) due to unemployment benefit as the labour market deteriorates.

### The tax burden should be reduced in 2009

The mandatory tax burden should fall back in 2009 (-0.5% after +3.5%). The taxes paid by households should slow down very sharply (+0.1% after +4.6%). Revenues from income tax (IRPP) should decline this year for three reasons: the slowdown in incomes last year; the reform of the taxation of dividends<sup>(3)</sup>; and the suppression of the last two of the three provisional instalments for low-income households, as part of the stimulus plan. The contributions paid by employees in 2009 should be down (-0.8% after +1.6%) due to the decline in payroll. Contributions paid by the self-employed should also be down (-3.5 % in 2009 after +3.8% in 2008). However, other current taxes<sup>(4)</sup> should accelerate in 2009, notably due to the increase in accommodation tax.

### Thanks to the fall in inflation, purchasing power should accelerate a little in 2009

All in all, in 2009, nominal gross disposable income should only progress by +0.7%, which is well down on 2008 (+3.4%). Nevertheless, purchasing power should progress a little more strongly in 2009 than in 2008 (+1.1% after +0.6% and +3.0% in 2007): it should benefit from the clear fall in inflation (-0.4% after +2.8%), while the sharp acceleration in prices in 2008 had weighed down considerably on household purchasing power. Purchasing power per consumption unit, which takes account of demographic trends, should see an upturn in 2009 (+0.4% after a fall of 0.1% in 2008; see box). ■

(3) The measure introducing lump-sum taxation of dividends at source made it possible to make early payment of the tax that would have been due in 2009 in 2008: the tax was therefore collected twice in 2008 and the amount collected will return to usual levels in 2009.

(4) These are mainly local taxes (accommodation tax, part of property tax on land), the solidarity tax on wealth and part of vehicle registration taxes.

Table 3

### The social transfers received and paid by households

	change as a %								
	Half-yearly averages						Annual averages		
	2007		2008		2009		2007	2008	2009
	S1	S2	S1	S2	S1	S2			
<b>Social cash benefits received by households (100%)</b>	<b>2.0</b>	<b>1.6</b>	<b>1.5</b>	<b>2.2</b>	<b>2.5</b>	<b>1.4</b>	<b>3.6</b>	<b>3.5</b>	<b>4.4</b>
Social Security benefits in cash (71%)	2.1	1.9	2.0	2.3	2.1	2.4	3.9	4.2	4.5
Private funded social benefits (7%)	-0.2	1.5	0.4	2.7	0.5	1.9	1.6	2.5	2.8
Unfunded employee social benefits (14%)	3.4	2.8	2.1	1.6	1.2	1.2	5.9	4.3	2.6
Social assistance benefits in cash (8%)	1.0	-2.9	-2.9	1.8	11.1	-8.3	-0.5	-3.5	7.5
<b>Total social contribution burden</b>	<b>1.4</b>	<b>1.5</b>	<b>1.8</b>	<b>0.5</b>	<b>-0.3</b>	<b>-0.6</b>	<b>3.5</b>	<b>2.8</b>	<b>-0.4</b>
Actual social contributions paid by households (100%)	1.4	1.4	1.7	0.3	-0.6	-0.8	3.4	2.6	-0.8
including : Employers contributions <sup>(1)</sup> (64%)	1.2	1.6	1.7	0.8	-0.4	-1.0	3.5	2.9	-0.5
Employees contributions (29%)	1.8	1.2	0.6	0.9	-0.8	-0.9	3.6	1.6	-0.8
Self-employed contributions (7%)	0.7	1.3	6.4	-6.2	-1.0	1.3	2.0	3.8	-3.5

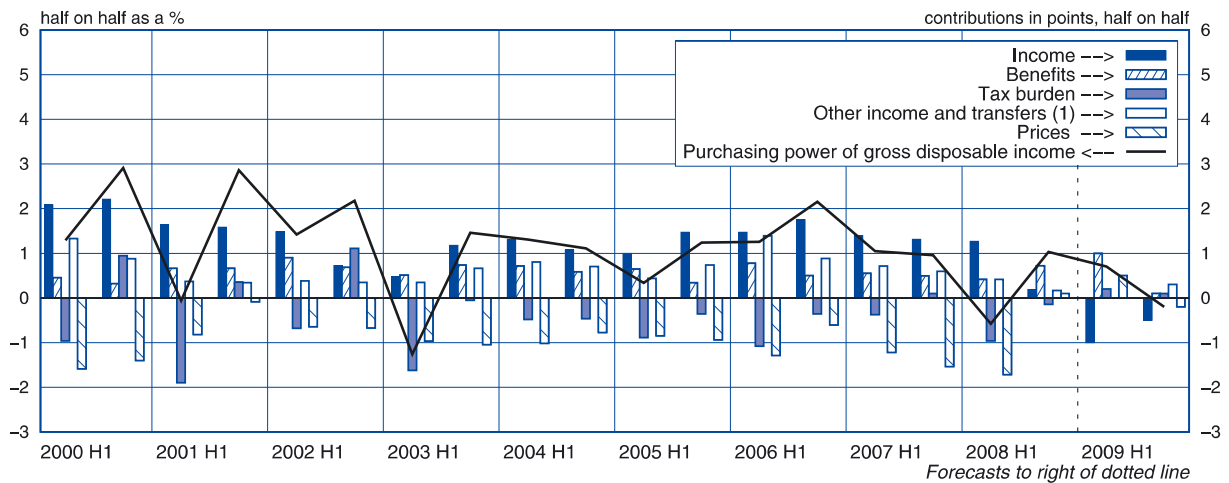
Forecast

N. B.: the figures in parentheses give the structure of the year 2007.

(1) For accounting reasons, employer contributions are considered in both revenue and expenditure in the national accounts: they therefore have no effect on gross disposable income.

Source: INSEE

## 2 - Purchasing power of available income and contributions



(1) GOS of "pure" households, property income and current transfers (see note (3)).  
 Comment: these contributions are calculated "excluding accounts restatement of the tax credit".  
 Source: INSEE

### Box - Different measurements of purchasing power

The household income that is presented and analysed in *Conjoncture in France* represents all the income received by all households. Indeed, it is this value which is relevant on the macroeconomic level, for example to build the balance between resources (GDP and imports) and uses (consumption, investment, exports, etc.) or to forecast GDP.

This value must be corrected if we wish to measure the mean purchasing power of the French people, in order to take account of both the growth in the number of households and the changes in their composition.

The most pertinent correction in this respect consists in dividing income by the number of consumption units in France. This concept takes account of demographic growth,

but also of the fact that certain consumption items may be shared within a household (household appliances, for example). A large household therefore makes certain "economies of scale" compared to a smaller household. In 2008, the growth in the number of consumption units was 0.7% (as a comparison, the growth in the number of inhabitants was 0.5% and growth in the number of households 1.4%).

Therefore, in 2009, purchasing power per consumption unit should rise (+0.4% after -0.1% in 2008). Per inhabitant, the rise should be 0.6%, while purchasing power per household should fall again (-0.3% after -0.8% in 2008). ■

# Household consumption and investment

By the end of 2009, households are not expected to have increased their consumption by much (respectively +0.3%, +0.1% and +0.1% over the next three quarters), in line with trends over the last year. Consumption should still be supported slightly by gains in purchasing power in H1, but is likely to be slowed by the rise in unemployment which is encouraging households to increase their savings as a precautionary measure. Their savings ratio should reach 15.6% in 2009, from 15.3% in 2008. Households are expected to continue to reduce their investments as they did in 2008 (-1.2% per quarter by the end of 2009).

to replace old vehicles that came into force on 4 December 2008. However, their purchases of household equipment goods, previously very dynamic, now stagnated (+0.1% in Q1 after +2.0% in Q4), as such expenditure can easily be postponed.

Consumption of services rebounded very slightly in Q1. However, it is likely to remain sluggish until the end of 2009 despite the support provided by the VAT cut in the restaurant sector starting in July 2009.

Last, consumption of food products declined in Q1 (-0.6%), thereby cancelling out its upturn in Q4 2008 (+0.6%).

## In early 2009, consumption remained sluggish

In Q1 2009, household consumption grew moderately (+0.2%, see Table). It was handicapped by the sharp drop in purchasing power, which was dragged down by total wages (see "Household income" note). However, households seem to have reduced their savings in order to smooth out their consumption.

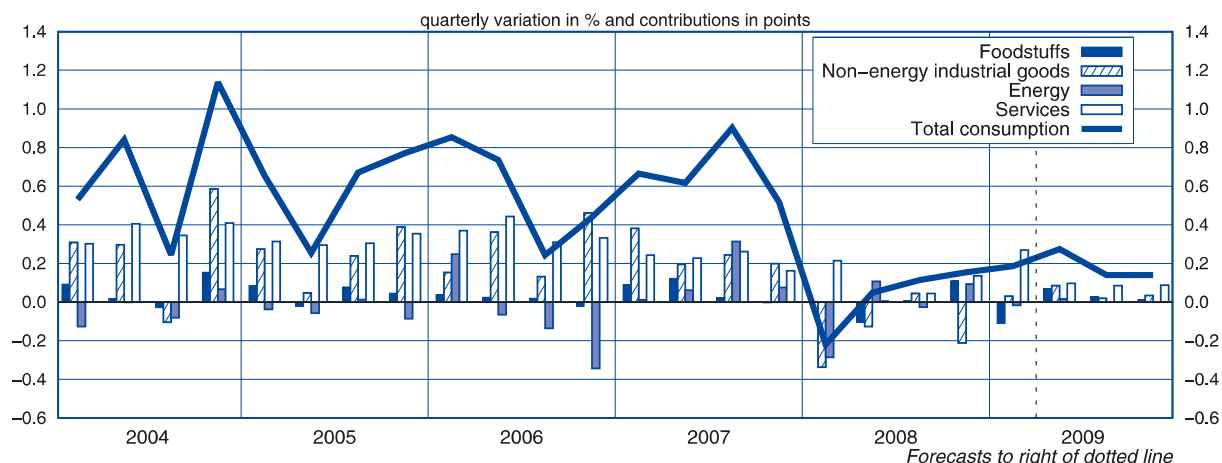
Households increased their purchases of non-energy industrial goods slightly in Q1 (+0.1% after -0.9%, see Graph 1). Above all, they accelerated their car purchases (+2.4% after -1.8%), making the most of the scrapping incentive

## Consumption expected to stagnate in H2

In Q2, the purchasing power of income should see a sharp upswing (+0.7% after 0.0%): households are set to benefit from the rise in their gross disposable income combined with the new drop in inflation. Purchasing power will then stagnate in H2 2009 (see "Household income" note).

Faced with these contrasting purchasing power trends, households are likely to decide to smooth their consumption, as is usually the case in similar circumstances (see Graph 2). They will probably

1 - Contributions of the various items to quarterly household consumption





## Household consumption and investment

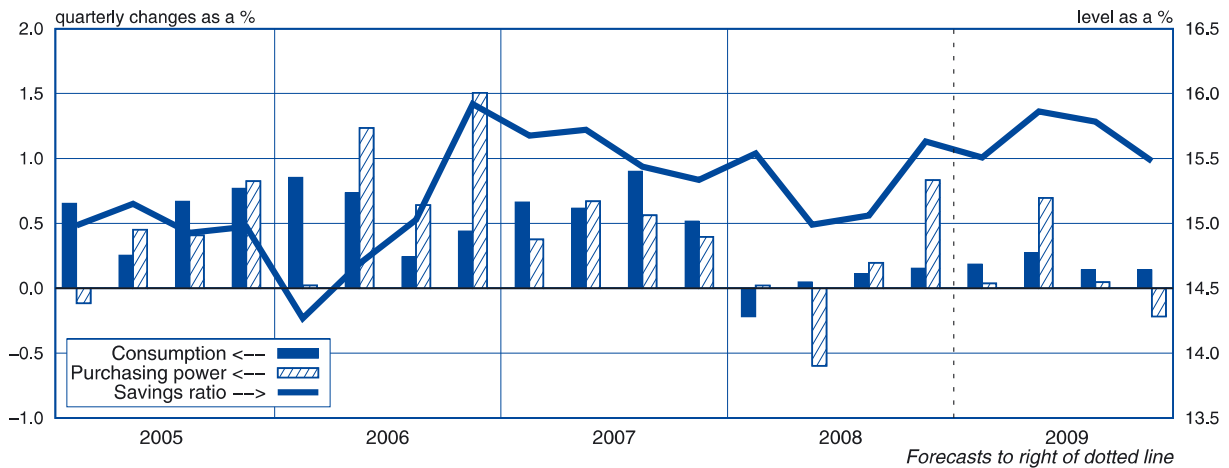
increase their savings ratio in Q2 then reduce it slightly in H2. On average over 2009, they should raise their savings ratio to 15.6%, from 15.3% in 2008, in reaction to the rise in unemployment and the uncertainty surrounding their future income. Their consumption should increase by 0.3% in Q2 then stagnate in H2 (+0.1% per quarter).

Loan award conditions are still far more restrictive than they were a few years ago and the prospects of quick capital gains, which previously stimulated their property purchases, have now come to an end. As these two factors are still ongoing, household investment should continue to decline (-1.2% over the next three quarters), as attested to by the new drop in housing starts since the start of the year. ■

### Household investment likely to continue to decline

In Q1, households once again reduced their investment, mainly composed of housing purchases: -1.5% after -1.4% in 2008 and +5.5% in 2007.

### 2 – Consumption, purchasing power and savings ratio



Source: INSEE

### Household consumption and investment expenditure

	change as a %												Annual changes			
	Quarterly changes												2006	2007	2008	2009
	2007				2008				2009							
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
<b>Total household consumption expenditure</b>	0.7	0.6	0.9	0.5	-0.2	0.0	0.1	0.2	0.2	0.3	0.1	0.1	2.6	2.4	0.9	0.7
including:																
Food (17%)	0.5	0.7	0.1	0.0	0.0	-0.6	0.0	0.6	-0.6	0.4	0.2	0.1	0.7	1.1	-0.1	0.1
Non-energy industrial goods (24%)	1.5	0.8	1.0	0.8	-1.4	-0.5	0.2	-0.9	0.1	0.4	0.1	0.1	4.1	4.8	-0.6	-0.2
Energy (7%)	0.4	0.9	4.4	1.0	-3.9	1.5	-0.4	1.3	-0.3	0.2	0.0	0.0	-0.3	-1.4	0.4	1.0
Services (52%)	0.5	0.5	0.5	0.3	0.4	0.0	0.1	0.3	0.5	0.2	0.2	0.2	2.9	2.2	1.2	1.1
<b>Government individual expenditure</b>	0.3	0.5	0.3	0.1	0.3	0.4	0.9	0.3	-0.1	0.4	0.4	0.4	1.5	1.5	1.5	1.2
<b>Total actual consumption</b>	0.6	0.6	0.8	0.4	-0.1	0.1	0.3	0.2	0.1	0.3	0.2	0.2	2.4	2.2	1.1	0.8
<b>Household investment</b>	1.5	0.8	0.8	1.2	0.1	-1.3	-2.8	-2.6	-1.5	-1.2	-1.2	-1.2	6.4	5.5	-1.4	-6.9

Forecast  
Source: INSEE

# Corporate investment and inventory

In 2009, corporate investment is likely to decline very sharply (-8.9%). In Q2 this decline should still be marked (-2.7%): financing conditions are still difficult, business prospects remain gloomy and production capacities are still greatly under-utilised. The decline in investments should go on to ease in H2 thanks to improved financing conditions and slightly better business prospects.

The adjustment of inventory weighed heavily on business in late 2008 and early 2009. In Q2, the contribution of inventory changes to growth should be negative once again, but owing to the substantial adjustment already made, running down of inventories of non-energy industrial goods should be less pronounced.

## The fall in investments should slow by the end of 2009...

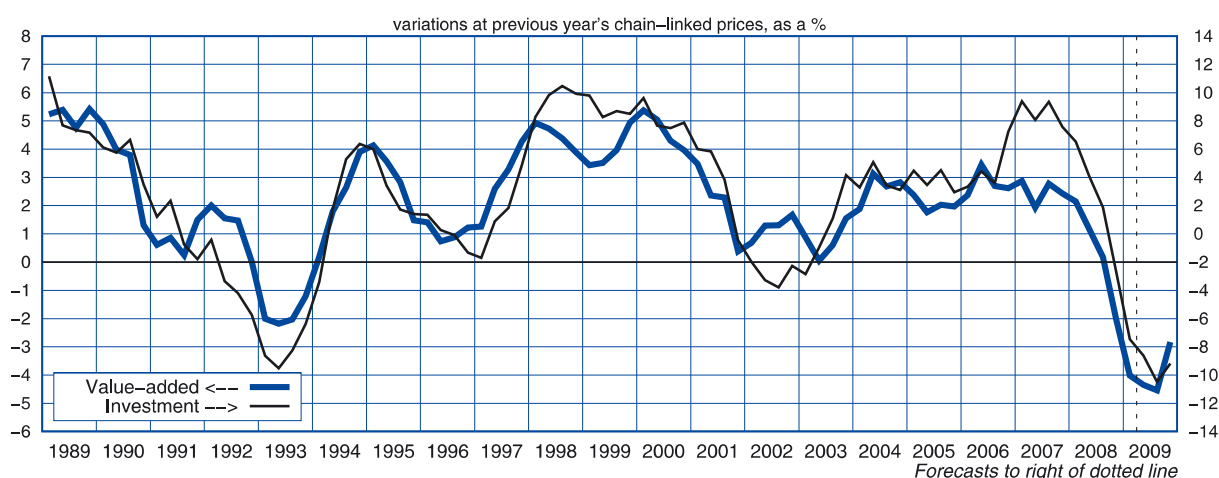
In Q1 2009, gross fixed capital formation (GFCF), that is, the investment of non-financial enterprises (NFE), fell by 3.2%, more than in Q4 2008 (-2.7%, see Table 1). Enterprises continued to adjust their investment to the drop in value-added (see Graph 1): the investment rate returned to its level of end 2006 (19.0%). Enterprises greatly reduced

their investments in non-energy industrial goods (-6.7% after -5.0% in Q4 2008): they are still confronted with under-utilisation of their production capacities, poor demand prospects and globally difficult financing conditions. In particular, they scaled back their automobile purchases by 12.5% and their capital goods expenditure by 5.8%.

The drop in investment should continue at a gradually more moderate pace throughout 2009: -2.7% in Q2, -2.3% in Q3 and -1.3% in Q4. Industrialists surveyed in the business tendency surveys indicate that business prospects are still poor, albeit less so than in previous months, and still consider their order books to be very thin. They see global financing conditions as still being unfavourable even though the tightening of lending conditions appears to be coming to an end.<sup>(1)</sup> Real interest rates are increasingly high, close to 1997 levels. Last, production facilities are being used less and less: in April, industrial companies stated that they were only using 70.6% of production capacity, against 75.0% in January, 85.3% one year earlier and almost 84% over the long-term average (see Graph 2).

(1) According to the quarterly Banque de France bank survey on the distribution of credit in April 2009, fewer and fewer banks are thinking of further restrictions on conditions for granting credit to companies.

## 1 - Investment and value-added of non-financial enterprises (NFE)



Sources: INSEE

Additionally, industrialists are once again highly pessimistic about the growth of their capital expenditure for the rest of the year. In their replies to the April survey on investment in industry, they again revised their investment forecasts downwards, as illustrated by the revision indicator<sup>(2)</sup> which is once again very negative.

### ... thanks to the less pronounced drop in investments in non-energy industrial goods and services

Investment in non-energy industrial goods should therefore continue to decline until the end of the year. This decline should, however, become less and less pronounced (-5.0% in Q2 2009, then -3.5% and -1.5%) in line with less unfavourable business prospects. In May, intentions to order capital goods, representing two-thirds of investments in non-energy industrial goods, were still at a far lower level than normal; but they have stopped deteriorating according to the two-monthly business tendency survey of the wholesale trade.

The fall in construction expenditure should also ease in Q2 (-0.6% after -1.5% and -1.6% in the two previous quarters) because of a rebound in public works investment. Indeed, the dip in public works activity in Q1 2009, which was partly linked to the poor weather conditions, should be corrected in Q2 2009. However, in H2 2009, construction expenditure is likely to contract once again, and more sharply (-2.0% in Q3 and Q4). In May, more contractors indicated a drop in orders

(2) The investment revision indicator summarises the changes in company forecasts between two successive surveys for the investments of the same year. It is centred and reduced. It generally appears to be well correlated with quarterly growth in the GFCF of enterprises in the current quarter (see "Prévoir l'investissement des entreprises? Un indicateur des révisions d'anticipations dans l'enquête Investissement dans l'industrie" report in *Conjoncture* in France, March 2005, in French).

when they replied to the business tendency survey on the building industry. Furthermore, public works expenditure is expected to fall once again as indicated by the reduction in the contracts signed in Q1.<sup>(3)</sup>

Last, other investments - mainly in computer services - are expected to decline in Q2 2009 (-1.5%). The business prospects of enterprises in the "consultancy and assistance" and "IT activities" sectors, observed in the business tendency survey on services, are still poor.

Over 2009 as a whole, the GFCF of NFE should suffer a notable drop (-8.9%). This is mainly due to the substantial cut in investments in non-energy industrial goods (-16.4%). Expenditure in construction and other services should be less affected, but will nonetheless slide by 4.9% and 1.6% respectively.

### Inventory changes once again weighed on growth in Q1 2009

Inventory adjustment weighed heavily on growth in late 2008 and early 2009 (see *Table 2*). This adjustment was particularly pronounced for non-energy industrial goods (-0.8 point contribution) and to a lesser extent energy products (-0.1 point).

The adjustment of inventory of non-energy industrial goods is mainly ascribable to the large drop in output in the automobile and intermediate goods sectors: as early as January, the entrepreneurs questioned in the business tendency survey in industry were expecting global and foreign demand to plummet. In addition, imports of capital goods and automobiles fell sharply (respectively by -8.6% and by -15.0%).

(3) According to the monthly business tendency survey by the *Fédération Nationale des Travaux Publics* in March 2009.

Table 1

### Investment by non-financial enterprises (NFE)

Variations at previous year's chain-linked prices, as a %

	Quarterly variations												Annual variations		
	2007				2008				2009				2007	2008	2009
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Non-energy industrial goods	4.6	0.1	2.7	1.1	2.9	-1.9	-1.2	-5.0	-6.7	-5.0	-3.5	-1.5	9.8	1.7	-16.4
Building and public works	2.5	1.4	0.7	3.7	1.7	-1.6	0.0	-1.6	-1.5	-0.6	-2.0	-2.0	8.8	3.6	-4.9
Services	0.4	1.6	1.5	1.3	0.3	-0.6	0.7	-0.3	0.3	-1.5	-1.2	-0.5	6.6	2.3	-1.6
<b>All non-financial enterprises</b>	<b>2,8</b>	<b>0,9</b>	<b>1,8</b>	<b>1,9</b>	<b>1,8</b>	<b>-1,5</b>	<b>-0,3</b>	<b>-2,7</b>	<b>-3,2</b>	<b>-2,7</b>	<b>-2,3</b>	<b>-1,3</b>	<b>8,6</b>	<b>2,4</b>	<b>-8,9</b>

Forecasts  
Source: INSEE

## Corporate investment and inventory

The adjustment of inventory of energy products to growth in Q1 2009 induced an exceptional drop in imports (-7.1% against +3.3% in the previous quarter).

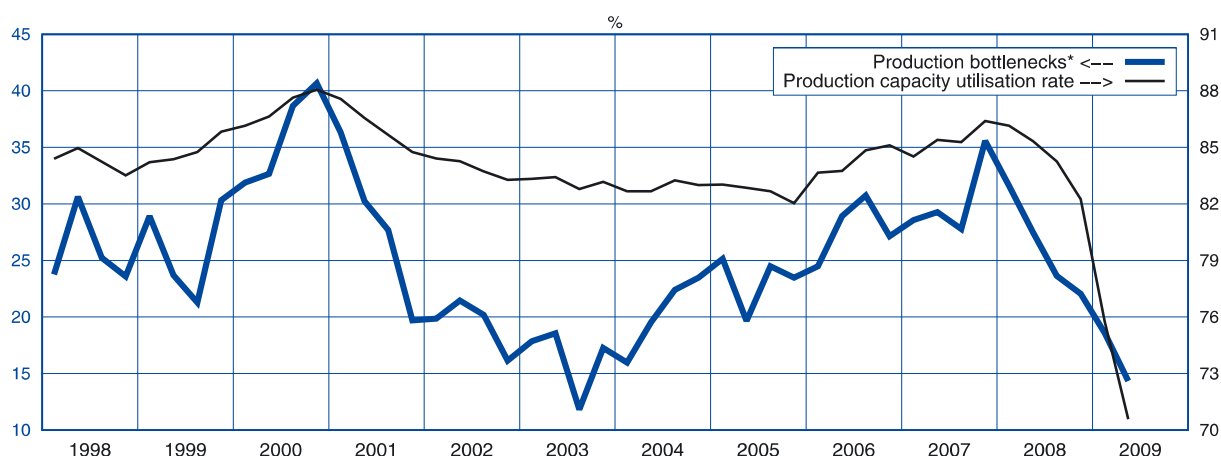
### In Q2 2009, inventory should weigh less heavily on growth

In Q2, after the major adjustment of inventory in the previous two quarters, the contribution of inventory changes to growth should once again be negative, although to a lesser extent (-0.3 point). The running down of inventory of non-energy

industrial goods is likely to be more moderate: production prospects are less unfavourable and the decline in demand appears to be less marked. Additionally, the adjustment already made has brought inventory back in line with demand, as shown in the business tendency survey on industry. In the course of Q2 2009, the automobile sector in particular indicated a marked lightening of inventory, bringing it back to a level close to normal.

In H2 2009, the contribution of inventory to growth should be virtually nil: the fall in demand is expected to slow and inventory should once again be more or less in line with demand. ■

## 2 - Tensions on production capacities in manufacturing industry



\* Proportion of enterprises which, if they received more orders, could not produce more with their current means.  
Source: INSEE, quarterly survey on activity in industry

Table 2

### Contribution of inventory changes to growth

	in GDP points								Annual changes		
	Quarterly changes								2007	2008	2009
	2008				2009						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
<b>Agricultural and agrifood products</b>	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.1	0.0	0.1
<b>Non-energy industrial goods</b>	0.1	0.3	-0.2	-0.9	-0.8	-0.3	0.0	0.1	0.0	-0.3	-1.8
Including:											
Consumer goods	0.0	0.0	0.0	0.0	-0.1				0.0	-0.1	
Automobile	0.2	-0.1	0.0	-0.8	-0.2				0.0	-0.1	
Capital goods	-0.2	0.4	-0.4	0.2	0.1				0.0	-0.1	
Intermediate goods	0.0	0.1	0.1	-0.3	-0.6				0.1	-0.1	
<b>Energy products</b>	0.0	0.0	0.2	0.2	-0.1	0.0	0.0	0.0	-0.1	0.1	0.2
<b>Other (construction, services)</b>	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>TOTAL (*)</b>	0.0	0.2	0.0	-0.7	-0.8	-0.3	0.0	0.1	0.0	-0.3	-1.5

Forecasts

(\*) Inventory changes include acquisitions net of sales of valuables.

Source: INSEE