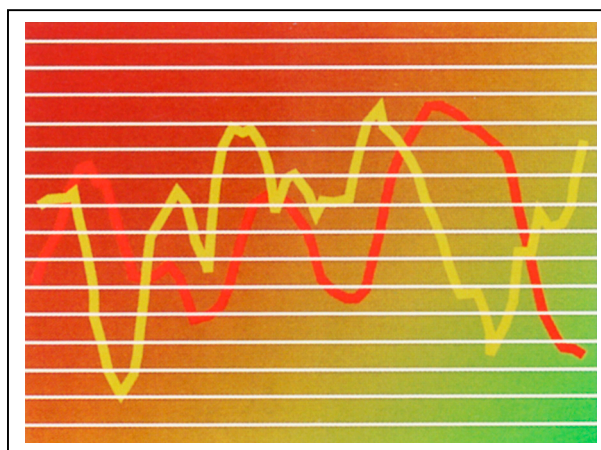


***CONJONCTURE* IN FRANCE**

RECESSIONS



DECEMBER 2008

RECESSIONS

GENERAL OUTLOOK	7
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FORECAST REVIEW	19
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SPECIAL ANALYSIS

- Two New Indicators to Help Analyse the Economic Outlook in France 21

INTERNATIONAL DEVELOPMENTS

- International overview 43
- United States and United Kingdom 47
- Japan, China, and emerging Asia 50
- Euro zone 53
- Consumer prices in the euro zone 58

Focus

- Points of comparison between the situation of the French economy today and during the 1993 recession 16

STATISTICAL APPENDIX	61
---------------------------------------	----

Recessions

In Q4 2008 and early 2009, activity should decline sharply in industrialised countries. In early 2009, almost all these countries should therefore be in recession, and the French economy should not be an exception to the rule.

The general slowdown since summer 2007 had already turned into a moderate downturn in activity by Q3 2008, and renewed financial tensions in the wake of the bankruptcy of Lehman Brothers investment bank have made the business outlook even gloomier.

Tighter lending and an all-round rise in risk aversion are pushing firms to cut down on investment expenditure and to scale back their inventories sharply.

Increased unemployment and rising uncertainties as to future income prospects, meanwhile, are leading households to increase their savings as a precautionary measure, a trend that looks set to be particularly strong in countries such as the UK and US where heavy household debt to finance consumption had brought savings levels down to all-time lows.

In France, the business tendency surveys suggest a downturn in activity of 0.8 % in Q4 2008 followed by 0.4 % in Q1 2009. In Q2 2009, the slide in activity could be lessened to some extent (-0.1 %) as the first effects of the economic stimulus plan work their way

through, under the assumption that the strong action taken by central banks and States around the world proves to be effective in easing financial tensions.

The unemployment rate is expected to continue rising. It should hit 8.0% in Q2 2009, although this level remains well below that reached at the beginning of 2006.

The financial situation in coming months is the main source of uncertainty surrounding this scenario. Lingered doubts as to the value of banks' assets mean that a further worsening of the financial crisis cannot be ruled out. This would result in the downturn being sharper and longer-lasting than expected. On the other hand, the ongoing intensification and diversification of state and central bank involvement to resolve the crisis could ease these tensions more quickly than expected, thereby limiting the extent of the downturn.

The uncertainty is also great regarding the worldwide impact of the stimulus plans targeting households and business. For certain major plans, in the United States in particular, the timing, scale and exact terms of the plan are still unknown.

Additionally, their effectiveness is even more awkward to assess than usual: it could be undermined if households and businesses continue to favour caution, and could be amplified if the plans do succeed in restoring confidence and get households and companies back into more normal spending patterns. ■

The world economy slowed down sharply once again in Q3

The advanced economies shrank...

In Q3 2008, the activity of the advanced economies fell (-0.2% after +0.2% in Q2), under the effects of declining corporate investment and household consumption. This fall affected the main economies, and especially the United States (-0.1 %), Japan (-0.5%), the United Kingdom (-0.5%) and the Euro Zone (-0.2%). In Germany and Italy, activity dropped sharply for the second consecutive quarter (-0.5% in both countries).

...and emerging economies experienced a sharp slowdown

The worldwide downturn is now also affecting the emerging countries, with growth weakening in India, Russia and Brazil. Industrial production in China returned to its post-Asian crisis growth levels, while the whole of South-East Asia is slowing down as world trade falls off.

The financial and property crises show no signs of weakening

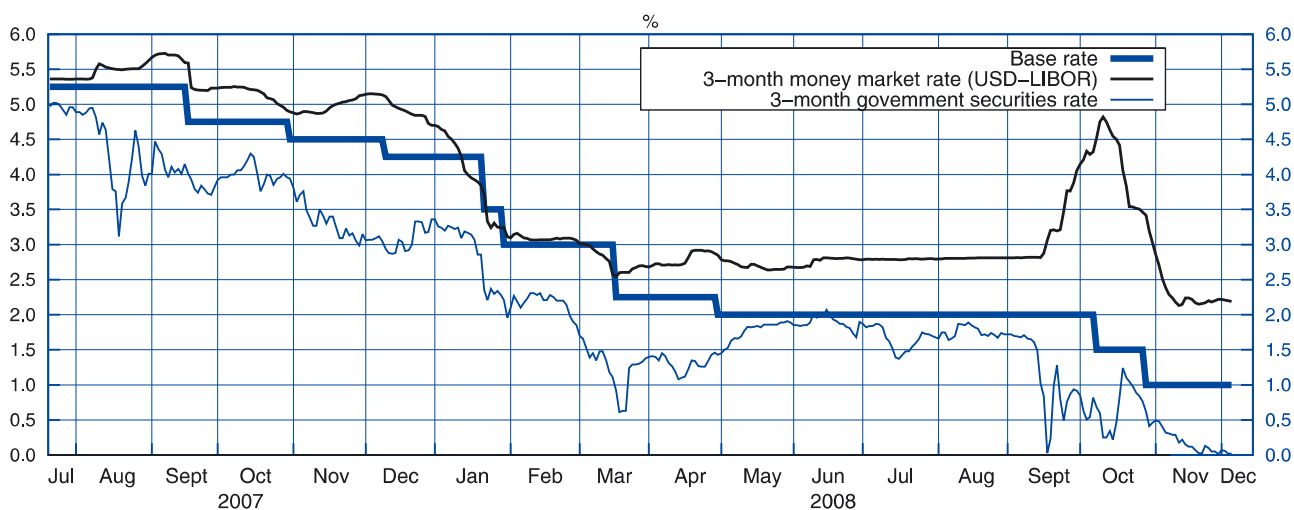
The financial crisis continues...

Tensions are still running high on interbank markets, although they have declined slightly from their peak at the time of the Lehman Brothers bankruptcy: rates remain well above those of the central bank base rates (see Chart 1). These tensions are having repercussions on corporate and household borrowing: banks have tightened their lending standards in the industrialised countries and this is likely to continue, according to surveys of the banks. Stock markets have also declined sharply and are hardly conducive to raising funds from stock issues. Tighter financing would weigh heavily on household expenditure, and especially on investment by households and by companies.

...despite energetic measures by central banks and the authorities

Many major steps have been taken to try to get the financial situation back to normal, with central banks making massive liquidity injections and bringing their base rates down sharply, and several States guaranteeing their banks and even recapitalising or nationalising certain banks that were in trouble. While this action has avoided any chain reactions, it has not succeeded in bringing financial markets back to normal. However, it may begin to bear fruit within the next few quarters by loosening the stranglehold on investment and gradually getting growth started again.

1 – United States: short-term interest rates



Source: DataInsight

Property market correction continues

The US real-estate market, which seemed to be showing some signs of improvement at the end of the summer, has since taken a dive again. In the United Kingdom, the decline is now very sharp and property prices continue to slide at rates of close to 15% year on year. The property market is also experiencing a severe correction in Ireland, where residential commencements in H1 2008 were half the figure for H1 2007. In Spain, the construction sector is plunging into crisis, with further bankruptcies among major companies and record stocks of unsold homes. In France, prices are beginning to decline, the number of transactions is down and new house stocks are constantly rising. In this context, household investment is expected to continue its downward trend and construction sector activity is likely to hold back growth in these economies.

France unlikely to escape recession

The sharp decline in business surveys everywhere points to a drop in activity

In all the advanced economies, the surveys have been headed in the wrong direction since September and this downturn is affecting all sectors. These results suggest that there will be a particularly pronounced drop in activity in Q4 (see Chart 2). This downturn is likely to continue into the beginning of 2009, although less sharply under the assumption that government measures begin to restore confidence and to nudge financial and banking markets back towards normality. All major advanced economies should follow this pattern, while the emerging economies should experience a distinct slowdown in their activity.

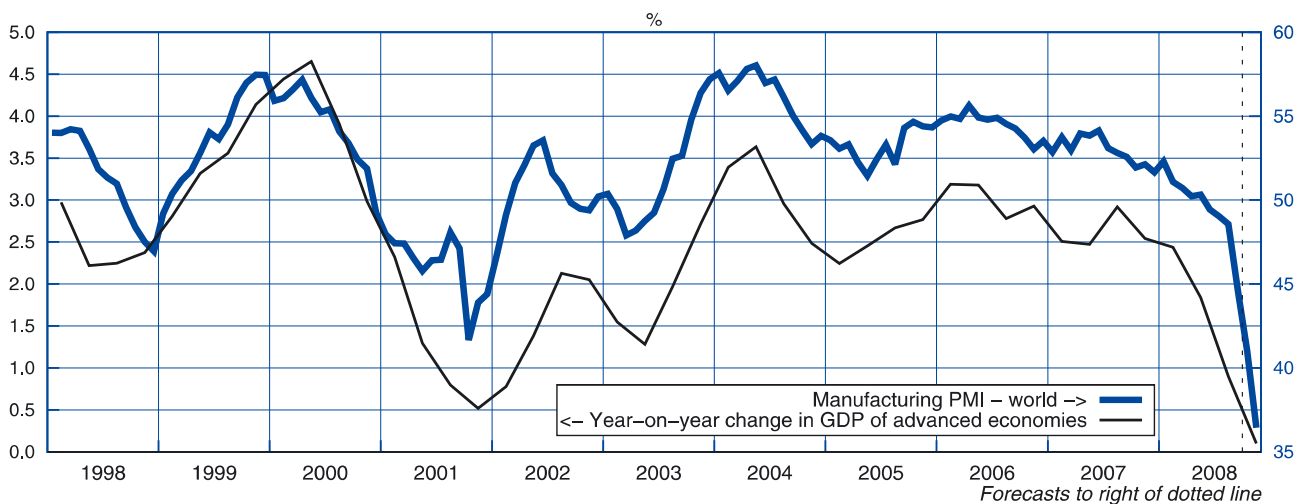
French exports down in the wake of declining world demand

As a consequence of the downturn in the activity of our main trading partners, world demand for French exports is expected to fall back by more than 3% between Q3 2008 and Q2 2009, after rising by 6% in 2007. The impact of the worldwide slump on French exports could be softened somewhat, however, by the recent fall in the Euro. All in all, after an upturn in Q3, French exports are expected to fall in Q4 2008, and this decline is likely to continue, although to a lesser extent, in the first half of 2009.

Output in sharp decline in France, especially in industry

The business climate has considerably deteriorated in France in the last year and a half, coming close to the levels seen in the 1993 recession (see Chart 3). Moreover, the turning point indicator constructed by the INSEE on the basis of its surveys has now spent the last 11 months in the zone indicating an unfavourable

2 – Purchasing Manager Index (PMI) and growth in activity in the advanced economies



Sources: DataInsight, INSEE estimates

situation (see “Two New Indicators to Help Diagnose the Economic Outlook in France”). These indicators suggest a fall in output in the main economic sectors. However, production could be supported from early 2009 by the effects of the stimulus plans adopted in the industrialised countries, and notably in France. In contrast, the slide should be particularly steep in Q4 2008 in manufacturing industry, as indicated by the latest industrial output figures for October, particularly due to the automobile industry. Faced with excess stock levels in the wake of declining sales, the manufacturers have had to close down plants for extended periods in Q4 to bring stock levels down. These large-scale efforts to run down stocks are expected to weigh heavily on industrial output (contribution of -1.2 points) and on GDP (-0.4 points). The construction sector is also expected to suffer further from the effects of the financial and property crises.

Activity to stay in decline in France in the first half 2009

Through to mid-2009, activity in the French economy is expected to remain in decline. The fall in GDP is expected to be sharp in Q4 2008 (-0.8%), and to continue in the first half 2009 although to a lesser extent. Growth overhang for the year 2009 at the end of Q2 is expected to be clearly negative (-1.1%).

Business and household investment expected to fall sharply

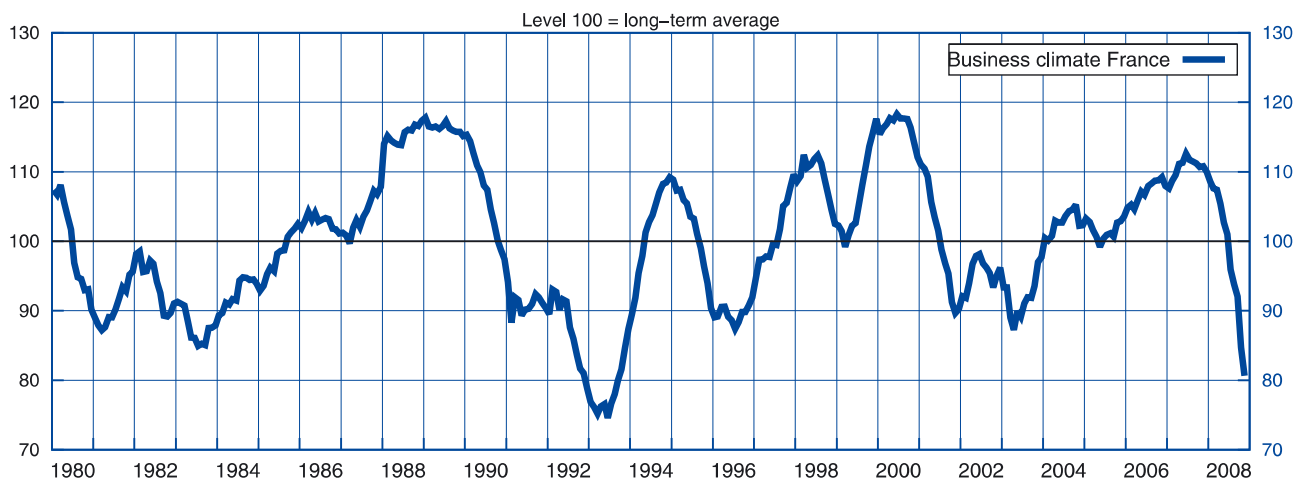
Productive investment to fall back

Corporate investment is set to fall in Q4 2008 and Q1 2009. As in the other advanced economies, lending has become much tighter in France and this is likely to continue in coming months, according to the survey carried out by the Banque de France, even though, for the moment, this has had limited effects on the amount of loans being granted. Moreover, companies have little incentive to invest, faced as they are with weak demand and production capacity utilisation rates that have shown a marked fall. However, increased investment by public companies and a surge in social housing programmes as part of the economic stimulus plan should begin to limit the decline in corporate investment in Q2 2009. Likewise, the announced upturn in government spending demand should support growth in the first half 2009.

Household investment expected to remain in sharp decline

Household investment on housing should also continue to suffer from tighter lending conditions. This downturn is confirmed by the short-term construction-sector indicators: housing starts and building permits are down again this quarter. Household investment should fall sharply once again in the coming quarters.

3 – New business climate indicator France



Source: INSEE

Sliding oil prices should drag down worldwide inflation

Inflation around the world increased sharply in the first half of 2008

All over the world, inflation was driven up in the first half 2008 by soaring commodity prices, and notably in energy and food. Oil prices, in particular, reached the record level of \$147 a barrel of Brent in July 2008, pushing inflation to 5.4% in July in the United States, 4.0% in July in the Euro Zone and 5.2% in September in the United Kingdom. This surge in prices also affected South-East Asia, China and India, leading these countries to take measures to curb inflation in the course of 2008.

But oil prices have plummeted since the summer...

Oil prices fell sharply from summer 2008 (see Chart 4), before levelling out at around \$50 per barrel of Brent. The prospect of a continued decline in demand for oil among developed and emerging countries alike is driving expectations of a lasting oil market surplus. The market should therefore ease in Q1 2009, and oil prices should not exceed \$50 to our forecasting horizon.

...as have other commodity prices

The slump in activity in the developed countries has also had an impact on industrial commodity prices which fell in Q3. At the same time, food commodities have also seen their prices fall after contributing to the rise in inflation in 2008.

Inflation should fall sharply...

This pronounced decline in commodity prices is already bringing down inflation rates everywhere. In October, for example, year-on-year consumer prices were up just 4.5% in the United Kingdom, 3.7% in the United States and 2.7% in France, and up only 2.1% in the Euro Zone in November. Inflation has also started to fall back in emerging countries, and notably in China and in India. This fall in inflation should continue in coming quarters, profiting from the slide in commodity prices which will continue to work its way through the economy. By mid-2009, the rise in consumer prices should not exceed 1% year-on-year in the United States and the Euro Zone.

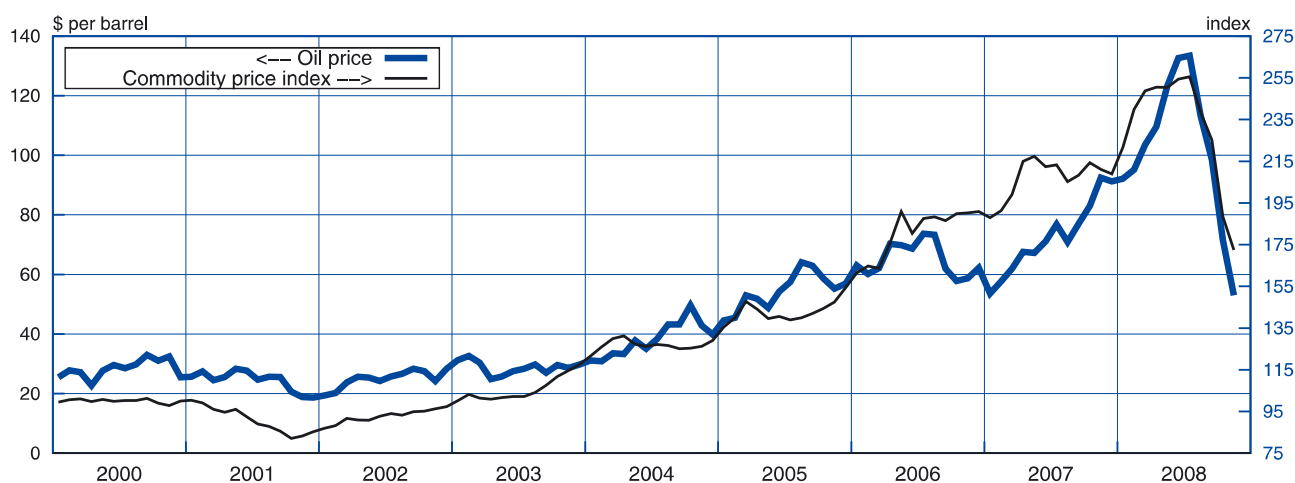
... and should be just 0.3% in France in June 2009

In France, the sharp drop in energy prices and, to a lesser extent, in food products, should result in a marked decline in inflation (see Chart 5). The price rise over a year should be no more than 1.5% in December 2008 and only 0.3% in June 2009. On average over the year 2008, however, the price rise should come to 2.9%, mainly due to soaring commodity prices over the first part of the year.

Excluding energy and fresh food products, inflation should remain fairly stable

Since mid-2008, "core" inflation, meaning excluding energy and fresh food products, has increased slightly, from 2.0% in June to 2.1% in October, under the effect of the past increase in production costs. However, it should fall back again

4 - Brent oil and commodity prices



Source: Financial Times

by June 2009 to 1.8%, due to the reduction in processed food product inflation and the downturn in demand which is hardly conducive to price rises by producers or distributors.

The labour market should continue to deteriorate

The decline in employment set to accelerate in early 2009

In the wake of declining activity, the French economy should continue to shed jobs in late 2008 and these losses should be even greater in early 2009. Employment should fall by a total of almost 100,000 jobs in the second half 2008 and then by around 170,000 jobs in the first half 2009. Non-agricultural market sectors should lose around 150,000 jobs in the second half 2008 and more than 210,000 jobs in the first half 2009. Industry should continue to shed jobs, while construction should begin to do so in early 2009. In contrast, non-market paid employment, and self-employment are set to continue growing. The large number of new subsidised employment contracts, in particular, should help to stop the fall in the number of beneficiaries observed in 2008, and even to increase their numbers slightly.

Rise in unemployment

The fall in unemployment since 2006 has ground to a halt with the turnaround in the economic situation in Q2 2008. Due to the large number of expected job losses, unemployment should increase in late 2008 and early 2009. The unemployment rate as defined by the ILO for Metropolitan France should come to 8.0% on average in Q2 2009, thereby returning to its levels in mid-2007 (see Chart 6).

Despite falling inflation, consumers likely to be cautious

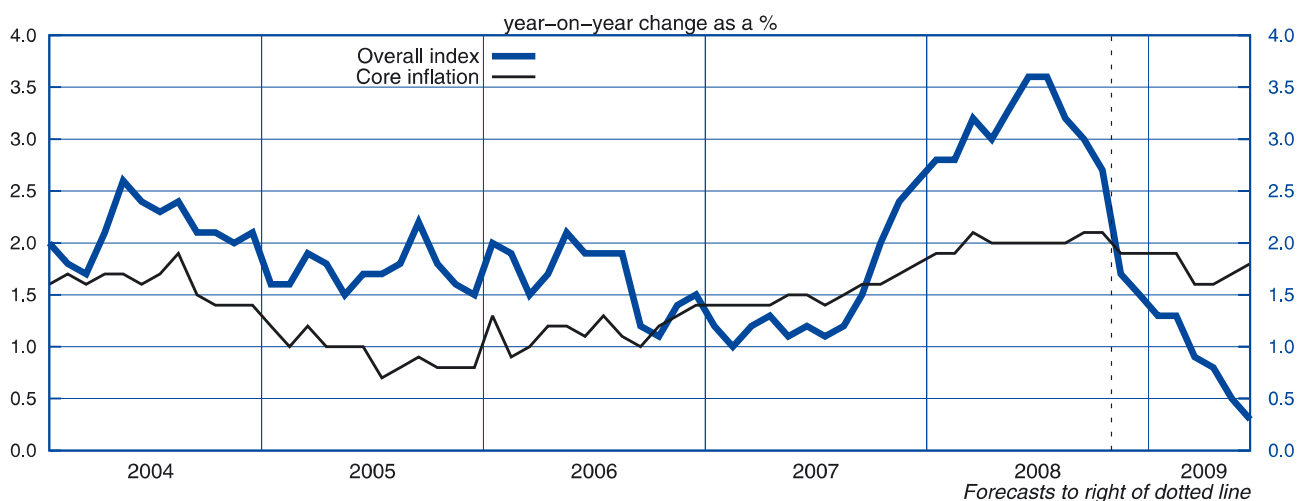
Purchasing power should level out at end 2008 then resume its rise in early 2009

In the second half 2008 and first half 2009, purchasing power should be severely penalised by deteriorating income in the wake of the economic slowdown and job losses. Moreover, income growth has no longer been stimulated in 2008 as it had been in 2007 by sharp reductions in income tax. Real household income should be sustained, however, in the course of the first half of 2009 thanks to the sharp fall in inflation and government support measures.

But consumers look set to remain cautious

Against a backdrop of increased uncertainty, and despite an expected increase in real income, household consumption is likely to be at a standstill in late 2008 and Q1 2009, although it should be boosted slightly at the start of 2009 by the introduction of a bonus to replace older motor vehicles. However, faced with a

5 - Consumer price index and underlying inflation in France



Source: Eurostat, INSEE forecasts

deteriorating labour market and economic uncertainties, households are expected to adopt a cautious approach. The savings ratio should rise to 16.2% in Q2.

Imports set to decline

French imports of goods and services are likely to decrease from Q4 2008 onwards, after remaining somewhat buoyant since the beginning of the year. They are likely to be held back until mid-2009 by the falls in investment and consumption. The recent depreciation of the Euro works in favour of domestic products and is likely to contribute to this trend.

Some major uncertainties surround this forecast

The outcome of the financial crisis still uncertain

The development of the situation on financial markets and in the banking sector remains most uncertain, between determined support and restructuring measures, and weakened financial institutions and markets.

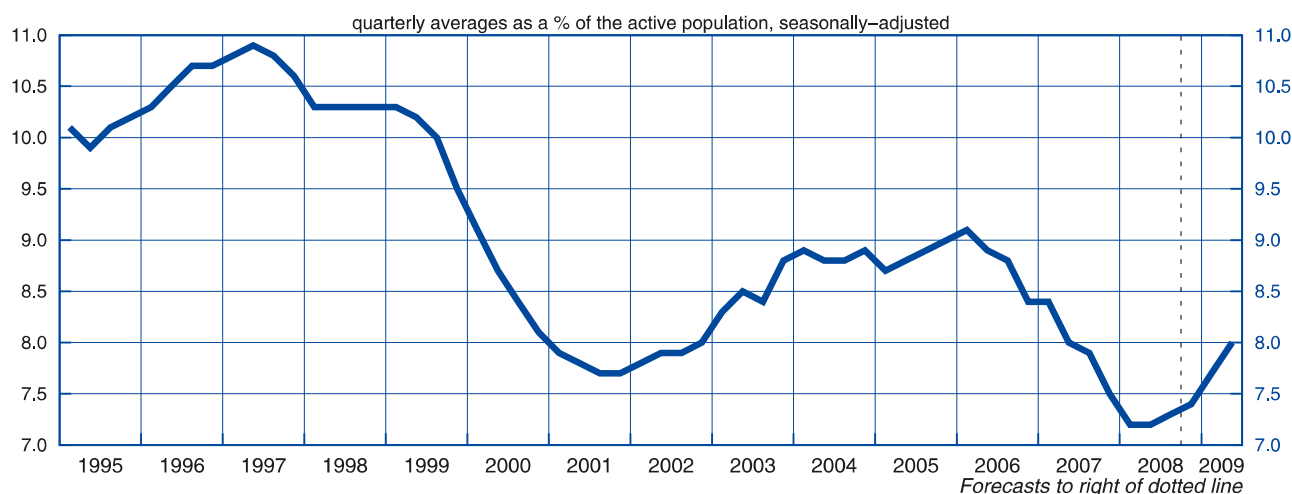
What will be the scale and impact of government stimulus plans?

A second unknown concerns the stimulus plans being implemented by governments in coming months. The uncertainty concerns the nature and the scale of the measures that will be taken in some countries, and notably in the United States, as well as the impact of all these plans. In fact, this impact will depend on reactions to them, and in particular on whether confidence is restored or not. Depending on this, the additional income received by households could either be channelled into consumption and contribute to getting the economy moving again, or could largely go towards savings, thereby reducing the expected effects.

How far will oil prices fall?

Oil prices are another unknown. A further drop in energy prices would boost household purchasing power, but an upturn in oil prices cannot be ruled out, for example if OPEC succeeded in implementing a sharp cutback in its production quotas. ■

6 – Unemployment rate as defined by the ILO



Scope: Metropolitan France, population of households, people aged 15 years or older
Source: INSEE, labour force survey

France: supply and use

in real terms, at previous year's chain-linked prices, seasonally and working-day adjusted, quarterly and annual changes, %

	2007				2008				2009		2007	2008	2009 ovhg
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	0.5	0.6	0.7	0.3	0.4	-0.3	0.1	-0.8	-0.4	-0.1	2.1	0.8	-1.1
Imports	2.0	2.3	1.2	-1.1	1.6	-0.4	1.9	-1.3	-0.6	-0.2	5.9	2.2	-1.0
Household consumption	0.7	0.9	0.8	0.5	-0.1	0.0	0.2	0.1	0.0	0.3	2.5	0.9	0.4
Public consumption*	0.3	0.4	0.4	0.3	0.4	0.5	0.5	0.4	0.6	0.5	1.3	1.6	1.5
Total GFCF	1.3	0.8	0.9	0.8	0.6	-1.5	-0.3	-1.6	-1.6	-0.9	4.9	0.2	-3.9
of which:													
NFEs	2.0	1.4	1.5	0.9	1.0	-1.0	0.3	-1.6	-1.7	-0.8	7.3	1.8	-3.6
Households	0.5	0.3	0.3	0.4	0.1	-2.7	-1.6	-2.2	-2.1	-1.4	3.0	-2.6	-6.1
Exports	0.8	1.8	0.4	0.3	2.4	-1.9	1.9	-2.3	-1.2	-0.7	3.2	2.2	-2.9
Contributions													
Domestic demand excluding change in inventories	0.7	0.7	0.7	0.5	0.2	-0.2	0.2	-0.2	-0.2	0.1	2.7	1.0	-0.2
Change in inventories**	0.2	0.0	0.3	-0.6	0.0	0.3	0.0	-0.4	-0.1	-0.1	0.2	-0.1	-0.3
Net foreign trade	-0.4	-0.2	-0.2	0.4	0.2	-0.4	0.0	-0.2	-0.1	-0.1	-0.8	0.0	-0.5

Forecast — ovhg: overhang

*Includes consumption expenditures by non-profit institutions serving households

**Inventory changes include acquisitions net of sales of valuables

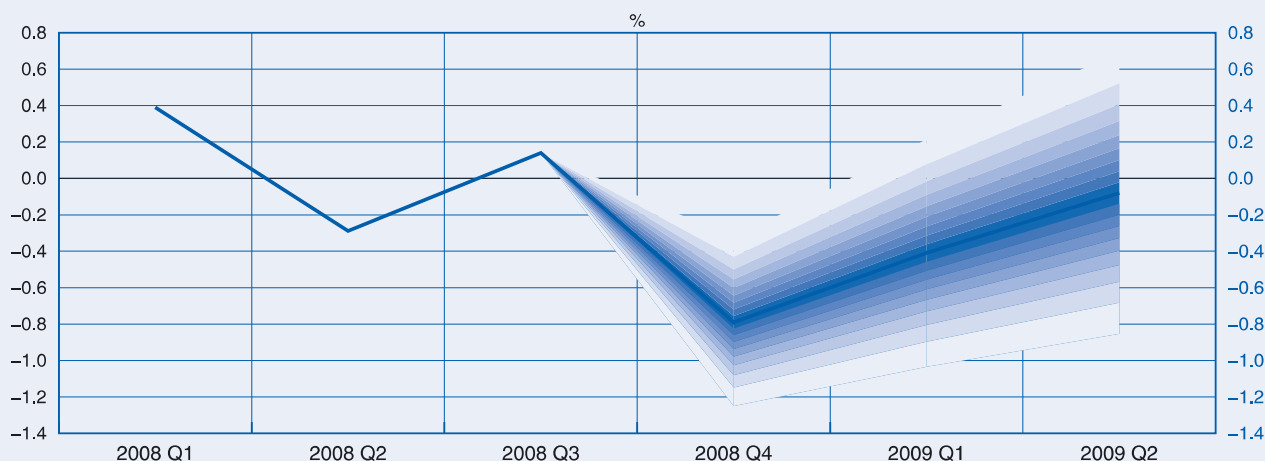
Source: INSEE

Fan chart for Conjoncture in France

The fan chart plots the set of most likely scenarios around the baseline forecast (black line). The first and darkest band covers the likeliest scenarios around the baseline, which have a combined probability of 10%. The second band, which is a shade lighter, comprises two sub-bands just above and just below the central band. It contains the next most likely scenarios, raising the total probability of the first two bands to 20%. We can repeat the process, moving out from the center to the exterior and from the darkest band to the lightest, up to a 90% probability. As the bands widen, they therefore cover an ever-larger range of possible outcomes. The width of these bands is based on the historical dispersion of INSEE forecasts at each of the horizons at stake, summarised by their standard deviation (for more details about the method, readers may refer to the INSEE Note de Conjoncture for June 2008, pages 15 to 18). To take account of the particularly great uncertainty surrounding this forecast, the standard deviation has been increased in relation to the historical value for the first two quarters 2009: for Q1, it has been increased from 0.33 to 0.38 and for Q2 from 0.37 to 0.47. For Q4 2008,

however, the historical standard deviation was used. Uncertainty to this forecast horizon is limited by the existence of the business surveys supplying direct information on activity. In its latest report on inflation, the Bank of England also increased its estimation of the uncertainty around its growth forecasts, but from the first quarter of its estimate in this case. It can therefore be estimated that the first result to be published by the quarterly accounts for Q4 has a 50% chance of being between -1.0 % (lower limit of the fifth band from the bottom) and -0.6 % (upper limit of the fifth band from the top). Likewise, it has a 90% chance of being between -1.2% and -0.3 % in Q4 2008. The probability of the published figure being positive is very low. For Q1 2009, it can be estimated in the same way that the first results to be published by the quarterly accounts have a 50% chance of being between -0.7% and -0.2 %⁽¹⁾ and a 90% chance of being between -1.0 % and +0.2%. The probability of the figure being positive can be estimated to be around 15%. For Q2 2009, the range of possible outcomes is even wider, with a confidence interval of 90% from -0.9% to +0.7%. ■

(1) The values that can be read on the graph are between -0.67% and -0.15%; as no such degree of precision can be claimed, they have been rounded off to -0.7 % and -0.2%.



Source: INSEE

Focus – Points of comparison between the situation of the French economy today and during the 1993 recession

The recession of 1992-1993 and the foreseeable one in 2008-2009 seem to share a certain number of explanatory factors: in both cases, the slowdown occurred in France in a deteriorated international environment. Also, the construction sector and property market suffered a downturn in both periods, private-sector players found themselves heavily in debt and lending conditions tightened. However, there are differences: the timeline has not been the same – in particular, the United States and United Kingdom experienced an upturn just as Europe was going into recession –, the price of commodities is higher today and the causes of the tighter lending conditions are different. This time, the cause is the general rise in risk premiums, while in the early 1990s, it was the consequence of a rise in base rates to defend the exchange rate of the French Franc against the Deutschmark.

In terms of results, the scenario presented in this paper can be compared to the 1993 recession:

- A significant slump in activity is expected in Q4 2008 (-0.8%) and Q1 2009 (-0.4 %); gross domestic product (GDP) also declined sharply in Q4 1992 (-0.5%) and Q1 1993 (-0.7%);
- At the end of the first half of 2009, growth overhang is expected to be -1.1%; at the end of the first half 1993, it was -1.0%;
- Between the last peak in activity, in Q1 2008, and Q2 2009, the fall in GDP is expected to be 1.4%; GDP fell by 1.1% between its peak in Q3 1992 and its low-point in Q1 1993⁽¹⁾.

Of course, the figures for the end of 2008 and Q1 2009 are only forecasts and the results could always prove to be better than expected. As shown by the fan chart (p. 15), the risk of GDP declining in Q4 2008 and Q1 2009 is very high, however, and

(1) This drop is less than one-tenth below the result of the "simple" addition of the falls in Q4 1992 and 1993 (-0.5% and -0.7%), due to rounding off the figures.

the results of the business outlook surveys in industry, services and construction confirm the fact that the current economic situation is very close to that at the end of 1992 (see Chart 1). For example, the business climate indicator in industry is barely above its 1993 low point, and the indicator for services is practically back down to that level.

It can therefore be enlightening to list the similarities between the mechanisms in action in these two periods, as well as any differences, and that is the subject of this study.

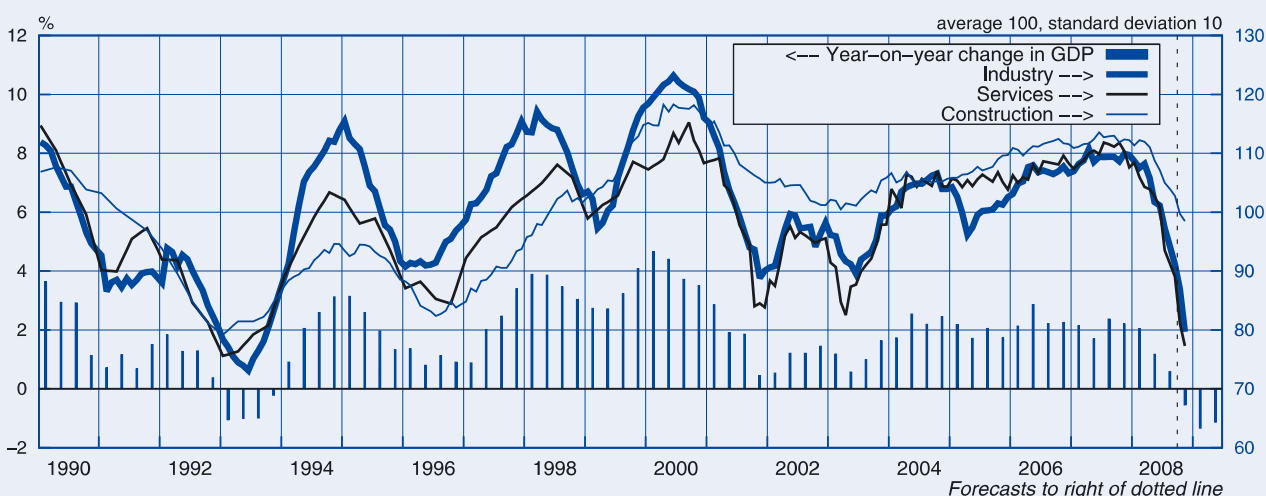
Today, the financial crisis and worldwide slowdown are bringing activity down

Three main factors might explain the current downturn in the French economy:

- The financial crisis could be having a negative impact on the economy through tighter access to loans for households and businesses. This tightening is visible in interest rates and in the criteria applied for granting loans, according to a survey by the Banque de France (although the slowdown in lending remains moderate for the moment). Also, the financial crisis brings with it a general upturn in risk aversion, resulting in a sharp widening of interest rate spreads between private and public sectors.
- The world slowdown should continue to put a brake on demand for French products and services, and therefore for French exports (exports overhang of -2.9 % expected at the end of June 2009).
- The downturn in the construction sector beginning in Q2 2008 is bringing growth down, while the sector had been making a positive contribution since 2004.

On the other hand, the fall in oil prices and in the value of the Euro since July are no longer factors in the slowdown, as things stand at present. They would even seem to be stimulating activity now, in fact, after penalising it over the first part of 2008.

1 – Growth and business climate indicators in industry, construction and services



Source: INSEE, business surveys

In 1993 too, a worldwide slowdown combined with a downturn in the property market

Several of these factors could be observed just before the recession of 1992-1993:

- The activity of many of France's trading partners started slowing down from the end of 1992. This contributed to worsening the crisis in France and penalising exports, which grew little in 1993 (+0.5%, after +5.5% in 1992).
- The international crisis in the early 1990s was also driven by a world downturn on property markets, affecting France from 1990. On the one hand, this caused significant losses for several banks and insurance companies, in the image of events from the end of 2007 onwards with the subprime lending crisis. On the other, the downturn had a large impact on the construction sector, in which output dropped by more than 8% in 1993. Even if the property market downturn in France is currently less severe, the fall in demand should have a big impact on construction sector activity: after a slight decline in 2008, production should fall more sharply in 2009, with the overhang for 2009 at the end of Q2 coming to -2.9 %.

Very high private debt in the early 1990s, as in 2008

At the start of the 1990s, monetary conditions were not very supportive in France. Today, access to financing has also tightened, although in other ways (see below). Private debt also reached record levels in both periods. However, while the debt ratio of non-financial companies in 2008 is comparable to that observed in 1992, household debt in 2008 reached record levels (over 70%, against 57% at its highest point in 1991, see *Chart 2*).

From 1991, tighter monetary conditions combined with high debt affected company solvency and hit domestic demand. This had weakened already in 1991, leading to a first downturn in activity. In 1993, company investment fell by 8.2 %, after a drop of 3.5 %

in 1992 (in 2009, the overhang is expected to be -3.6 % at the end of Q2, after +1.8% in 2008). Also, in an uncertain context, households gave their preference to saving over consumption, with the latter declining by 1.2% in Q1 1993 and by 0.3% over the year as a whole. As purchasing power had almost stood still, the savings ratio rose to 15.8 % at the start of 1993. At the end of 2008 and the start of 2009, a rise in the savings ratio is also expected.

However, alongside these similarities, there are also major differences, notably in the timeline and in the causes of the tightening of financial conditions.

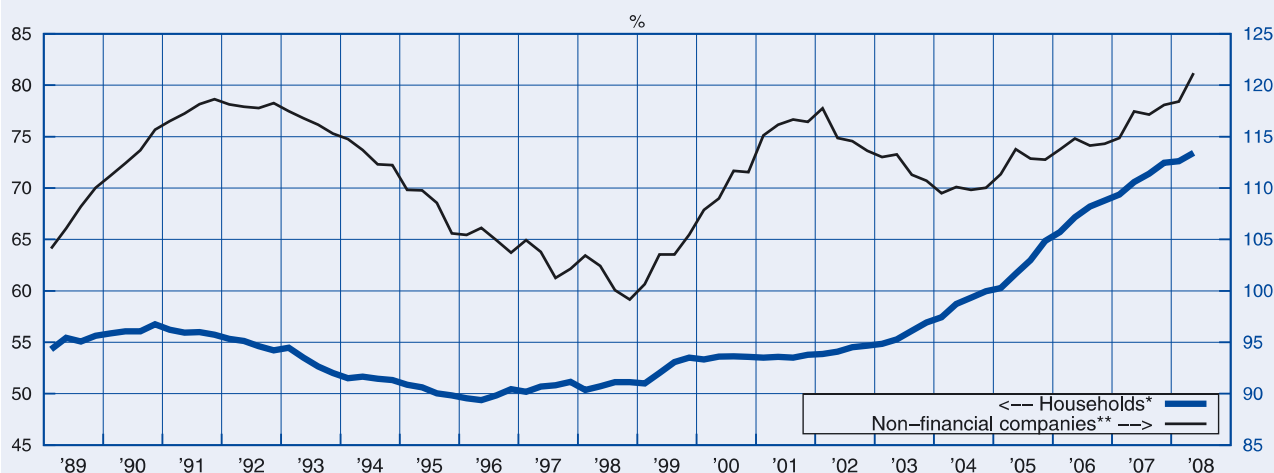
In 1992, the US and UK had already climbed out of recession...

The United States and United Kingdom fell into recession as early as the end of 1990. The strong growth of the late 1980s had brought with it a sharp increase in private debt, resulting in a fall in domestic demand when access to financing became more difficult. Other factors may have contributed to the slowdown in these economies: the rise in base rates in the United States, which had a policy of combating inflation at the time, and also the Gulf War. However, the American and British economies had already climbed out of recession by 1992, while they are in recession today at the same time as the other major economies.

... and the rise in oil prices had been limited and short-lived

The Gulf War had generated a sharp rise in oil prices in 1990, although this rise was not as steep as those in recent years. Also, by early 1991, oil prices had fallen to their former levels, so well before the recession in France. Today, although the price of Brent oil has returned to its 2005 levels, after soaring between January 2007 and July 2008, it still remains well above its levels in the early 1990 in constant Euros.

2 – Household and non-financial company debt ratio



* Household debt in relation to cumulative gross disposable income over four consecutive quarters

** Non-financial company debt in relation to cumulative value added over four consecutive quarters

Source: INSEE, quarterly and annual financial accounts retroprojected prior to 1994

Restrictive monetary policy in 1992-93, more supportive today

One of the reasons that is often referred to when explaining the scale of the 1993 crisis in France is the increasingly tough French monetary policy of the early 1990s. The aim of this was to conserve the nominal anchor of the Franc against the Mark in the European Monetary System (EMS). At the beginning of the 1990s, German reunification and the expansionist budget policy of the German government had caused a spike in inflation which the Bundesbank had tried to control through a restrictive monetary policy. To conserve the nominal parity of the Franc against the Mark, France had therefore raised its base rates, notably on the occasion of the attacks on the EMS in September 1992. The Banque de France only started to lower its rates at the end of 1992, with the tenders base rate coming down from 9.6% to 9.1%. In contrast, the monetary policy of the European Central

Bank is currently more supportive: its main base rate is 2.5%. Interest costs on companies are therefore lower than they were in the 1992-1993 recession.

Much higher risk aversion today than in the early 1990s

Currently, rates on the private market are heading upwards due to the risk aversion of financial agents. On the money market, for example, the spread between the three-month interbank market rate and the three-month public sector rate have been over 1.5% since late September 2008; they exceeded 3% in early October. In 1992-1993, these differentials were well below 1%. On the bond market, the differential between long-term rates on private bonds and government bonds has sharply increased since September. However, interest rates still remain well below those seen in 1992-1993. ■

Forecast Review

Q3 growth proved to be higher than the forecast in the Point de Conjoncture (+0.1% against -0.1%), notably due to better-than-expected growth in consumption. The difference in relation to the forecast remains small, however, and the diagnosis of stalling growth is not brought into question. The forecast for Q4 has been revised sharply downwards (-0.8% against -0.1% previously). The economic climate has indeed become gloomier since our last forecast, as shown by the dive in the composite business climate indicator since September. Tensions on financial markets have increased and industry is seeking to scale back its stocks, especially in the automobile sector.

the October Point de Conjoncture. Households would therefore appear not to have been as cautious as expected in Q3.

Several other items were also better than expected, thereby explaining the GDP forecast error for Q3. In particular, corporate investment grew slightly (+0.3%) when it had been expected to decline (-0.2%). On the other hand, energy and agricultural output were somewhat below expectations.

The differences in relation to the forecasts were therefore small, and are not the result of an underestimation of underlying growth in the French economy.

Q3 a little better than expected

GDP grew slightly in Q3 2008 (+0.1%), a better performance than that forecast in October's Point de Conjoncture (-0.1%). This forecasting error is small, however, and falls within the 50% confidence interval of the forecast⁽¹⁾ (see Chart 1): the figures published for Q3 do not bring into question the general diagnosis of stalling growth.

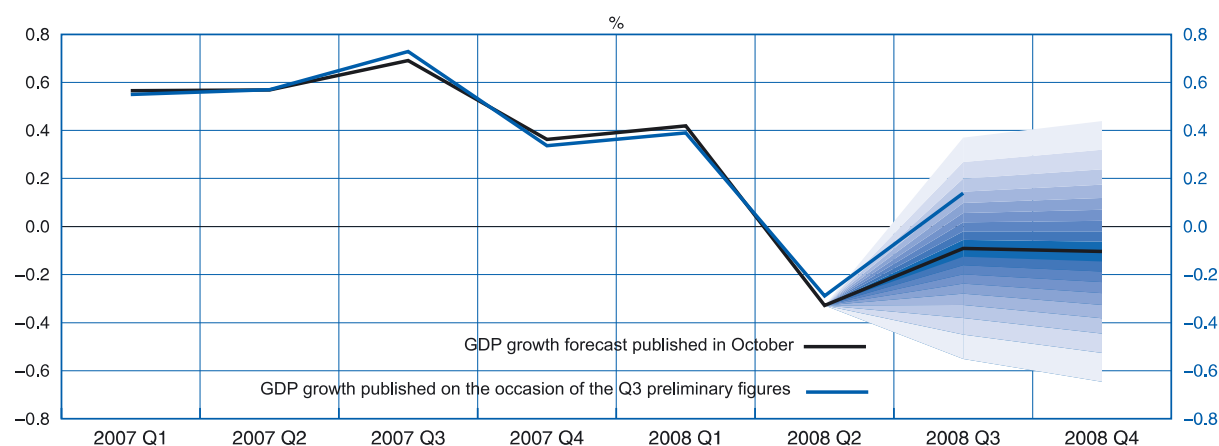
Half of the GDP forecasting error comes from the error in the household consumption forecast: consumption in fact increased slightly (+0.2%) when it had been expected to be at a standstill in

Q4 forecast revised significantly downwards

The information we have gathered since our last forecast leads us to lower our forecast for Q4: the slide in GDP is now expected to be 0.8%, compared with the moderate drop of 0.1% expected previously.

(1) This forecasting error should be placed in perspective, however, as it comes close to the level of precision to which the GDP growth rate is measured.

1- Fan chart published in October and actual growth



* Construction of the fan chart is explained in the box in the general outlook.
Source: INSEE

Forecast Review

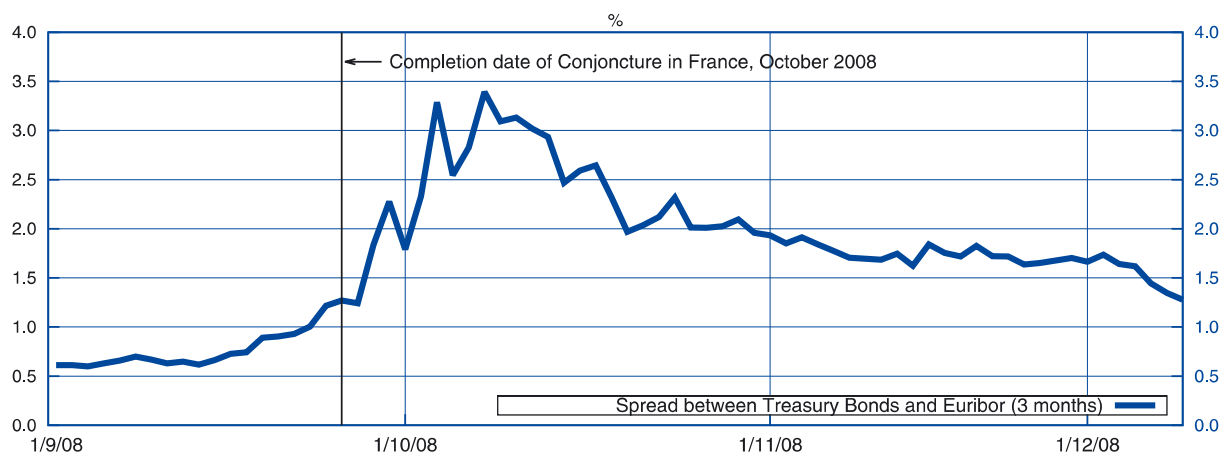
The composite business climate indicator in industry slumped by more than 10 points between September and November. It now stands at 80, and therefore well below its long-term average of 100. This deterioration concerns past production, production forecasts and order books. The business climate has also declined considerably in services (77 in November against 89 in September) and construction (98 in November against 103 at the end of September). In services and industry, the business climate has therefore plunged to levels very close to those recorded in 1993 (see Focus: "Points of comparison between the situation of the French economy today and during the 1993 recession"). This clear slide in the surveys therefore suggests that a sharp drop in activity is on the way for Q4.

Industrialists facing depressed demand, notably carmakers, are seeking to reduce their stocks, and since September, more and more industrial firms have been declaring higher-than-usual inventory levels in the monthly survey. Consequently, stocks should make a significantly negative contribution to Q4 activity (-0.4 points expected, against a previous forecast of 0.0).

This deterioration is due in particular to the worsening of the financial crisis since the October document was written. For example, spreads between interest rates on Treasury bonds and interest rates on loans to the private-sector have soared (see Chart 2), reflecting high risk aversion and a high level of uncertainty. Households and firms thus face tightened lending standards. This is weighing down on household investment, for which the forecast has been revised downwards (-2.2% against a previous forecast of -1.2%), as has that for corporate investment (-1.6% against -0.1%).

Import forecasts have been revised downwards, in the light of reduced domestic demand. Similarly, the exports forecast has been brought down considerably, in line with the more pronounced downswing in worldwide activity: the drop should be all the greater in that the figure for Q3 was higher than can be explained by export determinants (world demand and competitiveness)■

2 - Increased tensions on financial markets



Source: Banque de France