International overview

In Q3 2008, GDP dropped slightly (-0.2%) in the advanced economies. Investment in construction continued its downward spiral at roughly the same rhythm as in the previous quarters, while household consumption fell, notably in the United States, after remaining still in Q2.

Until mid-2009, activity in the advanced economies will probably continue to decline. Although households and businesses enjoy lower energy costs, they will be even harder hit by the financial crisis, which has gathered pace since mid-September, and by its fallout. Indeed, loss of wealth and credit tightening will continue to undermine both consumption and investment.

The emerging economies are confronted with the sharp drop in trade outlets in the advanced countries and with tougher financing conditions on international markets, thereby accentuating their slowdown.

The world economy will continue to slow between now and mid-2009

GDP growth ground to a halt in the advanced economies in Q3 (-0.2%). In Q4 it will decline. Business prospects have deteriorated, according to purchasing managers: moderately up to July, then sharply in September and once again in October. The PMI has dropped to its post-9/11 level. Our calibration based on survey indicators shows a decline of 0.7% of GDP in the advanced economies (see Focus, "*Measuring international macroeconomic trends*", page 53 of *Conjoncture in* France, March 2008). An aggregation of our country-by-country forecasts indicates an even bigger decrease (–0.9% for the economies studied), due among other things to the inclusion of the very poor American employment figures. This decline in activity will continue in the first half of 2009, but should then be attenuated providing the gradual normalisation of the financial markets takes place and the expected stimulus plans come into effect.

Table 1

Industrialized countries: consolidated supply and use table

in real terms

	Quarterly changes, %										Annual changes, %		
	2007				2008				2009		2007	2008	2009 ovhg*
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	**0.5**	**0.7**	**0.8**	**0.2**	**0.4**	**0.1**	**-0.2**	**-0.9**	**-0.4**	**-0.2**	**2.3**	**0.9**	**-1.3**
Private consumption	0.5	0.6	0.5	0.2	0.3	0.0	-0.3	-0.6	-0.4	-0.2	2.1	0.4	-1.2
Public consumption	0.5	0.7	0.6	0.5	0.3	0.6	0.9	0.5	0.6	0.8	2.1	2.3	2.2
Investment	0.3	-0.1	0.3	-0.4	-0.3	-1.0	-1.1	-2.5	-2.2	-1.9	0.7	-2.4	-6.2
Exports	0.6	1.7	3.5	1.0	1.7	0.9	0.9	-2.2	-1.6	-1.1	6.6	5.0	-3.6
Imports	1.3	0.0	1.3	-0.3	0.6	-1.4	0.7	-2.7	-1.9	-1.2	2.8	-0.5	-4.9
Contributions to GDP growth													
Domestic demand excluding inventories	0.5	0.5	0.5	0.2	0.2	-0.1	-0.2	-0.7	-0.5	-0.3	2.0	0.3	-1.4
Inventories	0.1	0.0	0.2	-0.2	0.0	-0.2	0.1	-0.3	0.0	0.0	-0.1	-0.2	-0.2
Net exports	-0.2	0.3	0.2	0.2	0.2	0.4	-0.1	0.1	0.1	0.0	0.5	0.8	0.3

Forecasts — *ovhg: overhang

Sources: national statistical institutes; IMF; INSEE estimates

In the major emerging countries, the slowdown will worsen. Indeed, their leading business indicators have fallen sharply since September. For example, in Brazil, the falling confidence indicators point to a sharp decline in growth. Russian industrial production will continue to drop. China is suffering from sluggish world demand, as shown by its October slowdown in industrial production, which has fallen to growth levels equivalent to those after the 1997 crisis. Similarly, the economies of South-East Asia will steadily decline owing to the stagnation in demand from their trading partners and the tightening of conditions for access to international financing.

Overall, world growth will drop substantially by mid-2009. This worldwide downturn will go hand-in-hand with a decrease in trade. World demand for French products will diminish.

The financial markets still tense

The collapse of Lehman Brothers in September brought tension on the financial markets (see "Financial markets" note). Since then, the spread between the three-month monetary rate and the American base rate has remained well above its long-term average. Similarly, the spread between the bond rates of the highest-rated companies and those of government securities is high in both the USA and Europe, demonstrating the great difficulty businesses are facing in financing themselves, as well as the continuing trend of the flight to quality.

State intervention has marked a turning-point in the financial crisis. In the United States, the Paulson Plan provides a budget of $700 billion, which was initially earmarked to buy back the "toxic" assets of banks. The problems encountered in implementing

Table 2

Main industrialized countries: GDP

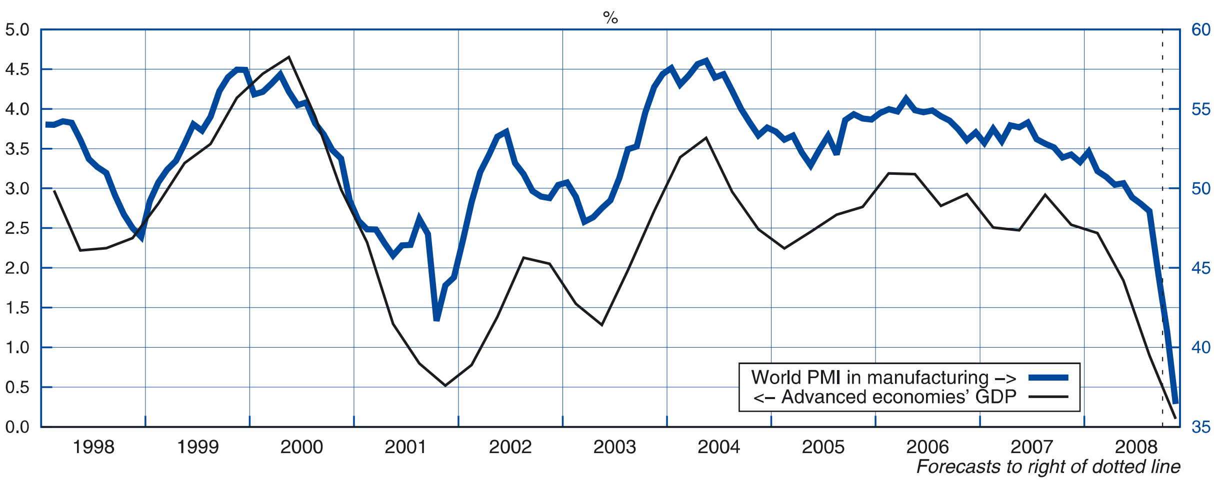
in real terms

	Quarterly changes. %										Annual changes. %		
	2007				2008				2009		2007	2008	2009 ovhg*
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
Total	**0.5**	**0.7**	**0.8**	**0.2**	**0.4**	**0.1**	**-0.2**	**-0.9**	**-0.4**	**-0.2**	**2.3**	**0.9**	**-1.3**
United States	0.0	1.2	1.2	0.0	0.2	0.7	-0.1	-1.0	-0.5	-0.3	2.0	1.3	-1.4
Japan	1.2	-0.2	0.5	0.5	0.6	-1.0	-0.5	-0.8	-0.4	-0.1	2.4	0.0	-1.5
United Kingdom	0.9	0.8	0.8	0.5	0.3	0.0	-0.5	-0.8	-0.4	-0.2	3.0	0.8	-1.4
Euro zone. of which:	0.7	0.5	0.6	0.3	0.7	-0.2	-0.2	-0.7	-0.4	-0.2	2.6	0.9	-1.2
Germany	0.4	0.4	0.6	0.3	1.4	-0.4	-0.5	-0.6	-0.4	-0.2	2.6	1.3	-1.4
Italy	0.3	0.1	0.2	-0.4	0.5	-0.4	-0.5	-0.7	-0.4	-0.2	1.4	-0.5	-1.4

Forecasts — *ovhg: overhang

Sources: national statistical institutes; IMF; INSEE estimates

1 - GDP growth and PMI (Purchasing Managers' Index) in manufacturing



Sources: DataInsight, INSEE estimates

this plan, particularly the difficulty in valuing these assets which no longer have a market price, have led to these funds being redirected: they are now destined to re-capitalise the American banking system, support consumer access to loans, and reduce real-estate foreclosures. In the Euro Zone, the public authorities have committed to ensuring that no major financial institution will go bankrupt, whilst seeking to encourage banks to lend more. In the United Kingdom, several banks have been nationalised.

The American Federal Reserve (FED), which brought its base rate down to 1%, might lower it to 0.5% or even less in order to support domestic demand (see Chart 2; see also the report "*How to anticipate the decisions of the ECB and the FED*", French ed. only). The European Central Bank (ECB) and the Bank of England are also looking to relax monetary policy while inflationist tensions are being eased.

However, despite the action of States and the relaxing of monetary policies, the conditions for financing the world economy remain extremely tight, both with banks and on the financial markets. Additionally, several emerging economies are experiencing large-scale capital outflows while their currencies are placed under great pressure. They are all the more affected by the crisis in that their financial systems are heavily reliant on Western marketplaces.

Towards a clear downturn in inflation

Inflation should level off at the end of 2008 and start of 2009.

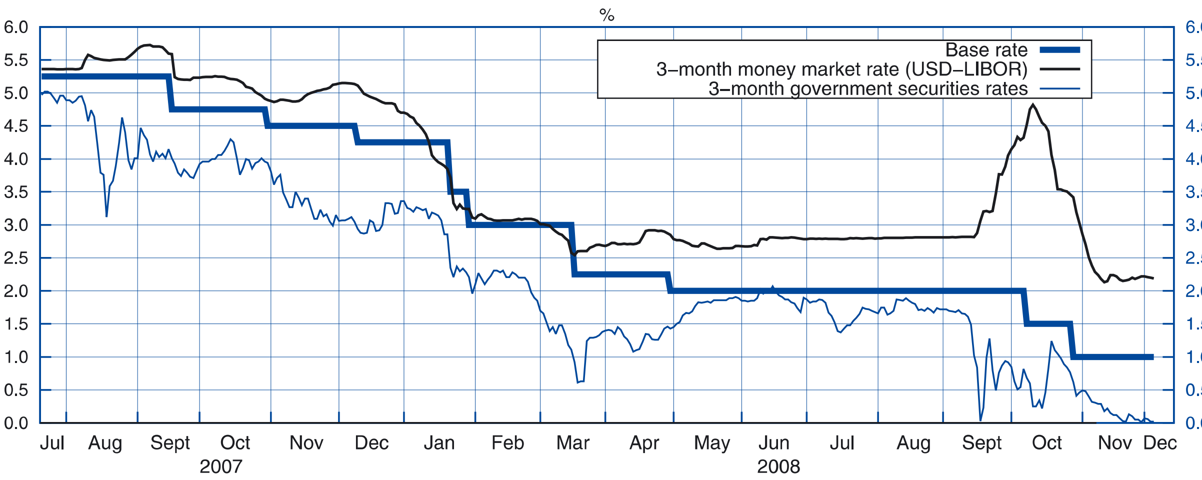
Energy and food inflation will fall back in Q4 this year and will then remain low, in the perspective of a stabilisation of oil prices at around $50 a barrel. Indeed, the prices of agricultural and energy commodities have fallen sharply since mid-July (see Chart 3). The Brent barrel price has dropped by almost 65% in four months. The prospect of a long-lasting slowdown in the world economy has also weighed heavily on the prices of industrial and mineral commodities.

Additionally, underlying inflation will fall back in the first half of 2009, under the combined effects of the slowdown in activity and the fall in commodity prices.

Principal unknowns: the effect of public policies

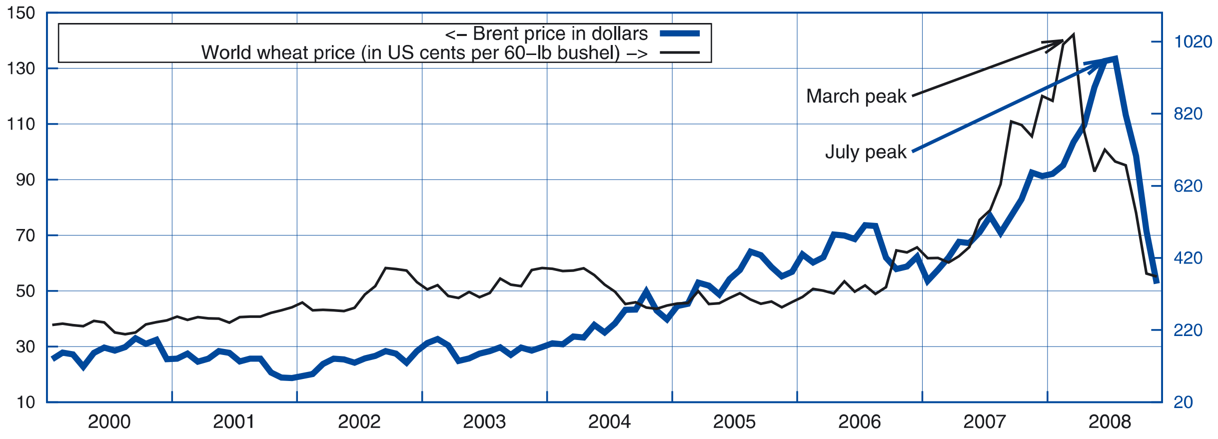
The outcome of public policies implemented to stimulate the world economy is the main unknown surrounding our international scenario. Further progress in restoring the good working of the financial and credit markets, or the rapid implementation of stimulus plans, could restore world growth faster than anticipated. However, if the public authorities do not manage to stabilise the financial markets, or if the stimulus plans are too slow in coming or are not targeted properly, the current crisis could get even worse. ■

2 - United States: short-term interest rate yields



Sources: DataInsight

3 - Commodity prices



Sources: DataInsight, INSEE estimates

United States and United Kingdom

Between mid-2008 and mid-2009 the American economy will experience four quarters of slowdown. A deteriorating employment situation, reduced income levels and the drop in household wealth will take their toll on demand (investment in housing and consumption). In addition, exports will go down because of the drop in world demand and the recent appreciation of the dollar against the European currencies.

In the United Kingdom, activity will fall sharply in Q4. Credit conditions are worsening, housing construction is still in freefall, and household consumption will be undermined by the decrease in household wealth. Nevertheless, this decline will be stemmed slightly around Q2 2009, under the effect of the plan adopted this autumn.

American activity suffering a slowdown

The American economy will suffer a downturn in the coming three quarters. On the one hand consumption and housing investment will continue to slide until mid-2009. The worsening labour market will bring about a drop in household income. 1.2 million jobs have already been lost between August and November and more losses are still to come. The real disposable income of households will diminish accordingly (0.3% per quarter), despite the drop in inflation. Wealth will also be eroded by the deterioration of the property and stock markets, a phenomenon which has intensified since the summer: combined with the credit crunch, this wealth erosion has led households to increase their savings *(see Chart 1)* and limits their ability to secure remortgage loans .

On the other hand, exports should fall sharply owing to the slowdown in world demand and the recent appreciation of the dollar against the euro, which is taking its toll on the competitiveness of American businesses. Last, faced with the drop in trade outlets and tougher financing conditions, companies will reduce their stock levels and postpone investments.

However, the drop in demand from households and businesses may gradually be stemmed providing public action leads to a certain normalisation of the financial and credit markets and restores confidence among households and business leaders.

Table 1

United States: supply and use table

%

	Quarterly changes, %										Annual changes, %		
	2007				2008				2009		2007	2008	2009 ovhg*
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	**0.0**	**1.2**	**1.2**	**0.0**	**0.2**	**0.7**	**-0.1**	**-1.0**	**-0.5**	**-0.3**	**2.0**	**1.3**	**-1.4**
Household consumption (70%)	1.0	0.5	0.5	0.2	0.2	0.3	-0.8	-1.0	-0.7	-0.3	2.8	0.3	-2.1
Investment (16%)	-0.9	0.7	-0.2	-1.6	-1.4	-0.4	-1.4	-2.7	-2.9	-3.0	-3.1	-4.2	-7.8
Non-residential (10%)	0.8	2.5	2.1	0.8	0.6	0.6	-0.2	-2.0	-2.5	-3.0	4.9	2.7	-6.2
Residential (6%)	-4.3	-3.0	-5.6	-7.6	-6.9	-3.5	-5.2	-5.0	-4.0	-3.0	-17.9	-20.7	-12.8
Exports (10%)	0.2	2.1	5.3	1.1	1.2	2.9	1.4	-2.0	-1.5	-1.0	8.4	7.5	-2.6
Imports (16%)	1.9	-0.9	0.7	-0.6	-0.2	-1.9	-0.5	-3.5	-2.5	-1.5	2.2	-3.1	-7.0
Contributions to GDP growth													
Domestic demand excl. inventories	*0.6*	*0.6*	*0.5*	*0.0*	*0.0*	*0.3*	*-0.5*	*-1.0*	*-0.8*	*-0.4*	*1.9*	*0.1*	*-2.1*
Inventories	*-0.3*	*0.1*	*0.2*	*-0.2*	*0.0*	*-0.4*	*0.1*	*-0.4*	*0.0*	*0.0*	*-0.4*	*-0.3*	*-0.2*
Net exports	*-0.3*	*0.4*	*0.5*	*0.2*	*0.2*	*0.7*	*0.3*	*0.4*	*0.3*	*0.1*	*0.6*	*1.5*	*1.0*

Forecasts — *ovhg: overhang
(%): share of nominal GDP in 2005
Sources: BEA, INSEE estimates

Overall, GDP will fall in the coming three quarters (-1.0% in Q4 and -0.5% and -0.3% in Q1 and Q2 2009). There are two unknowns surrounding this forecast: the policies implemented to cope with the crisis, and the development of the American trade balance. Indeed, activity could get back on track earlier and more effectively than anticipated if financial tensions are eased or vigorous fiscal stimulation is implemented. Conversely, the expected support for foreign trade may not materialise if the dollar appreciates further against the euro, or if worldwide activity declines more sharply than forecast.

In the United Kingdom, activity is also slowing

Activity in the United Kingdom will slacken until mid-2009: household demand will decrease and the economy will still be suffering from the effects of the credit crunch.

Corporate investment in the UK will be heavily penalised by poor business prospects and by the much stricter financing conditions resulting from the financial crisis. Investments will fall over the next three quarters, but this fall will gradually be softened (-3.6% in Q4 2008, then -2.8% and -1.5% in Q1 and Q2 2009).

In parallel, the decrease in real-estate investment has been exacerbated in the second half of 2008 under the effect of the property and financial crises (see *Chart 2*). Early signs of improvement will appear in Q2 2009, suggests the RICS[(1)] survey on first-time buyers, but this decrease will still continue at a sustained rate.

Employment will fall further and wage levels will slow down over the coming quarters. As a result, the disposable income of households will continue to slow in the wake of Q3 2008, and will even fall slightly in Q2 2009.

However, lower prices will sustain household purchasing power at the end of 2008 and beginning of 2009. Energy prices will fall sharply in Q4, contributing to a drop in inflation. The 2.5% cut in the VAT rate, applied since 1st December, will also contribute to this, although only part of this cut will be transferred to prices. The overall consumer price should just about progress in Q4 (+0.2%), fall sharply in Q1 2009 (-0.5%) and then stabilise in Q2.

In this way, household purchasing power will increase slightly within our forecasting period after the downturn in Q3 2008 (-0.3%). But the savings ratio of households, which had fallen considerably in recent years, will be on the rise: the drop in household wealth owing to the property and financial crises will cause households to save more, as will the widespread uncertainly surrounding growth and employment prospects. Consequently, household consumption will decline over the period as a whole (-0.5% in Q4 2008, and –0.2% in each of the following two quarters).

(1) Royal Institute of Chartered Surveyors.

Table 2

United Kingdom: supply and use table

%

	Quarterly changes, %										Annual changes, %		
	2007				2008				2009		2007	2008	2009 ovhg*
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GDP	**0.9**	**0.8**	**0.8**	**0.5**	**0.3**	**0.0**	**-0.5**	**-0.8**	**-0.4**	**-0.2**	**3.0**	**0.8**	**-1.4**
Household consumption (61%)	0.9	0.9	1.1	0.6	0.8	-0.1	-0.2	-0.5	-0.2	-0.2	3.0	1.8	-0.8
Investment[1] (18%)	1.5	-0.4	1.0	1.8	-2.0	-2.8	-2.4	-4.1	-2.8	-1.4	7.1	-4.5	-8.6
Non-residential (11%)	1.1	0.9	1.5	2.7	-1.9	-1.0	-0.2	-3.6	-2.8	-1.5	9.8	-0.7	-6.8
Residential (5%)	2.9	1.1	-3.5	-2.8	-4.8	-4.2	-11.0	-6.5	-4.0	-2.0	3.3	-17.3	-16.4
Exports (26%)	0.4	0.9	1.9	-0.7	0.7	0.0	-0.3	-1.7	-1.3	-0.8	-4.5	0.8	-3.3
Imports (30%)	0.9	-0.3	4.4	-0.4	-0.3	-0.5	0.1	-2.2	-1.5	-0.8	-1.9	0.5	-3.8
Contributions to GDP growth													
Domestic demand excl. inventories	*0.9*	*0.6*	*1.0*	*0.8*	*0.4*	*-0.4*	*-0.3*	*-0.9*	*-0.5*	*-0.2*	*3.5*	*1.0*	*-1.6*
Inventories	*0.1*	*-0.2*	*0.6*	*-0.2*	*-0.4*	*0.3*	*-0.1*	*-0.1*	*0.0*	*0.0*	*0.2*	*-0.3*	*-0.1*
Net exports	*-0.2*	*0.4*	*-0.8*	*-0.1*	*0.3*	*0.1*	*-0.1*	*0.2*	*0.1*	*0.0*	*-0.6*	*0.1*	*0.3*

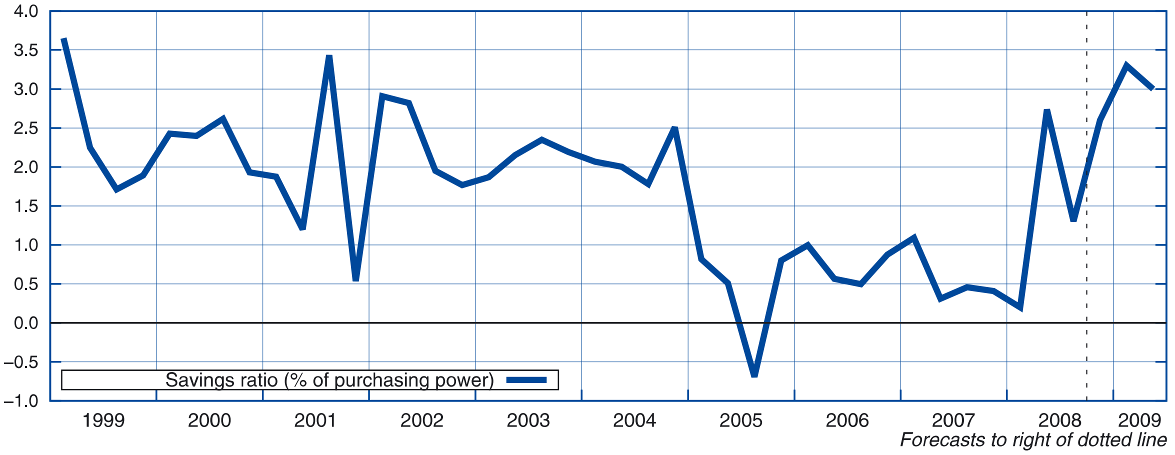
Forecasts — *ovhg: overhang
(%): share of nominal GDP in 2007
1. Total also includes public-sector investment, not separated here
Sources: BEA; INSEE estimates

Exports will slow under the effect of a slack international trading environment. Imports will drop sharply in Q4 and then less markedly, in line with domestic demand. So, after having been negative in Q3, the contribution of foreign trade will once again be positive in Q4; but this will then be cancelled out by a new fall.

Overall, British GDP will decline considerably in Q4 (-0.8%) due to less investment by businesses and less demand by households. In the first half of 2009, activity will continue to fall, although more slowly. The growth overhang will be clearly negative (-1.4%) by mid-2009.

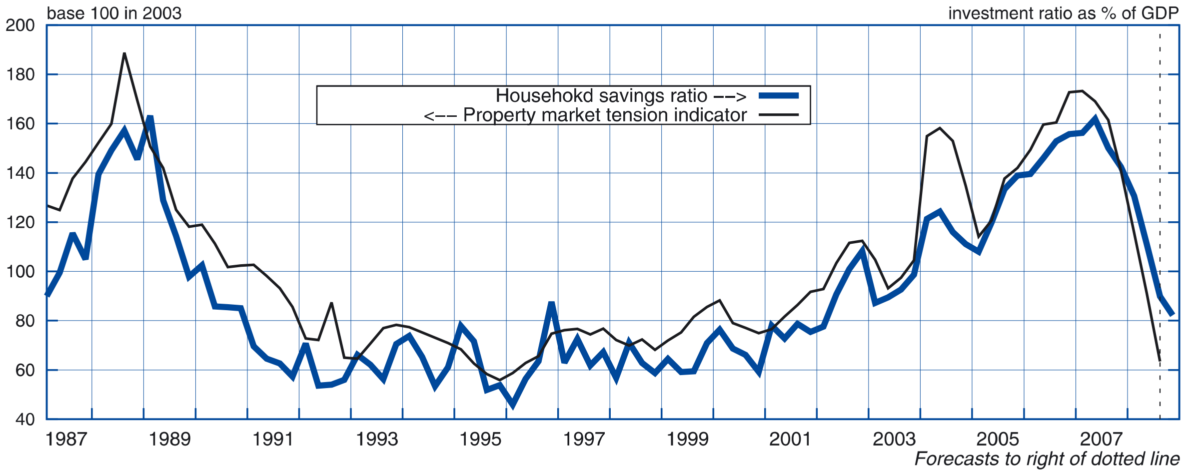
The scale of the drop in investment faced with the financial crisis is one of the major unknowns in this forecast. Another one is the impact of the VAT cut. It is difficult to accurately predict how much of this cut will actually be transferred to consumer prices and how households will divide this extra purchasing power between consumption and savings. On this latter point, the fall in demand should lead to big price cuts in order to attract customers; but the financial difficulties of businesses may encourage them to hold on to a significant share of that VAT cut. ■

1 - United States household savings ratio



Sources: DataInsight, INSEE estimates

2 - United Kingdom household investment ratio



Sources: DataInsight, INSEE estimates

Japan, China, and emerging Asia

In Japan, activity dropped again in Q3 2008 after a sharp fall in Q2. This can mainly be attributed to the downturn in foreign trade and in corporate investment. GDP should continue to fall throughout the first half of 2009: the decline in world growth combined with the appreciation of the yen will handicap Japanese exports, while corporate investment will continue to drop.

In both South-East Asia and China, activity will slow under the effect of the downturn in foreign trade and corporate investment.

Economic decline in Japan

In Q3 2008, Japanese GDP slowed for the second consecutive quarter. In reaction to this downturn, the central bank brought down its interest rate by 20 basis points on 31 October. In parallel, the Japanese government has been looking into the possibility of implementing a plan to bolster the economy, worth 27,000 billion yen (4.8% of GDP, three quarters of which is not expenditure strictly speaking, but guarantees) in order to halt the decline in domestic demand, in particular non-housing investment. However, these measures have still not been adopted. They are therefore unlikely to do much to boost the economy by mid-2009: the next three quarters will see a further downturn in activity.

Corporate investment will suffer from poor business prospects and tightening financing conditions. As the sharp fall in orders for machines in the second half of 2008 suggests, capital goods expenditure will continue to drop in the first half of 2009.

Japanese exports rebounded slightly in Q3 2008 after a substantial drop in Q2 (see Chart 1). This rebound was essentially due to an upswing in demand from the European Union and South-East Asia. It was short-lived, however: exports fell again sharply in Q4 2008, owing to the world economic slowdown and the appreciation of the yen against the euro and the dollar since July (see Chart 1). This

Japan: supply and use table

in real terms

	Quarterly changes, %										Annual changes,%		
	2007				**2008**				2009		**2007**	**2008**	**2009 ovhg***
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**			
GDP	**1.2**	**-0.2**	**0.5**	**0.5**	**0.6**	**-1.0**	**-0.5**	**-0.8**	**-0.4**	**-0.1**	**2.4**	**0.0**	**-1.5**
Household consumption (57%)	-0.2	0.5	0.0	0.0	0.9	-0.7	0.3	0.0	0.2	0.2	0.7	0.7	0.4
Investment (23%)	2.3	-3.3	0.1	-1.2	-0.1	-2.0	-0.8	-1.8	-1.3	-0.3	0.9	-4.1	-3.7
Non-residential (15%)	4.0	-3.8	2.4	0.2	0.3	-2.1	-2.0	-3.0	-2.0	-0.5	5.5	-2.6	-6.1
Residential (4%)	-1.2	-3.4	-8.4	-10.1	4.7	-2.6	3.9	2.5	0.5	0.5	-9.1	-8.1	4.0
Public consumption (18%)	0.4	1.5	-0.5	2.0	-0.4	-0.9	-0.3	0.1	0.1	0.1	2.0	0.4	-0.1
Exports (14%)	2.7	1.9	2.6	2.6	3.4	-2.6	0.8	-4.0	-3.0	-2.0	8.4	4.6	-7.6
Imports (13%)	0.4	1.2	-0.4	0.9	1.0	-3.0	2.3	-2.0	-1.5	-1.0	1.5	0.1	-3.4
Contributions to GDP growth													
Domestic demand excluding inventories	*0.5*	*-0.3*	*0.0*	*0.1*	*0.4*	*-1.0*	*-0.1*	*-0.4*	*-0.1*	*0.1*	*0.9*	*-0.5*	*-0.7*
Inventories	*0.3*	*-0.1*	*0.0*	*0.1*	*-0.3*	*0.0*	*-0.2*	*0.0*	*0.0*	*0.0*	*0.3*	*-0.3*	*0.0*
Net exports	*0.4*	*0.1*	*0.5*	*0.3*	*0.5*	*0.0*	*-0.3*	*-0.4*	*-0.3*	*-0.2*	*1.1*	*0.8*	*-0.8*

Forecasts — *ovhg: overhang
(%): share of nominal GDP in 2005
Sources: Cabinet Office; INSEE estimates

drop will continue in the first half of 2009, although becoming gradually less marked. Imports will decline throughout the first half of 2009 at the same time as domestic demand.

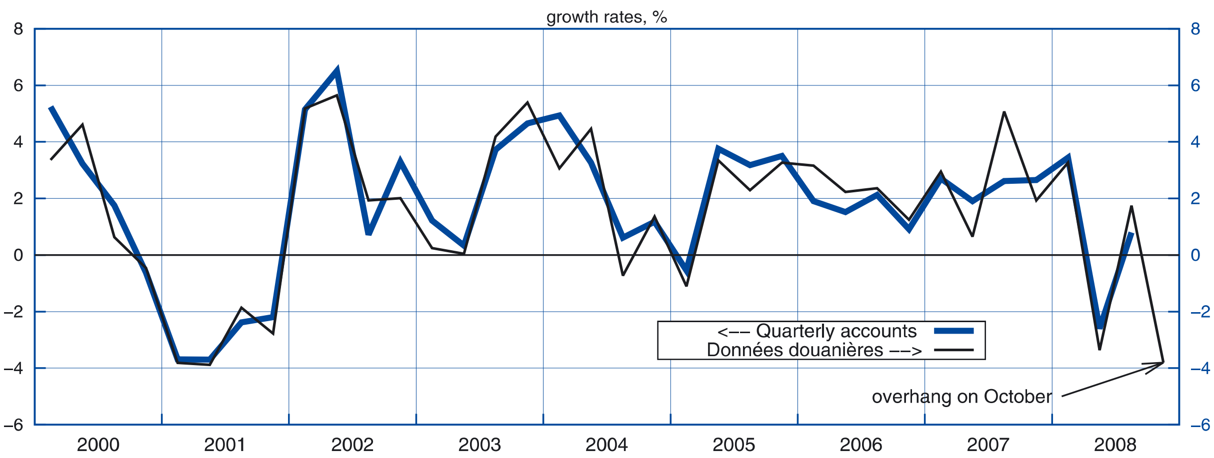
The Japanese economy cannot rely on household consumption for support since its main determinants are still poorly oriented. Employment and nominal wages once again suffered a slowdown in Q3 2008. This moderation of wage levels will extend into next year as the tensions on the labour market lessen. Conversely, a fall in inflation will sustain household purchasing power somewhat over the coming quarters. Indeed, the rise in inflation in Q3 did not last long: the increase in food and energy prices which caused it in the first place gave way to a drop in oil prices and the appreciation of the yen against the dollar and the euro since last July, causing inflation to fall again.

However, household confidence once again deteriorated in Q3 2008: in particular, durables purchasing intentions dropped off (see Chart 2) and demand for consumer loans from credit institutions slowed. Overall, consumption expenditure by Japanese households will not grow much over the coming quarters.

Growth in China set to moderate

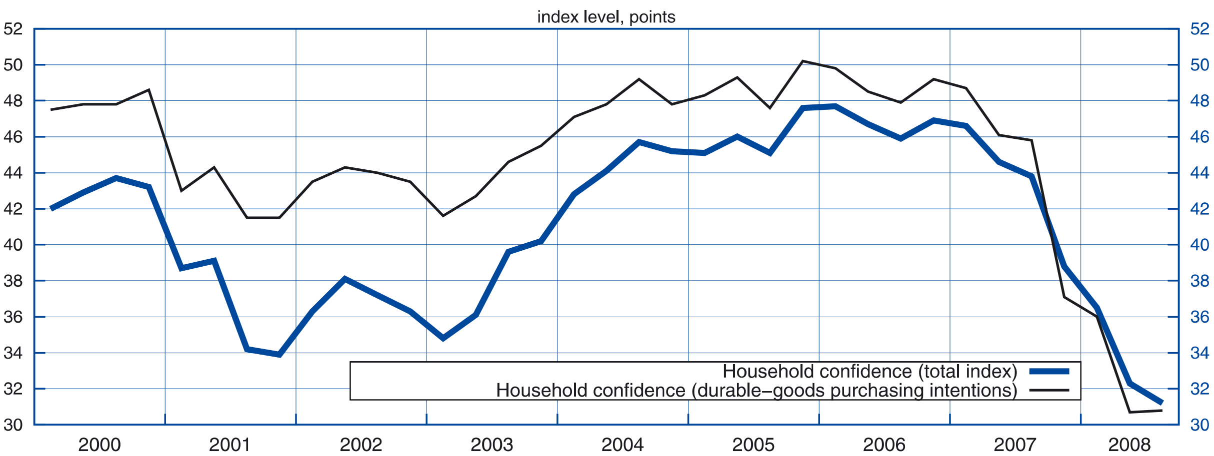
Chinese growth once again crumbled in Q3 2008: year-on-year GDP stood at +9.0% against +10.3% on average for the first half of 2008. The slowdown has been particularly marked in industry: in October, the industrial production index rose by 8.2% over one year, against an average of +15% for the first nine months of the

1 - Japanese exports



Sources: Economic and Social Research Institute (Japan), Bank of Japan

2 - Japanese household confidence



Sources: Economic and Social Research Institute (Japan) year. This drop in activity will continue throughout the forecasting period under the effect of sluggish foreign demand and corporate investment.

Chinese exports fell slightly over the last few months: +19% in October, year-on-year, against more than 22% on average over the first nine months of the year. The Chinese trade surplus nonetheless continued to grow, as imports in value slowed with the drop in the prices of commodities. By mid-2009, exports will have continued to fall owing to the poor economic situation of its main trading partners.

Corporate investment remained robust in Q3, despite the erosion of economic activity: capital goods expenditure grew by more than 27% year-on-year, against an average of +25% in the first half of 2008. But this performance is unlikely to continue given the recent drop in business confidence. The drop in exports will cause businesses to moderate their investment expenditure over the coming quarters.

Faced with the slowdown, the Chinese Central Bank lowered its interest rate on three occasions between September and November, bringing it down to 5.58%. At the same time, the required reserve ratio was lowered from 17.5% to 15.0%. This relaxing of monetary policy will continue in the coming quarters, particularly as inflationist tensions have started to ease: inflation fell considerably between April and November 2008, mainly due to the decrease in food prices (see Chart 3). This fallback will extend through the coming quarters. The Chinese authorities have also announced the implementation of a budgetary plan to revive the economy, the effects of which are likely to be moderate between now and mid-2009.

Overall, Chinese growth will gradually be eroded over the coming quarters: year-on-year, GDP growth will have fallen to under +8.0% in Q2 2009.

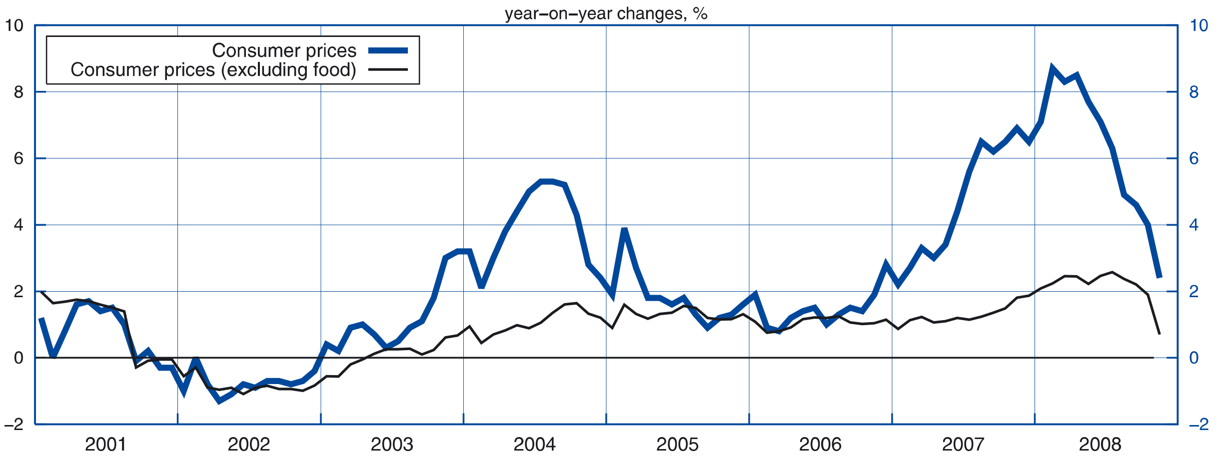
Lower investment levels in South-East Asia

In South-East Asia, growth receded slightly in Q3, mainly due to the slowdown in domestic demand, and in particular corporate investment.

Activity is likely to continue slowing at the end of 2008 and the start of 2009. The downturn in world growth will penalise exports from Asian countries, leading companies to moderate their investment expenditure.

Inflation continued to rise in Q3 2008, due to the higher commodity prices, particularly for foodstuffs. However, the simultaneous drop in the price of oil and rice in recent months would seem to indicate that consumer prices reached a high point in July (+8.5% year-on-year, against +7.2% in September). Inflation should therefore gradually drop in South-East Asia for the first half of 2009. This should allow central banks in the zone to bring in new interest rate cuts in the coming quarters, in order to boost economic growth. ■

3 - Chinese inflation



How to read the Chart: The weight of the food component, which was not given by the Bank of China, has been estimated by regression. The result obtained conforms to other available estimates. The index not including food has been calculated like a Tornqvist index.
Sources: Chinese National Bureau of Statistics, INSEE estimates

Euro zone

Activity in the Euro Zone fell back once again in Q4 2008 (–0.2%). Investment and foreign trade were behind this new drop.

GDP should slacken even further in Q4 (-0.7%): private consumption should be penalised by the 2008 slowdown in purchasing power, despite the drop in inflation at the end of the year; and investment should fall back once again owing to the poor prospects in terms of demand and increased financing difficulties.

In the first half of 2009, activity should continue to fall (-0.4% in Q1, then -0.2% in Q2). However, public action to restore the banking and financial markets to good working order, and the confidence of economic agents, may lead to a gradual improvement in activity.

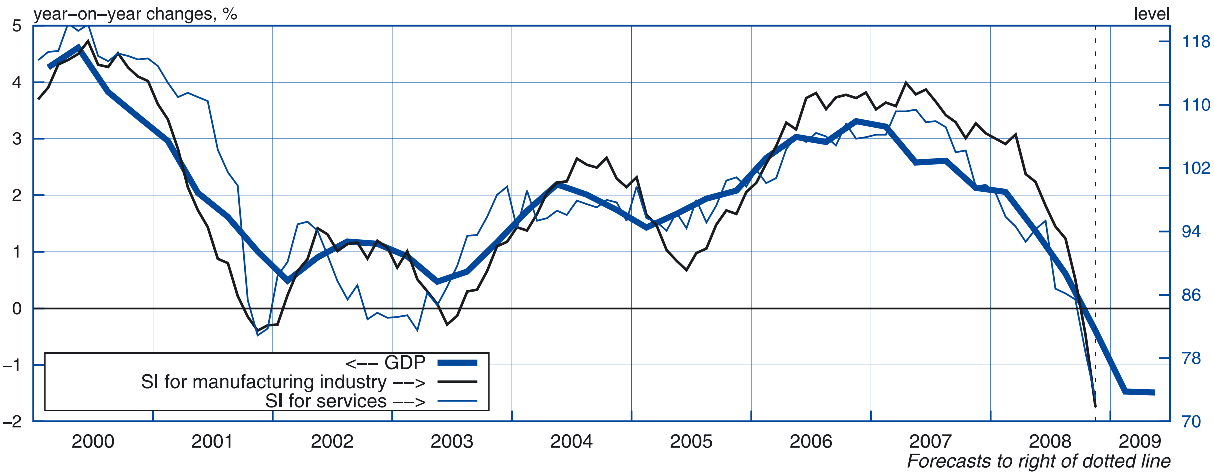
Activity should continue to shrink in the Euro Zone

In Q3 2008, activity in the Euro Zone fell back once again (-0.2%, as in the previous quarter). Industrial production in the Euro Zone continued to drop (-0.9%, after –0.7% in Q2) and production in the construction industry also decreased (-0.8% in Q3). Germany and Italy went through a second consecutive slowdown, while Spanish GDP declined after growth that was only just positive in the previous quarter.

Economic outlook surveys have been almost continually gloomy since the second quarter of 2007. They showed a new low point in November (see Chart 1). The main Euro Zone countries – Germany, Spain, France and Italy – are all concerned, as are all business sectors. Industrial production prospects, below their long-term level since August, fell once again in November. In the services sector, the deterioration of the confidence index points to a lower contribution to growth from this sector.

As a result, activity in the Euro Zone should continue to drop in Q4 2008 (-0.7%). Over the year as a whole, average GDP growth should be +0.9%, after +2.6% in 2007 (see Table 1). Business activity in the Euro Zone as a whole, and in each of its main countries, should continue to fall back in the first half of 2009. But it should do so less markedly as time goes on (-0.4% in Q1 2009 and –0.2% in Q2), under the effect of public action to bring the financial and credit markets back to normal and to restore the confidence of households and businesses. At the end of the first half of the year, the growth overhang for 2009 should be clearly negative (-1.2%).

1 - Euro zone: GDP and "synthetic" indicators (SIs) from surveys



Sources: European Commission; Eurostat; INSEE estimates

Household consumption penalised by lower purchasing power despite lower prices

The drop in activity should gradually start to weigh on employment, which should continue to slow at the end of 2008 and then drop in early 2009 (-0.1% per quarter). In 2008, it should progress by 1.3% after 2.0% in 2007 (see Table 2). This downturn on the labour market should be shared across all the main Euro Zone countries (see Chart 2). The Spanish labour market suffered a reversal in Q2 2007, with unemployment figures going up by more than three points (from 8.2% in Q1 2007 to 11.5% in Q3 2008), a rise that was mainly attributable to the effects of the property crisis on the construction sector. In Italy, salaried employment should only progress by +0.9% in 2008, a marked slowdown compared with 2007 (+1.6%). Last, although the German economy continued to create jobs in Q3 2008 (+0.3% for salaried employment), the labour market should suffer from the persistent downturn in activity between now and June 2009.

The worsening employment situation is likely to weigh on actual wages. Furthermore, inflation in the Euro Zone has fallen back after a peak in late 2007 and Q1 2008. The nominal wage per head therefore slowed down in Q3 and Q4 2008 and should do so more markedly in the first half of 2009.

Despite the support provided by lower inflation, household purchasing power should level off, owing to the worsening labour market situation and the drop in actual wages. Purchasing power would stagnate in the second half of 2008 and should diminish in early 2009 (-0.1% in Q1, then –0.2% in Q2).

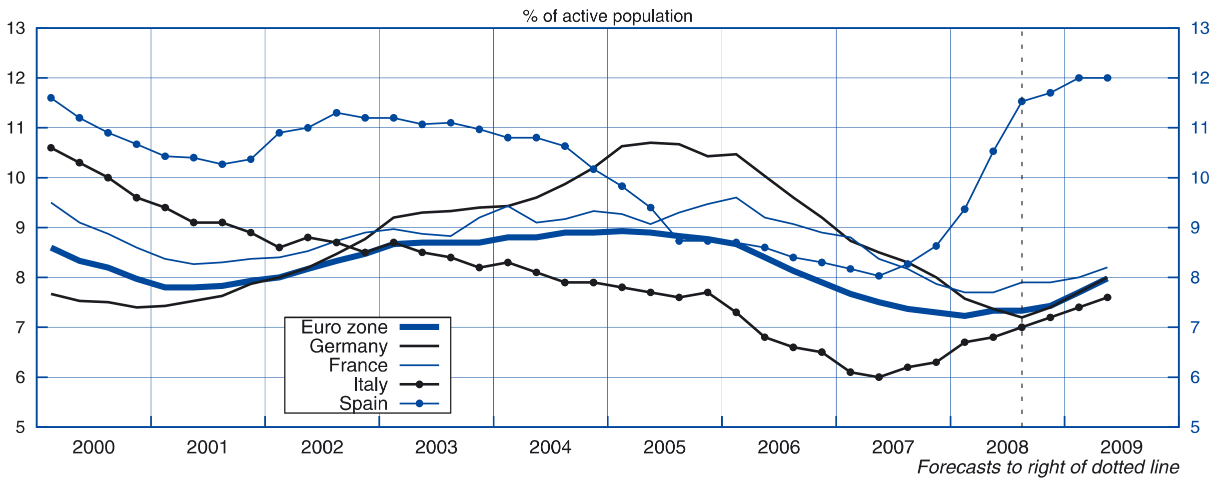
Consequently, household consumption should fall until the first quarter of 2009 (-0.3% per quarter), after a static Q3 (+0.0%). In the current context of heightened economic uncertainty, consumers are clearly postponing some expenditure items, as shown by the drop in vehicle registrations and in the consumption of durables. An improvement may come about in Q2 2009 (-0.1%), further to the action by public authorities to restore confidence.

The slowdown in activity and the tougher financing conditions should affect investment

Investment has decelerated sharply following the slowdown in demand. Industrial production prospects continued to deteriorate in Q3, as did the sectoral confidence indices. Additionally, production capacity tensions eased substantially (see Chart 3).

The sharp deterioration in financing conditions since October (see *"Financial Markets"* note, French ed. only) should also affect investment, which is likely to fall back sharply in Q4 2008 (-2.3%). This drop should become less marked in the first half of 2009 (-1.7% in Q1 and -1.1 % in Q2), providing the action of the public authorities leads to a gradual return to normal of the financial and banking situation.

2 - Harmonized unemployment rates in euro zone



Source: Eurostat

The reversal on the property markets in a number of Euro Zone countries (Spain, Ireland, Finland, France) should continue to take its toll on investment in construction. In Q2 2008, this investment fell by 1.6%, after a rebound in Q1 which had been largely attributable to the unusual situation in Germany[(1)]. Investment in construction is likely to continue to drop sharply over the next four quarters, according to the trends concerning building permits issued in the Euro Zone.

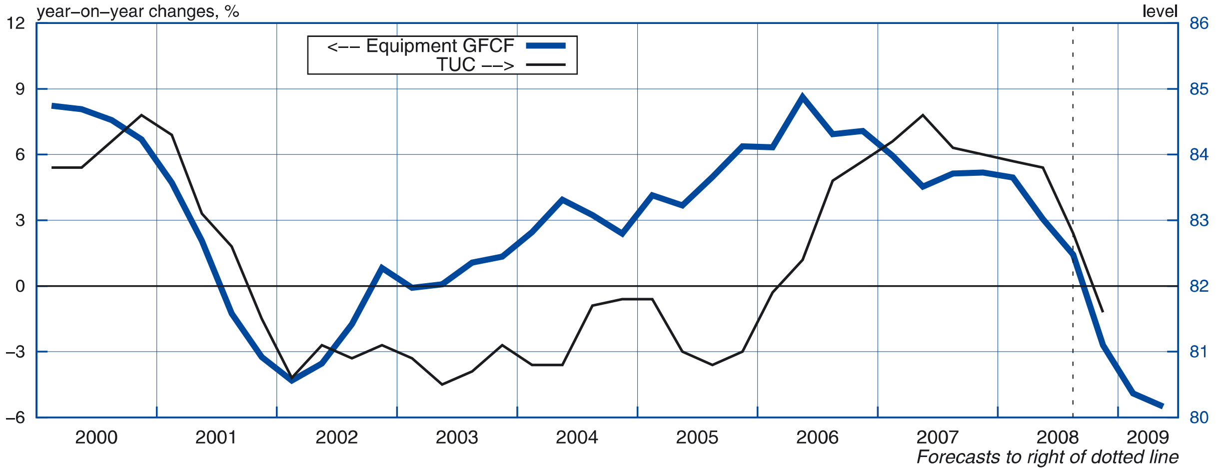
(1) The mild winter brought an unexpected upswing in building activity in Germany in Q1 2008.

Exports in decline due to the slowdown of the world economy

European exports should suffer from the downturn in world demand more than they should benefit from the recent appreciation of the dollar against the euro. Exports should thus fall throughout the forecasting period, although this should gradually become less marked: -1.9% in Q4 2008, then -1.3% in Q1 2009 and -1.0% in Q2 (see Chart 4).

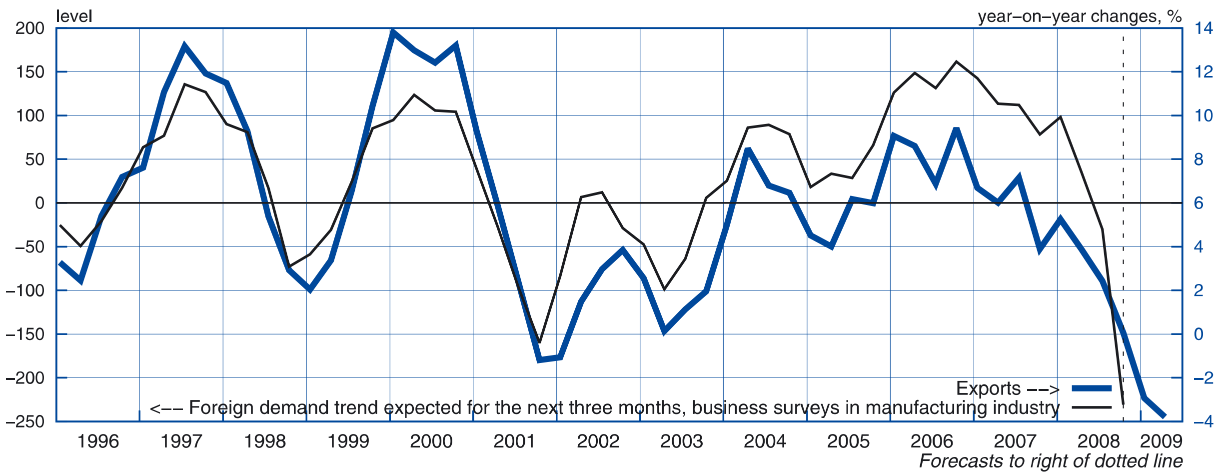
The drop in imports reflects that in domestic and foreign demand. Their downturn in Q4 2008 (-2.0%) should continue in early 2009 (-1.3% in Q1 and -1.0% in Q2). ■

3 - Euro zone: equipment investment and capacity utilization rate



GFCF: gross fixed capital formation
Sources: European Commission; Eurostat

4 - Euro zone: exports and expected foreign demand trend



Sources: European Commission; INSEE estimates

Table 1

Euro zone and main countries: GDP and its components

%

	Quarterly changes										Annual averages		
	2007				2008				2009		2007	2008	2009 ovgh*
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
GERMANY (28%)[1]													
GDP	**0.4**	**0.4**	**0.6**	**0.3**	**1.4**	**-0.4**	**-0.5**	**-0.6**	**-0.4**	**-0.2**	**2.6**	**1.3**	**-1.4**
Household consumption	-2.1	0.7	0.3	-0.2	-0.3	-0.6	0.3	-0.4	-0.2	-0.2	-0.3	-0.5	-0.7
Total GFCF[2]	0.4	-0.8	1.1	2.0	3.4	-1.4	0.1	-2.3	-1.6	-1.0	4.6	3.6	-4.3
Public consumption	1.5	0.0	0.4	0.1	1.1	0.9	0.8	0.4	0.4	0.4	2.2	2.5	1.6
Exports	-1.3	1.4	1.7	1.3	2.5	-0.2	-0.4	-1.5	-1.0	-0.6	7.7	3.9	-2.8
Imports	0.8	-0.5	2.7	-0.3	3.1	-1.4	3.8	-2.5	-1.1	-0.8	5.2	4.3	-0.4
Contributions to GDP growth													
Domestic demand excluding inventories	*-0.9*	*0.3*	*0.4*	*0.2*	*0.6*	*-0.4*	*0.3*	*-0.5*	*-0.3*	*-0.2*	*1.0*	*0.8*	*-0.9*
Inventories	*2.1*	*-0.8*	*0.4*	*-0.6*	*0.8*	*-0.4*	*0.9*	*-0.3*	*0.0*	*0.0*	*0.2*	*0.5*	*0.1*
Net exports	*-0.8*	*0.8*	*-0.3*	*0.7*	*-0.1*	*0.5*	*-1.7*	*0.3*	*0.0*	*0.0*	*1.4*	*0.1*	*-0.5*
ITALY (19%)[1]													
GDP	**0.3**	**0.1**	**0.2**	**-0.4**	**0.5**	**-0.4**	**-0.5**	**-0.7**	**-0.4**	**-0.2**	**1.4**	**-0.4**	**-1.4**
Household consumption	1.0	0.3	0.2	-0.4	0.0	-0.3	0.1	-0.4	-0.3	-0.2	1.5	-0.5	-0.8
Total GFCF	-0.3	-0.4	-0.1	0.5	-0.2	-0.3	-1.9	-2.0	-1.5	-0.7	0.8	-1.6	-4.5
Public consumption	0.4	-0.1	0.3	0.3	0.5	0.3	0.1	0.2	0.2	0.2	1.3	1.1	0.6
Exports	1.3	-1.5	2.7	-1.6	1.2	-1.1	-1.6	-2.0	-1.0	-0.6	4.5	-1.2	-4.0
Imports	1.1	-0.5	1.3	-1.2	-1.0	-0.8	-0.5	-1.6	-1.0	-0.6	4.0	-2.6	-3.1
Contributions to GDP growth													
Domestic demand excluding inventories	*0.6*	*0.1*	*0.1*	*-0.1*	*0.0*	*-0.2*	*-0.3*	*-0.6*	*-0.5*	*-0.2*	*1.3*	*-0.4*	*-1.3*
Inventories	*-0.4*	*0.4*	*-0.4*	*-0.2*	*-0.2*	*-0.2*	*0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*-0.5*	*0.1*
Net exports	*0.0*	*-0.3*	*0.4*	*-0.1*	*0.6*	*-0.1*	*-0.3*	*-0.1*	*0.0*	*0.0*	*0.1*	*0.4*	*-0.3*
SPAIN (12%)[1]													
GDP	**1.0**	**1.0**	**0.6**	**0.6**	**0.4**	**0.1**	**-0.2**	**-0.8**	**-0.6**	**-0.3**	**3.7**	**1.2**	**-1.5**
Household consumption	1.0	1.2	0.0	0.7	0.2	0.1	-1.0	-0.7	-0.7	-0.5	3.4	0.5	-2.0
Total GFCF	1.9	1.0	1.2	0.3	0.3	-1.9	-1.9	-2.7	-2.4	-1.8	5.3	-1.7	-7.0
Public consumption	1.4	0.8	1.1	1.0	0.7	2.1	2.1	2.1	2.1	2.1	4.9	5.4	7.0
Exports	-0.5	2.1	3.5	-1.0	-0.2	1.9	0.9	-1.8	-1.8	-1.0	4.9	2.7	-3.0
Imports	0.7	1.9	2.7	-0.5	-0.1	0.3	-0.8	-2.0	-1.8	-1.2	6.2	0.6	-4.5
Contributions to GDP growth													
Domestic demand excluding inventories	*1.4*	*1.1*	*0.6*	*0.7*	*0.3*	*-0.1*	*-0.8*	*-0.8*	*-0.8*	*-0.4*	*4.5*	*0.7*	*-2.1*
Inventories	*-0.1*	*0.0*	*0.0*	*0.0*	*0.0*	*-0.1*	*0.0*	*-0.1*	*0.0*	*0.0*	*-0.1*	*-0.1*	*-0.1*
Net exports	*-0.4*	*-0.1*	*0.0*	*-0.1*	*0.0*	*0.4*	*0.5*	*0.2*	*0.1*	*0.1*	*-0.8*	*0.5*	*0.7*
EURO ZONE (28%)[3]													
GDP	**0.7**	**0.5**	**0.6**	**0.3**	**0.7**	**-0.2**	**-0.2**	**-0.7**	**-0.4**	**-0.2**	**2.6**	**0.9**	**-1.2**
Household consumption	0.0	0.7	0.4	0.2	0.0	-0.2	0.0	-0.3	-0.3	-0.1	1.6	0.3	-0.6
Total GFCF	0.9	0.2	1.0	1.0	1.4	-0.9	-0.6	-2.3	-1.7	-1.1	4.2	1.2	-4.7
Public consumption	1.0	0.2	0.5	0.3	0.3	0.8	0.8	0.8	0.8	0.8	2.3	2.1	2.6
Exports	0.4	1.2	1.8	0.4	1.7	-0.1	0.4	-1.9	-1.3	-1.0	5.9	2.9	-3.3
Imports	1.1	0.8	2.2	-0.3	1.6	-0.4	1.7	-2.0	-1.3	-1.0	5.4	2.6	-2.8
Contributions to GDP growth													
Domestic demand excluding inventories	*0.4*	*0.5*	*0.6*	*0.4*	*0.4*	*-0.1*	*0.0*	*-0.5*	*-0.4*	*-0.1*	*2.3*	*0.8*	*-0.9*
Inventories	*0.6*	*-0.2*	*0.2*	*-0.3*	*0.2*	*-0.1*	*0.3*	*-0.2*	*0.0*	*0.0*	*0.0*	*0.0*	*-0.1*
Net exports	*-0.3*	*0.2*	*-0.1*	*0.3*	*0.1*	*0.1*	*-0.5*	*0.0*	*0.0*	*0.0*	*0.3*	*0.1*	*-0.2*

Forecast — *ovhg: overhang

1. Share of euro-zone GDP
2. Gross fixed capital formation
3. Share of industrialized countries' GDP

Source: Eurostat

Table 2

Euro zone: Household accounts

%

	Quarterly changes										Annual averages		
	2007				2008				2009		2007	2008	2009 ovgh*
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
Total wage bill	1.4	1.1	0.7	1.5	1.3	0.9	0.7	0.5	0.1	0.0	4.3	4.2	1.1
- Employment	0.6	0.5	0.5	0.5	0.3	0.2	0.2	0.1	-0.1	-0.1	2.0	1.3	0.0
- Wage per capita	0.9	0.5	0.2	1.0	1.0	0.7	0.5	0.4	0.2	0.1	2.4	3.0	1.0
Gross disposable income (GDI)	1.1	0.9	0.6	1.2	1.0	1.0	0.6	0.3	0.1	0.0	4.0	3.6	0.9
Saving ratio (% of GDI)	13.8	13.5	13.0	13.1	13.4	13.6	13.3	13.9	14.0	13.9	13.4	13.5	14.0
Household consumption deflator	0.6	0.6	0.7	0.9	0.8	0.9	0.9	0.0	0.2	0.2	2.2	3.1	1.0
Real total wage bill	0.9	0.4	0.1	0.6	0.5	0.0	-0.2	0.5	-0.1	-0.2	2.2	1.1	0.0
- Real wage per capita	0.3	-0.1	-0.4	0.1	0.2	-0.2	-0.4	0.4	0.0	-0.1	0.2	-0.2	0.0
Purchasing power of GDI	0.5	0.2	-0.1	0.3	0.3	0.1	-0.3	0.3	-0.1	-0.2	1.8	0.5	-0.1

Forecast — *ovhg: overhang

Sources: Eurostat; INSEE estimates

Consumer prices in the Euro Zone

Since June, "core inflation" has remained virtually stable in the Euro Zone, settling at 1.9% in October. It should stay at around this level until the end of the first half of 2009: the acceleration in production costs at the beginning of 2008 may have driven up prices, which should be compensated for by the downturn in demand.

Total inflation receded to 2.1% in November 2008 (provisional figure) after the high point in July, following the drop in the price of Brent. Between now and mid-2009, the fall in energy prices should continue this trend: total inflation should drop below 1.0% in June.

"Core inflation" will stay at around 1.9% at end June 2009

In the Euro Zone, "core inflation" as measured by Eurostat [1] hovered around 2.0% until October (see Table and Chart 1). The sharp rise in the prices of Brent and industrial commodities at the end of 2007 and in spring 2008 brought about an increase in the prices of non-energy industrial goods. It also made transport services more expensive. But the low level of consumption since the start of 2008 has compensated for the repercussions of these soaring prices, causing the prices of certain services, such as domestic services, to level off.

For the forecasting period, "core inflation" should remain more or less stable. The continuing downturn of the economic situation and the drop in the Brent price since summer may have counterbalanced the delayed upward effects of payroll costs and production prices in the manufacturing industry in early 2008.

The prices of non-energy industrial goods rose slightly year-on-year, progressing from 0.8% in June to 1.0% in October (see Table). In particular, consumer prices of automobiles and consumer goods recorded growth following the rise in production prices, reflecting the soar in commodity prices. Nevertheless; distributors did not pass on much of this rise to their price, because of the low levels of demand. They should continue to moderate their prices between now and June 2009 faced with the drop in demand. The recent drop in

(1) Excluding food, alcohol, tobacco and energy, but including indirect taxes. As a comparison, the INSEE "core" index for France only excludes 68% of food product (fresh produce, meat, dairy products, etc.) but is corrected for the indirect taxes effect. However, health products and services, the prices of which are administered, are removed from the scope of the INSEE index.

Euro-zone inflation

changes, %; contributions, percentage points

	Dec. 2007		June 2008		Oct. 2008		Dec. 2008		June 2009		Annual average		
Sectors (weights in 2008 index)	yoy	cyoy	yoy	cyoy	yoy	cyoy	yoy	cyoy	yoy	cyoy	2006	2007	2008
Total (100.0%)	3.1	3.1	4.0	4.0	3.2	3.2	2.2	2.2	0.7	0.7	2.2	2.1	3.3
Food (incl. alcohol and tobacco) (19.5%)	4.3	0.8	5.8	1.1	4.4	0.9	3.4	0.7	2.5	0.5	2.4	2.8	5.1
of which: Food (15.8%)	*4.8*	*0.7*	*6.4*	*1.0*	*4.7*	*0.7*	*3.4*	*0.5*	*2.5*	*0.4*	*2.3*	*2.7*	*5.6*
Alcohol and tobacco (3.7%)	*2.5*	*0.1*	*3.4*	*0.1*	*3.3*	*0.1*	*3.4*	*0.1*	*2.7*	*0.1*	*2.7*	*3.4*	*3.3*
Energy (9.8%)	9.2	0.9	16.1	1.5	9.6	0.9	0.3	0.0	-10.1	-1.0	7.7	2.6	10.8
Core inflation (70.7%)	1.9	1.3	1.8	1.3	1.9	1.4	1.9	1.3	1.9	1.3	1.4	1.9	1.8
of which: Non-energy industrial goods (29.7%)	*1.0*	*0.3*	*0.8*	*0.2*	*1.0*	*0.3*	*0.8*	*0.2*	*1.0*	*0.3*	*0.6*	*1.0*	*0.8*
Services (40.9%)	*2.5*	*1.0*	*2.5*	*1.0*	*2.6*	*1.1*	*2.7*	*1.1*	*2.5*	*1.0*	*2.0*	*2.5*	*2.6*

Forecast

yoy: year-on-year change

cyoy: contribution to year-on-year change

Sources: Eurostat; INSEE forecasts

the price of commodities, easing tensions in production costs, should also limit price rises at the end of the first half of 2009. The inflation rate for non-energy industrial goods prices should thus remain at around 1.0%.

In the services sector, price rises have been virtually stable year-on-year, at 2.6% in October against 2.5% in June (see Table), although the sharp rises in oil prices made transport services[(2)] more expensive. By June 2009, inflation in services will have stabilised at around 2.6%. The recent acceleration in unit wage costs in services will not continue, due to the downturn on the labour market.

Drop in energy inflation

After reaching a peak in July, the price of the Brent barrel dropped as a consequence of the major downturn in the economic situation of the developed countries. This drop brought a commensurate decrease in the energy inflation rate, which dropped from 17.1% in July to 9.6% in October, year-on-year. This was less spectacular in the Euro Zone as a whole than in France, because the price rises in electricity and gas following past increases in oil prices were more moderate in France than in the rest of the Euro Zone[(3)]. Providing the price of the oil barrel remains stable at $50 until June, the year-on-year energy price change will become negative in early 2009. At the end of the first half of the year, it should settle at –10.1% (see Table): a year earlier, the Brent barrel had reached $133.

(2) In Italy, notably, the prices of air transport services increased by 23% in August compared to July.
(3) In Spain and Italy, the leap in the Brent price has been transferred fully to electricity prices, as production mainly comes from oil and natural gas.

Food inflation on the slide

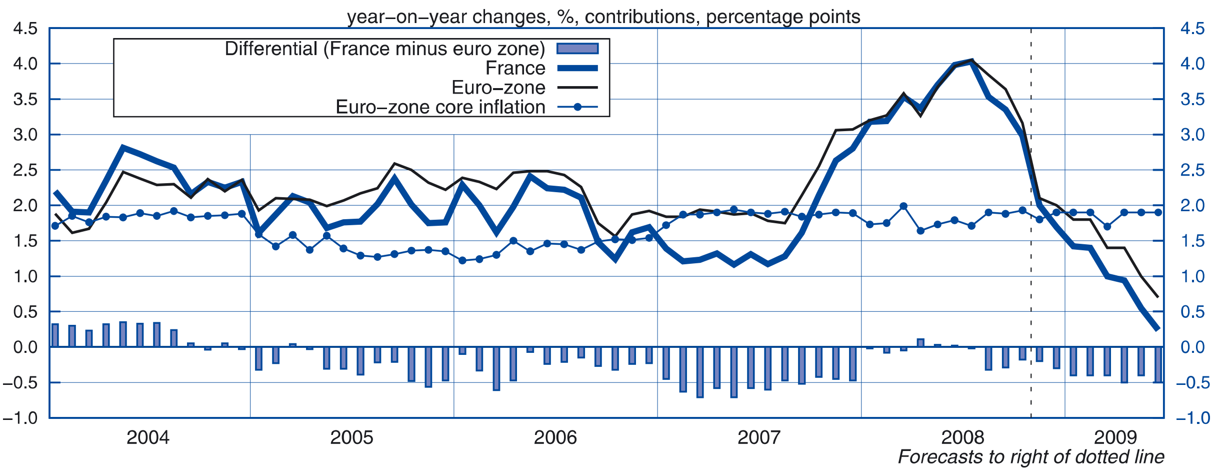
The soar in commodity prices started to feed inflation in autumn 2007. It stopped being transferred to consumer prices this autumn (see Chart 2). As a result, year-on-year food prices dropped to 4.4% in October, after 5.8% in June. In 2009, it should fall further, to 2.5% by June. On the one hand, raw materials prices for foodstuffs have decreased since June 2008, which will weaken consumer prices in the first half of 2009. On the other hand, the leap in food prices in the first half of 2008 will start to be withdrawn from the calculation of year-on-year inflation at the beginning of 2009.

Overall, inflation in the Euro Zone should fall to below 1.0% by June 2009.

Year-on-year prices should fall lower in France than in the Euro Zone in early 2009

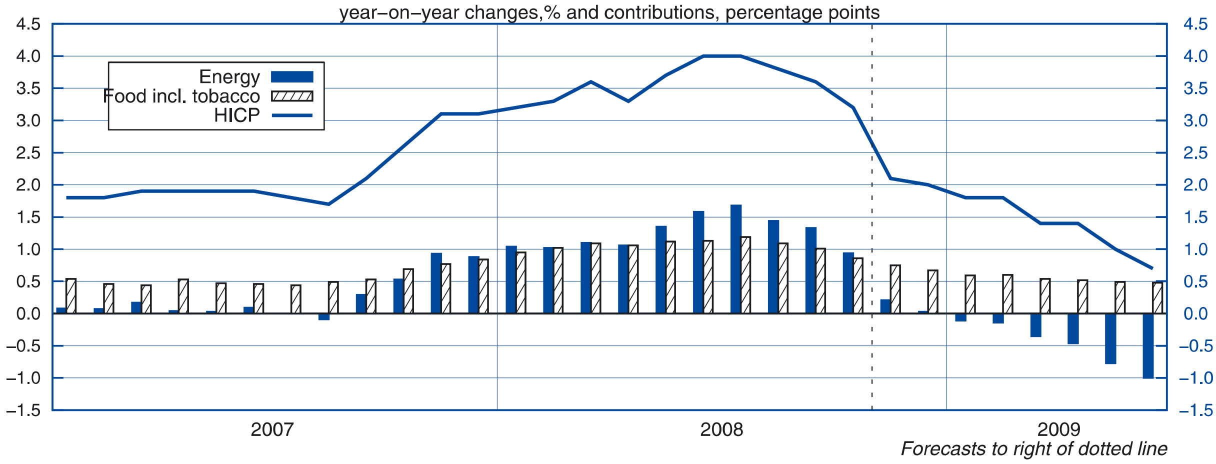
In August 2008, French year-on-year prices fell below those of the Euro Zone (see Chart 1): in France, the prices of fresh produce dropped far more and tobacco prices stabilised this year, whereas they had increased by more than 6% in August 2007. By the end of the first half of 2009, the gap should have stabilised at around -0.4 point, after a new widening of the gap in early 2009: the year-on-year figures will no longer include the recovery of prices, not including reimbursement, of certain health products and services in France; this recovery is due to the implementation of a medical excess since the start of 2008. ■

1 - Harmonised Index of Consumer Prices (HICP): France and euro zone



Sources: Eurostat, INSEE forecasts

2 - Euro-zone inflation: contribution of most volatile items



Sources: Eurostat, INSEE forecasts