

CONJONCTURE IN FRANCE

March 2011

**FACED WITH HEADWINDS,
ACTIVITY BEARS UP**

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Faced with headwinds, activity bears up

In Q4 2010, activity slowed down in the advanced economies. In Europe and in France, it was disrupted by bad weather conditions. The drop in US imports also slowed down international trade. These one-off factors weighed down on activity at the end of 2010: indirectly, they should give rise to an upturn in early 2011.

Such a rebound is already visible in the business tendency surveys. In the advanced economies, the business climate has been improving for several months and is now reaching high levels, suggesting a distinct acceleration in output at the start of the year. American economic policy, still very expansionary, and dynamic demand in emerging economies are continuing to buoy up activity in the advanced economies.

This upturn in activity is not a smooth one, however. The earthquake in Japan, the oil shock and rising commodity prices and difficulties in emerging countries controlling inflationary overheating: these are all factors that could slow down or cause jolts in world activity in 2011.

In Europe, households are likely to face higher inflation and economic policy is set to take a more restrictive turn. Consumption should remain weak, but growth in early 2011 should benefit from more buoyant demand from companies and from world trade. These growth prospects are shared unequally within the Euro Zone, however, against a backdrop of tensions surrounding sovereign debt.

In France, the improvement in the outlook suggests that activity will accelerate in early 2011, notably in the manufacturing industry. Growth in GDP should be 0.6% in Q1, then 0.4% in Q2. The recovery should therefore be strengthened, driven by investment and employment: 78,000 jobs should be created in the market sectors in H1, after 60,000 in H2 2010.

The rise in commodity prices should begin to have an effect, however, and household purchasing power is likely to slow down against a backdrop of continuing high unemployment. In this context, households should keep up a moderate rate of consumption in H1, followed by stagnation in Q2 2011, as a result of the backlash after the end of the scrappage bonus.

As usual, this scenario is surrounded by uncertainties. In particular, the consequences of the earthquake in Japan could be more pronounced in certain sectors if interruptions in supplies of certain high-technology components should last. On the other hand, entrepreneurs judge stock levels to be a bit low, therefore stocking up might turn out to be stronger in coming months, especially in France. Finally, the scenario foresees a slight fall in the savings ratio of European households in the face of fiscal adjustment policies. This fall could be more pronounced and feed stronger growth than has been envisaged here. Conversely, if the debt crisis should worsen in Europe, it could give rise to a stronger wait-and-see tendency among households and businesses. ■

In Q4 2010, a slowdown in the advanced economies linked to exceptional factors

Fall in activity in Japan and the UK

In all the advanced economies, activity slowed down in Q4 2010: +0.4% after +0.6%. In the United States, it accelerated slightly (+0.8% after +0.6%), buoyed up by dynamic domestic demand. US imports fell distinctly, however, with a strong tendency to run down stocks which weighed down on demand for products from other advanced economies. Activity declined in Japan (-0.3% after +0.8%), with the end of the scrappage bonus at the beginning of September, and in the UK (-0.5% after +0.7%), with a marked effect of the very poor weather conditions in December.

A slight slowdown in the Euro Zone linked to exceptional factors

In the Euro Zone, activity slowed down slightly in Q4 2010 (+0.3% after +0.4% in Q3). The economies of Germany (+0.4% after +0.7%) and France (+0.4% after +0.2%) in particular were affected by December's weather conditions which slowed down activity in construction.

World trade: demand in the advanced countries stalled at the end of 2010

The dynamics of world trade also strengthened in Q4, progressing by 2.3%, after 1.2% in the previous quarter. This general trend hides some big differences between emerging and advanced zones: while demand from the emerging countries was accelerating, trade in advanced countries stalled following the drop in US imports.

Activity set to accelerate in the advanced economies in Q1 2011

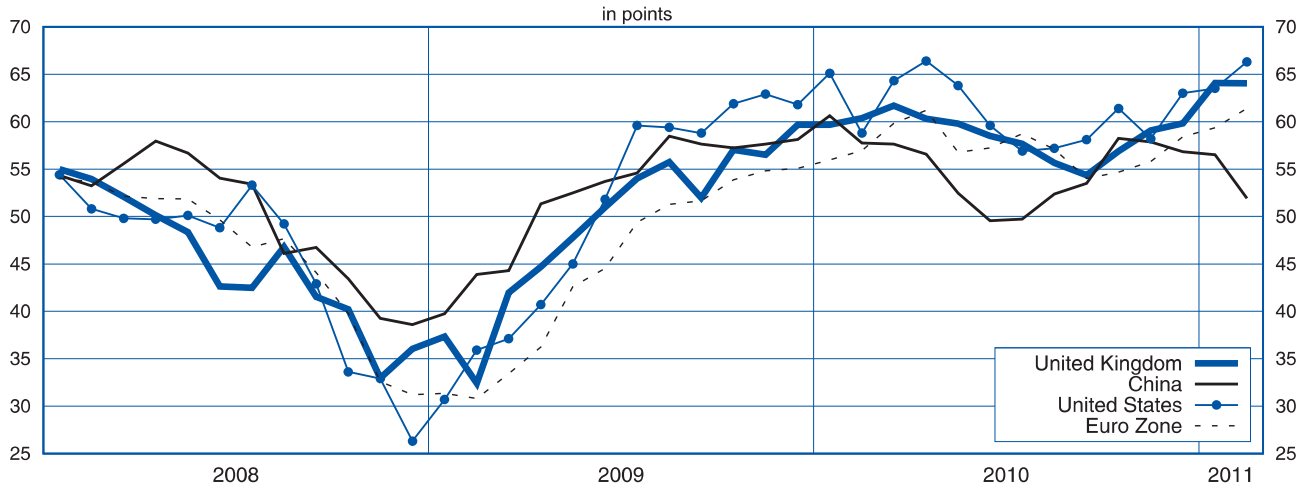
In early 2011, the business climate improved considerably in the US and Euro Zone...

Since October 2010, the short-term outlook has improved sharply in the USA (see Graph 1), both in industry and services. It has also progressed in the Euro Zone and UK, where it reached in February its highest level since the end of the crisis.

... and suggests an acceleration in activity in Q1 2011

Activity should accelerate noticeably in Q1 2011 in the advanced economies: +0.6% after +0.4% in Q4. The acceleration should be strong in the US (+1.0% after +0.8%) and in the Euro Zone (+0.6% after +0.3%), and activity should show a pronounced upturn in the UK (+1.0% after -0.5%). In Europe, activity in Q1 should benefit particularly from catch-up effects in the construction sector, after poor weather conditions at the end of 2010.

1 - The PMI manufacturing output indices are on a very positive trend in the developed countries, but down in China



Despite the shocks, activity should remain dynamic on the whole in the advanced countries through to mid-2011

The dramatic earthquake in Japan taking its toll on world trade

The dramatic earthquake that occurred on 11 March 2011 has hit prospects for an improvement in activity in Japan. This catastrophe should cause partial paralysis of Japanese production facilities. The scale of the shock is likely to be such that Japanese activity falls back in Q1, with the fall amplified in Q2. As a consequence, Japanese demand for products from its trading partners, mainly the other Asian countries and the US, should decline distinctly over the half-year.

Inflationary surge

In reaction to geopolitical tensions in North Africa and the Middle East on the one hand, and strong demand on the other, the price of oil rose considerably from Q2 2010. Food prices have also increased sharply since the summer of 2010. In the emerging countries, these price rises are causing inflationary overheat phenomena. The response of the monetary authorities, in China notably, is likely to slow down activity noticeably in H1 2011, as shown by the fall in the business tendency surveys (see Graph 1). In the advanced countries, the rise in inflation is likely to hit household purchasing power, especially given that the still-poor situation on labour markets should limit the ability of workers to negotiate wage increases.

Monetary and fiscal policies should remain accommodating in the United States...

The Federal Reserve should continue to conduct a highly accommodating monetary policy, keeping its base rate on the floor and continuing its programme of buying Treasury securities. The budget measures passed at the end of 2010 should also support household purchasing power distinctly.

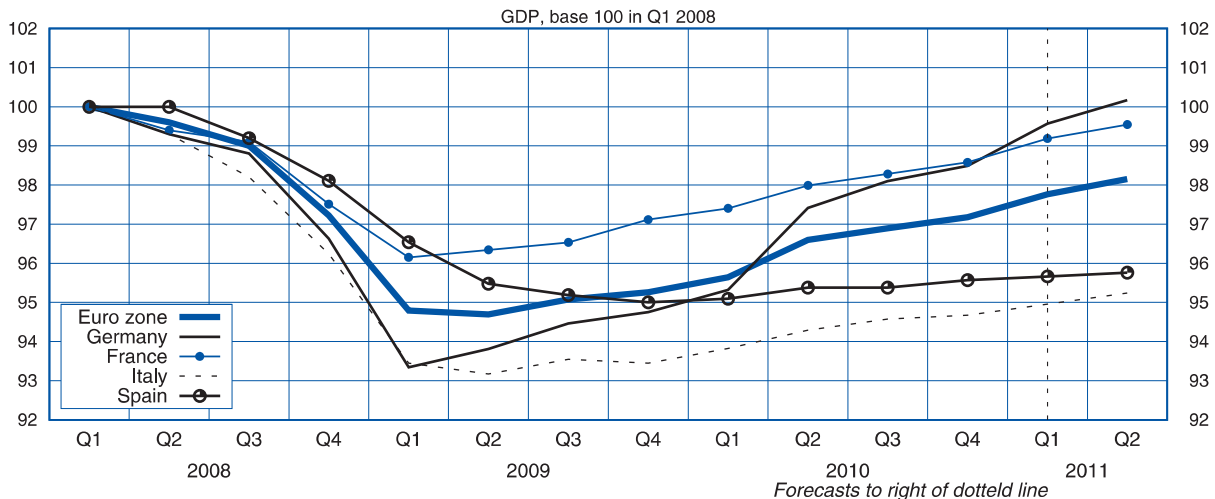
... but should become progressively tighter in Europe

Faced with the upturn in inflation, the European Central Bank should increase its base rate by 25 basis points in the course of Q2. It should carry on with the gradual withdrawal of unconventional measures. In addition to this, fiscal consolidation measures are to be implemented in Europe from 2011 (see Report, "Restrictive fiscal policies in Europe: what are the likely effects?"). They should have a significant impact on household purchasing power.

Contrasting situations in H1 2011

Through to the time horizon of our forecast, the advanced economies as a whole should continue to grow at a sustained rate (+0.6% in Q1 then +0.3% in Q2). National situations should be quite contrasted, however. In the UK, the introduction of fiscal consolidation measures should slow activity down noticeably in Q2 (+0.1%). In the US, activity is set to remain strong throughout the half-year (+1.0% then +0.8%), driven by domestic demand.

2 - Diverging trends in the Euro Zone



Source: national statistics institutes, INSEE forecasts

Through to mid-2011, Euro Zone activity set to remain dynamic

Exports and investment should support activity in the Euro Zone

In Q1 2011, activity should accelerate clearly in the Euro Zone (+0.6%). Euro Zone country exports should profit in particular from the upturn in American imports. In Q2, the growth in activity should return close to the trend observed since the end of the recession (+0.4%). It should be buoyed up by exports and investment in capital goods. Throughout H1, however, fiscal consolidation measures and the rise in commodity prices should weigh down on household purchasing power and on activity. Household consumption should therefore progress weakly (+0.2% then +0.1%).

Diverging trends in the Euro Zone

In this context, differences should continue to widen within the Euro Zone (see Graph 2). In Spain and Italy, weak domestic demand is likely to weigh down on growth. In Germany, on the contrary, activity should be buoyed up by investment. The dynamic performance of the German economy should have a spill-over effect on the rest of the Euro Zone.

Tensions surrounding European sovereign debt

The government debt of certain countries in the Euro Zone continues to cause concerns, and their financing costs have remained at a high level since November 2010. This could lead to something of a wait-and-see attitude in the behaviour of private agents.

In France, activity should accelerate in Q1 2011

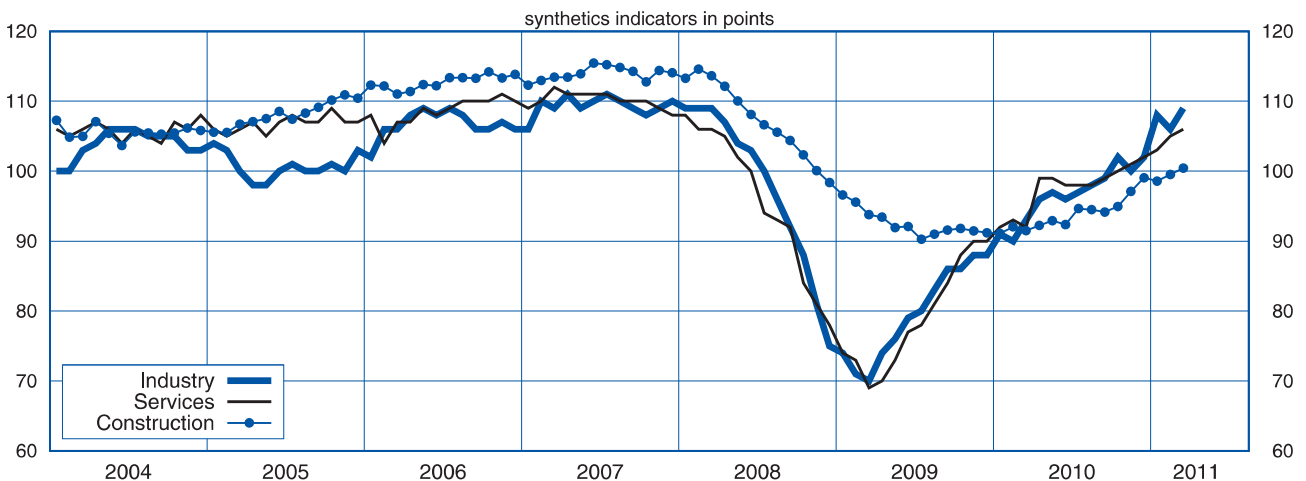
The business tendency surveys suggest an acceleration in activity in Q1 2011

In the short term, activity prospects in France, as shown in the business tendency surveys, are positive (see Graph 3). In manufacturing industry, the upturn in the indicators of past production and individual prospects suggests a marked acceleration in output at the start of the year. In services, the business climate indicator remains above its long-term average and continues to progress. The business climate in construction, although remaining at a low level, has been improving somewhat for several months.

Upturn in exports and support from domestic demand, in particular in Q1 2011

In the wake of world trade, foreign demand for French products should accelerate in Q1 (+2.1% after +1.2%). It should then slow down to a level close to its long-term average (+1.7% in Q2). Exports should therefore continue to boost growth in H1. The quarterly domestic demand profile, meanwhile, should be marked by a one-off upturn in the public works sector. In addition, household

3 - The business climate is headed in the right direction in services and industry, and is improving slowly in building



Source: INSEE

consumption should continue to be sustained at the start of the year by the "trailing" effects of the scrappage bonus, with deliveries of vehicles ordered before 31 December 2010. The after-effect of this is that consumption should no longer be boosting growth in Q2 (see Graph 4).

Foreign trade set to weigh down little on growth through to mid-2011

In Q4 2010, the contribution of stocks to growth was very negative (-0.9 points). This contribution partly reflects the sharp fall in imports (-1.2%), as a backlash against the high level of purchasing in the previous quarter. This should not be repeated in H1 2011. On the one hand, the slight stocking up trend should boost growth. On the other, imports should increase distinctly in Q1, buoyed up by the progression in domestic demand and exports. They are then likely to slow down in line with the trend in domestic demand. The contribution of foreign trade to growth should become neutral through to the time horizon of the forecast.

Inflation progressing, but second-round effects likely to remain limited

The continuing high level of unemployment and the still-limited use of production capacities are blocking the spread of inflationary tensions. But ultimately, the recent rise in commodity prices should be passed on progressively to consumer prices and notably to food prices which should increase through to June 2011. Until now, unlike in most Euro Zone countries, the recent rise in commodity prices has had few repercussions on consumer prices. It should work through more, however, over the period of our forecast. Core inflation should rise in France to 1.0% year-on-year by the end of June 2011 (see Graph 5). This rise in core inflation should be offset by the fall in prices of seasonal food products and energy. The year-on-year change in prices should thus stand at 1.9% in June 2011 after 1.8% in December 2010.

Corporate investment should progress through to mid-2011

Acceleration in investment in H1 2011

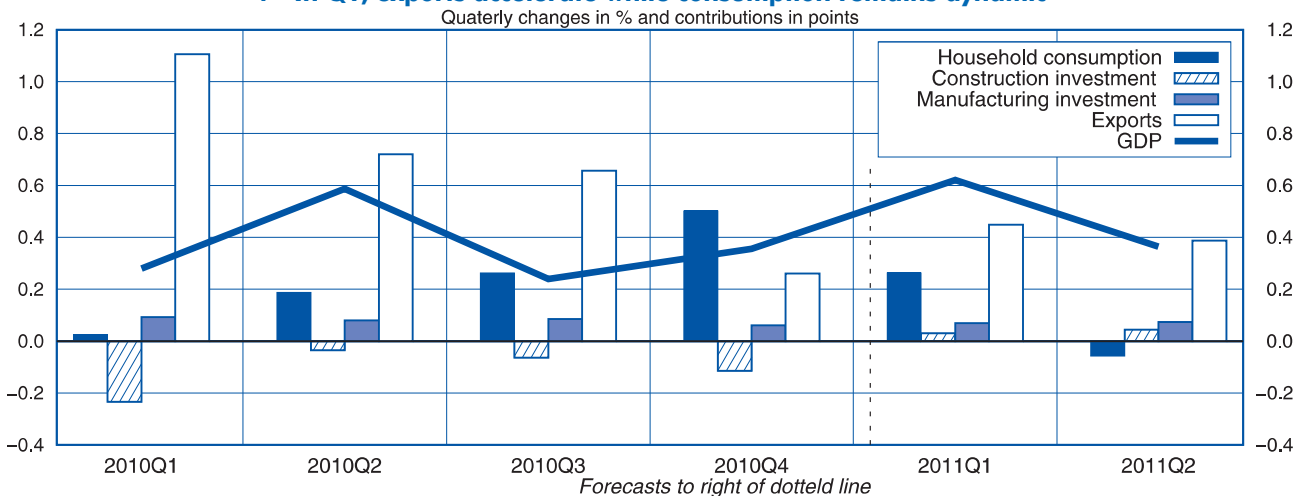
In H1 2011, corporate investment should accelerate, as indicated by the business tendency surveys conducted among entrepreneurs. Investment should be buoyed up by positive activity prospects and increased use of production capacities.

The labour market is improving progressively

The progression in activity should boost market-sector employment

Since the start of the crisis, employment has not responded to fluctuations in activity as it used to in the past. For example, the upturn in employment observed since the beginning of 2010 was earlier and greater than expected. Through to

4 - In Q1, exports accelerate while consumption remains dynamic



Source: INSEE

the time horizon of our forecast, this dynamic employment trend is likely to strengthen somewhat, buoyed up by the progression in activity. Job creations in the non-agricultural market sector should be around 78,000 in H1 2011, after 60,000 in H2 2010. However, employment in non-market sectors should decrease in early 2011, due to the fall in the number of people starting State-aided contracts. All in all, employment should increase by 76,000 in H1 2011, after 70,000 in H2 2010.

Unemployment stabilised by mid-2011

The unemployment rate stood at 9.2% (9.6% respectively including the overseas departments) of the active population in Q4 2010. It should stabilise by mid-2011 at 9.1% (9.5% respectively), which is to say a distinctly higher level than that before the crisis.

Real wage stability

The inflation shock should lead to a rise in nominal wages in H1 2011, but this catching up should only be partial and in part delayed, in a context in which the labour market situation is weighing on wage negotiations. The average wage per head should therefore progress a little less quickly than inflation through to mid-2011 and real wages should be stable in H1.

Household consumption held back by moderate purchasing power gains

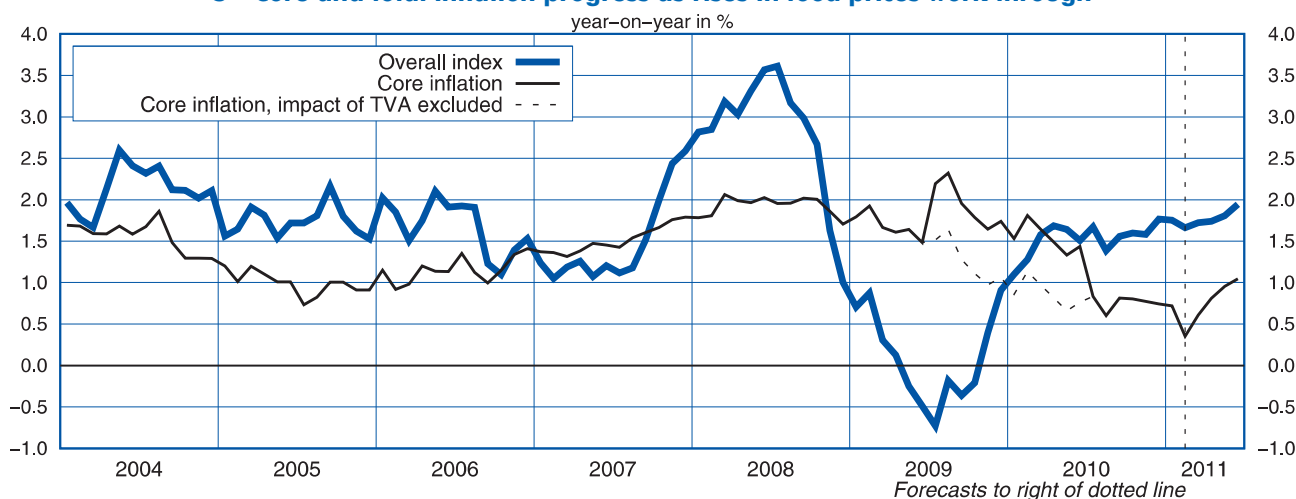
Although nominal income is holding up, the rise in inflation deducts from gains in purchasing power

In 2010, household purchasing power progressed by an annual average of 1.2%, after holding up through the crisis (+1.6% in 2009). In H1 2011, the progression in employment and nominal wages should buoy up household income. In contrast, fiscal revenues should accelerate in early 2011, linked to the improvement in incomes observed in 2010. The disposable income of households should progress, in current Euros, over the first two quarters of 2011 at the same rate as at the end of 2010 (+0.8% per quarter). Due to the upturn in inflation, household purchasing power should grow moderately: +0.1% in Q1 2011, then +0.3% in Q2.

Boosted by the "trailing" effect of the scrappage bonus, household consumption is likely to progress in Q1...

In Q4 2010, household consumption (+0.9%) was buoyed up by purchases of vehicles before expiry of the scrappage bonus. Due to the time required to deliver vehicles ordered at the end of 2010, this effect could carry over into early 2011. Consumption should therefore progress once again more quickly than purchasing power in Q1 2011 (+0.5%).

5 - Core and total inflation progress as rises in food prices work through



Source: INSEE

... and then fall back By a backlash effect, automobile purchases should then fall in Q2, leading to a fall in household consumption (-0.1%). In this way, households would restore part of their precautionary savings.

Aside from one-off effects in public works, the construction sector is getting back on track

Recovery in public works In the construction sector, production contracted once again in Q4 2010. This was mainly down to the marked fall in activity in public works, hit by bad weather conditions. In H1, production in construction should therefore increase slightly for the first time in three years.

Household investment in housing grows again Household investment in housing started rising again in H2 2010, in the wake of housing commencements. It should continue to progress in H1 2011.

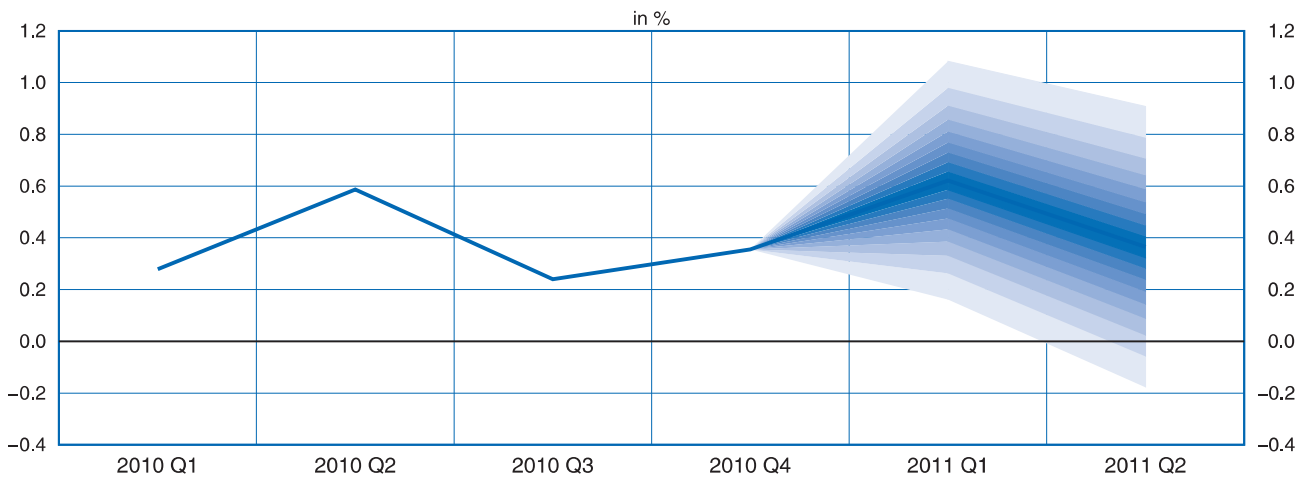
Uncertainties: the consequences of the catastrophe in Japan, the accentuation of stocking up and the impact of fiscal consolidation measures

The consequences of the catastrophe in Japan The consequences of the catastrophe that occurred in Japan could be more complex than a mere fall in Japanese demand for products from its partners. On the one hand, the strategic position of Japan in certain production chains could give rise to interruptions in supplies in some sectors. On the other hand, some countries could benefit from transfers of demand usually addressed to Japan.

Accentuation of the stocking up movement In France, industrialists report levels of stocks that remain low in the business tendency surveys, while also indicating a high level of orders on their books. This context could lead them to enter into a more pronounced stocking up movement than that included in the forecast.

Behaviour of private agents in a context of fiscal restrictions In 2011, the European countries are implementing fiscal consolidation strategies. The scenario taken here supposes that the effects of these policies on economic activity are partly offset by an upturn in household consumption. If these policies succeed in restoring household confidence in the sustainability of public finances, their effects might be attenuated. If, on the other hand, the restrictive impact of these policies is not counterbalanced by an increase in confidence among private agents, then European growth could be slower than in the scenario. ■

6 - Fan chart for *Conjoncture* in France



How to read it: the fan chart plots 90% of the likely scenarios around the baseline forecast (blue 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 from the centre outwards and from the darkest band to the lightest, up to a 90% probability (see the *INSEE Conjoncture in France* for June 2008, pages 15 to 18). It can therefore be estimated that the first result published by the quarterly accounts for Q1 2011 has a 50% chance of being between +0.4% (lower limit of the fifth band from the bottom) and +0.8% (upper limit of the fifth band from the top). Likewise, it has a 90% chance of being between +0.2% and +1.1%. In Q2, the 90% confidence interval is [-0.2% ; +0.9%].
 Source: INSEE

Key figures: France and its international environment

seasonally adjusted / working-day adjusted data (for prices), quarterly or annual averages, as a %

| | 2009 | | | | 2010 | | | | 2011 | | 2009 | 2010 | 2011 ovhg |
|--|-------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|-------------|------------|--------------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | | | |
| International environment | | | | | | | | | | | | | |
| Advanced economy GDP | -2.4 | 0.2 | 0.2 | 0.9 | 0.8 | 0.7 | 0.6 | 0.4 | 0.6 | 0.3 | -3.8 | 2.5 | 1.6 |
| Euro Zone GDP | -2.4 | -0.2 | 0.4 | 0.2 | 0.4 | 1.0 | 0.4 | 0.3 | 0.6 | 0.4 | -4.0 | 1.7 | 1.3 |
| Barrel of Brent oil (in dollars) | 44 | 59 | 68 | 75 | 76 | 79 | 77 | 86 | 104 | 110 | 61 | 80 | 109 |
| Euro-dollar exchange rate | 1.30 | 1.36 | 1.43 | 1.48 | 1.38 | 1.27 | 1.29 | 1.36 | 1.36 | 1.36 | 1.39 | 1.33 | 1.36 |
| World demand for French products | -8.3 | -1.6 | 3.6 | 2.5 | 3.9 | 4.1 | 1.3 | 1.2 | 2.1 | 1.7 | -12.0 | 11.6 | 6.0 |
| France - supply and use | | | | | | | | | | | | | |
| GDP | -1.4 | 0.2 | 0.2 | 0.6 | 0.3 | 0.6 | 0.2 | 0.4 | 0.6 | 0.4 | -2.5 | 1.5 | 1.4 |
| Imports | -5.7 | -3.2 | -0.4 | 2.9 | 1.9 | 3.9 | 4.0 | -1.2 | 2.1 | 1.3 | -10.6 | 7.8 | 5.1 |
| Household consumption | 0.1 | 0.2 | 0.3 | 1.0 | 0.0 | 0.3 | 0.5 | 0.9 | 0.5 | -0.1 | 0.6 | 1.7 | 1.4 |
| Public and NPISH consumption | 0.6 | 0.7 | 0.7 | 0.6 | 0.0 | 0.3 | 0.3 | 0.2 | 0.3 | 0.3 | 2.6 | 1.4 | 0.9 |
| Total GFCF | -2.3 | -1.4 | -1.5 | -1.0 | -0.7 | 0.9 | 0.5 | 0.3 | 0.8 | 0.9 | -7.0 | -1.6 | 2.2 |
| of which: NFEs | -3.0 | -1.7 | -1.5 | -1.1 | -0.6 | 1.3 | 0.4 | 0.5 | 1.2 | 1.2 | -7.9 | -1.3 | 3.0 |
| Households | -2.3 | -1.9 | -1.9 | -1.4 | -0.5 | 0.1 | 1.2 | 0.6 | 0.3 | 0.8 | -8.7 | -2.2 | 1.9 |
| Exports | -7.4 | -0.7 | 1.3 | 0.9 | 4.8 | 3.0 | 2.6 | 1.0 | 1.8 | 1.5 | -12.2 | 10.1 | 5.8 |
| Contributions | | | | | | | | | | | | | |
| Domestic demand excluding change in inventories (**) | -0.3 | 0.0 | 0.0 | 0.5 | -0.1 | 0.4 | 0.4 | 0.6 | 0.5 | 0.2 | -0.5 | 1.0 | 1.5 |
| Change in inventories (**) | -0.9 | -0.5 | -0.3 | 0.6 | -0.3 | 0.4 | 0.2 | -0.9 | 0.2 | 0.1 | -1.8 | 0.1 | -0.1 |
| Net foreign trade | -0.3 | 0.7 | 0.4 | -0.5 | 0.6 | -0.3 | -0.4 | 0.6 | -0.1 | 0.0 | -0.2 | 0.4 | 0.0 |
| France - situation of households | | | | | | | | | | | | | |
| Total employment (variation at end of quarter) | -154 | -64 | -45 | 35 | 45 | 65 | 63 | 8 | 29 | 47 | -228 | 181 | - |
| Non-agricultural market sector employment | -169 | -88 | -77 | 1 | 22 | 43 | 22 | 38 | 41 | 38 | -333 | 125 | - |
| Unemployment rate Metropolitan France | 8.6 | 9.2 | 9.2 | 9.5 | 9.5 | 9.3 | 9.3 | 9.2 | 9.2 | 9.1 | 9.5 | 9.2 | - |
| Unemployment rate France | 9.0 | 9.5 | 9.6 | 9.9 | 9.8 | 9.7 | 9.8 | 9.6 | 9.6 | 9.5 | 9.9 | 9.6 | - |
| Consumer price index (*) | 0.3 | -0.5 | -0.4 | 0.9 | 1.6 | 1.5 | 1.6 | 1.8 | 1.7 | 1.9 | 0.1 | 1.5 | - |
| Core inflation (*) | 1.7 | 1.5 | 2.0 | 1.7 | 1.6 | 1.4 | 0.8 | 0.7 | 0.6 | 1.0 | 1.8 | 1.2 | - |
| Household purchasing power | 0.6 | 0.9 | 0.6 | -0.1 | 0.0 | 0.5 | 0.7 | 0.3 | 0.1 | 0.3 | 1.6 | 1.2 | 1.1 |

Forecast

(*) Year on year on the last month of the quarter

(**) Inventory changes include acquisitions net of sales of valuable

Note: the volumes are calculated at the previous year's chain-linked prices, seasonally and working-day adjusted, quarterly and annual averages, as a %

Source: INSEE

The effects of a rise in oil prices on activity

Oil prices have increased sharply in the last few months due to physical tensions - growing demand with world recovery - and also geopolitical factors linked to recent events in North Africa and the Middle East.

For countries like France that import their oil, an oil shock obviously represents a transfer from domestic agents to the benefit of the oil-producing countries. It has a negative impact on activity. First of all, consumer prices increase under the effect of the rise in energy prices, which then affects domestic demand ("first-round" effects). The rise in oil prices also works through into producer prices via intermediate consumption, and into wages through wage negotiations. This sustains a price-wage loop ("second-round" effect). These domestic effects are reinforced by the foreign trade channel: the oil-exporting countries spend part of their additional revenues abroad, but France's main partners are also hit by the rise in oil prices, leading them to reduce their imports and thus penalising French exports.

The price of oil increased by €5⁽¹⁾ in Q4 2010, then again by €12 in Q1 2011. All in all, these increases in Brent prices should reduce growth in activity by 0.05 percentage points in Q1 2011 and then by 0.15 percentage points in Q2.

Channels of transmission of oil price rises through to activity

The effects on activity of a rise in oil prices can be broken down into direct and indirect effects. The direct effects correspond to the effects of the oil price rise on French activity, considered separately from its trading partners. Indirect effects take account of the fact that the trading partners are also hit by the rise in oil prices.

The direct effects can be broken down in turn into so-called "first-round" effects and "second-round" effects. In the very short term, the rise in oil prices is passed on to consumer prices by the rise in the prices of energy products. Household purchasing power is reduced and their consumption is affected, leading to a fall in activity. These are "first-round" effects.

In parallel, the rise in oil prices is passed on through wage and producer price formation processes. To preserve their purchasing power, employees demand wage increases, thereby increasing the wage costs of businesses. These businesses then pass on this rise and that in the cost of their intermediate consumption in their producer prices. Consumer prices thus increase again, giving rise to a price-wage loop. These are said to be "second-round" effects: the prices of French products increase, which reduces exports and increases imports.

The rise in oil prices also has indirect effects on the French economy, because France's partner countries are also affected by the oil price rise. The oil exporting countries benefit from an increase in their resources, and their demand for French products increases. For the other oil-importing countries, the rise in oil prices leads them to reduce their demand for French products. On account of the structure of French foreign trade, it is this latter effect that is the greater: world demand for French products falls.

In addition, the rise in oil prices also gives rise to a rise in export prices for France's main partners. This second indirect effect therefore plays an attenuating role: the price competitiveness of French products is less affected, as the prices of the country's competitors also increase.

A €20 shock on the price per barrel of oil reduces growth by 0.15 to 0.20 percentage points of growth in the quarters following the shock

All of these effects can be simulated using macro-economic models. First, the NIGEM⁽²⁾ multinational model developed by the NIESR⁽³⁾ is used to calibrate the reaction of the export prices of our partners and world demand for French products. These reactions among our partners are then put into the Mésange⁽⁴⁾ model on France. We simulated a €20 rise in the price of (Brent) oil.

All other things being equal, growth in activity is reduced by 0.2% in the first quarter following the shock, then again by 0.2% in the second quarter after the shock (see *Table 1*). Over the year as a whole on average, French growth loses half a percentage point.

The direct "first-round" effect translating the immediate loss of purchasing power due to the rise in the price of energy, is obtained on the hypothesis that wages and company producer prices do not adjust to the rise in oil prices. The "second-round" effect translates the extra cost due to these adjustments. To a one-year time horizon, the "first-round" effects are clearly the greater⁽⁵⁾.

Among the indirect effects, the rise in foreign prices quite logically has an attenuating effect, limiting the deterioration of the competitiveness of French products. The fall in demand from trading partners, on the contrary, has a negative effect on activity. The latter effect is the strongest of the indirect effects.

(1) The rise of \$10 over the quarter was partly softened by the rise in the value of the Euro in Q4 2010.

(2) National Institute Global Econometric Model.

(3) National Institute of Economic and Social Research.

(4) Modèle Économétrique de Simulation et d'Analyse Générale de l'Économie, see Klein C. and Simon O. (2010), "Le modèle MÉSANGE réestimé en base 2000. Tome 1 - Version avec volumes à prix constants", INSEE and Direction Générale du Trésor working document, n°G2010/03, n°2010/02, March 2010.

(5) In the long term, the direct "second-round" effects dominate.

The rise in the price of Brent in Q4 2010 and in Q1 2011 reduces activity by around 0.05 percentage points in Q1 2011 then by 0.15 points in Q2

The price per barrel of Brent has just seen two quarters of strong rises. It thus progressed by €5 in Q4 2010 and a further €12 in Q1 2011, supposing that oil prices stabilised at their early-March 2011 level (see *Oil and Commodities*).

The shock actually suffered by the economy is therefore equivalent to a succession of "elementary" shocks in each quarter, similar to that illustrated previously. The quarterly growth rate

should therefore be reduced by 0.05 percentage points in Q1 2011 then by 0.15 points in Q2 2011. Over the whole of 2011, supposing that oil prices stabilise at their current level, and taking account of the diffusion effects in Q3 and Q4, the activity growth rate should be reduced by 0.30 points. These results take account only of the effect of the shock in Euros on the French economy and its partners. In particular, they do not take account of any exchange rate movements that might modify the competitiveness of the French economy or any response from the central bank to the rise in inflation. ■

Table 1

Effect on the quarterly rate of growth in GDP of a €20 rise in the price of oil

| | Impact after... | | | | |
|--|-----------------|-----------|-----------|-----------|-----------------------|
| | 1 quarter | 2 quaters | 3 quaters | 4 quaters | Effect in annual mean |
| Total effect on growth | -0.20 | -0.20 | -0.20 | -0.15 | -0.50 |
| Direct effect, of which: | -0.10 | -0.10 | -0.10 | -0.10 | -0.25 |
| <i>First round</i> | -0.10 | -0.10 | -0.05 | -0.05 | -0.20 |
| <i>Second round</i> | -0.05 | -0.05 | -0.00 | -0.00 | -0.05 |
| Indirect effect, of which: | -0.10 | -0.10 | -0.10 | -0.05 | -0.20 |
| <i>Effect transmitted via world demand for French products</i> | -0.10 | -0.15 | -0.15 | -0.10 | -0.30 |
| <i>Effect transmitted via export prices of France's trading partners</i> | 0.05 | 0.05 | 0.05 | 0.05 | 0.10 |

Note: The effects presented in the table are rounded to the nearest 0.05 point. The cumulative total of effects is slightly different from the total effect because of the rounding process.

Source: variants using the Mésange and NiGEM models by the Economic Studies Department, INSEE

Table 2

Effect on activity of the rise in oil prices in Q4 2010 and in Q1 2011

| | Impact on the growth rate ... | | |
|---------------------------------|-------------------------------|------------|---------|
| | in Q1 2011 | in Q2 2011 | in 2011 |
| Total effect on growth : | -0,05 | -0,15 | -0,30 |
| <i>Direct effect</i> | -0,05 | -0,10 | -0,15 |
| <i>Indirect effect</i> | -0,00 | -0,10 | -0,15 |

Note: The effects presented in the table are rounded to the nearest 0.05 point. The cumulative total of effects is slightly different from the total effect because of the rounding process.

Source: variants using the Mésange and NiGEM models by the Economic Studies Department, INSEE

Review of the previous forecast

In Q4 2010, growth was not as strong as forecast, settling at 0.4% against the 0.5% announced in the December issue of *Conjoncture in France*. The difference can partly be explained by slightly less dynamic activity than forecast in the market service sector. Furthermore, the particularly difficult weather conditions in December penalised activity in certain sectors. Lastly, activity dropped sharply in the refining industry, as forecast. However, the rise in electricity output due to the drop in temperatures to below seasonal norms attenuated the decline of the energy sector as a whole.

In Q1 2011, the expected rebound in these sectors should have a positive effect on activity. Additionally, the 'trailing effect' of the scrapping allowance seems to have persisted in early 2011, and the after-effect of the expiry of this measure should come a little later than expected, in Q2. Our growth forecast is therefore revised clearly upwards for Q1.

In Q4 2010, slightly lower growth than forecast in the December *Conjoncture in France*

The growth rate stood at +0.4% in Q4 2010, a little lower than expected in the December *Conjoncture in France*. The 0.1 point error is small (see *Graph 1*). On the one hand, activity was a little

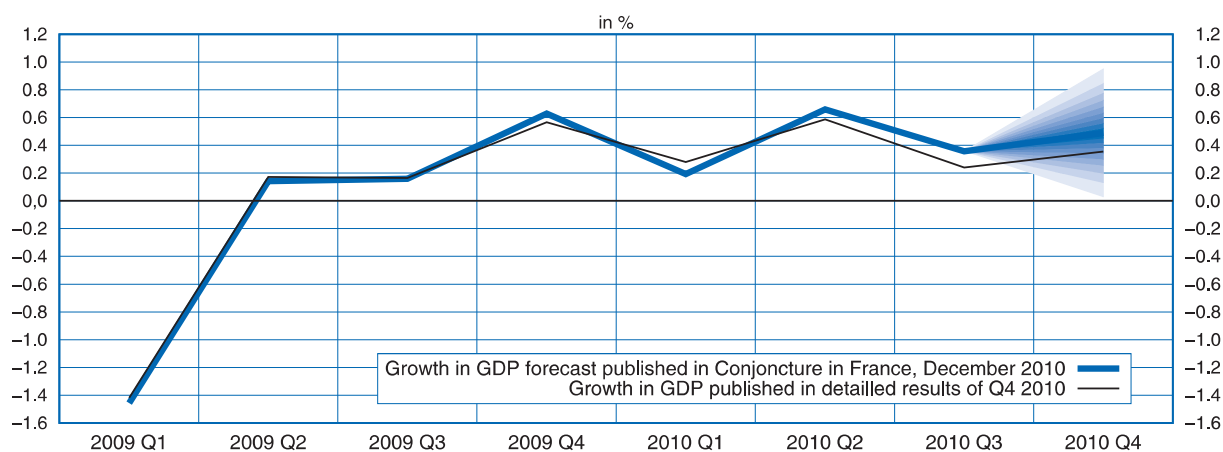
less dynamic in market services (+0.6% against +0.8% forecast). On the other hand, output in Q4 was disrupted by the difficult weather conditions in December: in civil engineering, but also in the manufacture of building materials, activity contracted sharply in December. Lastly, owing to the industrial action in the refineries in October, the production of refined petroleum products dropped, as predicted. However, with temperatures well below seasonal norms at the end of the year, electricity output increased, which largely attenuated the shock in the energy sector as a whole (-1.0%, against -4.0% forecast).

Dynamic domestic demand

In contrast to this mediocre performance in terms of activity, domestic demand was buoyant: it progressed by 0.6% (+0.7% forecast). This was the biggest rise in three years and came thanks to the conjunction of dynamic household consumption and investment continuing to pick up.

Boosted by automobile consumption showing strong growth in anticipation of the end of the scrapping allowance on 31 December 2010, total consumption progressed strongly (+0.9%, in line with the forecast). Total investment also continued its recovery (+0.3% against +0.5% in the December *Conjoncture in France*) with a rise in its household component (+0.6%), as predicted, and its corporate component (+0.5% against

1- Fan chart for *Conjoncture in France* for December 2010 and growth achieved



Source: INSEE

Review of the previous forecast

+0.7% forecast). Corporate investment in capital goods and in services remained dynamic, as forecast. However, the difficult weather conditions in Q4 brought about a decline in construction investment. Expenditure in building and civil engineering fell by 2.9%, against the -1.0% expected in December.

The growth differential between domestic demand and output was not made up for by imports but by a strongly negative contribution of inventory (-0.9 point). In fact imports dropped slightly, where we had anticipated a rise (see *Foreign trade note*). In early 2011, stock movements may reverse, which would be a positive uncertainty for growth.

Our growth forecast is revised clearly upwards for Q1 and is unchanged for Q2 2011

For Q1 2011, our growth forecast is revised clearly upwards: +0.6% against +0.3% forecast in the December *Conjoncture* in France. Several factors justify this revision.

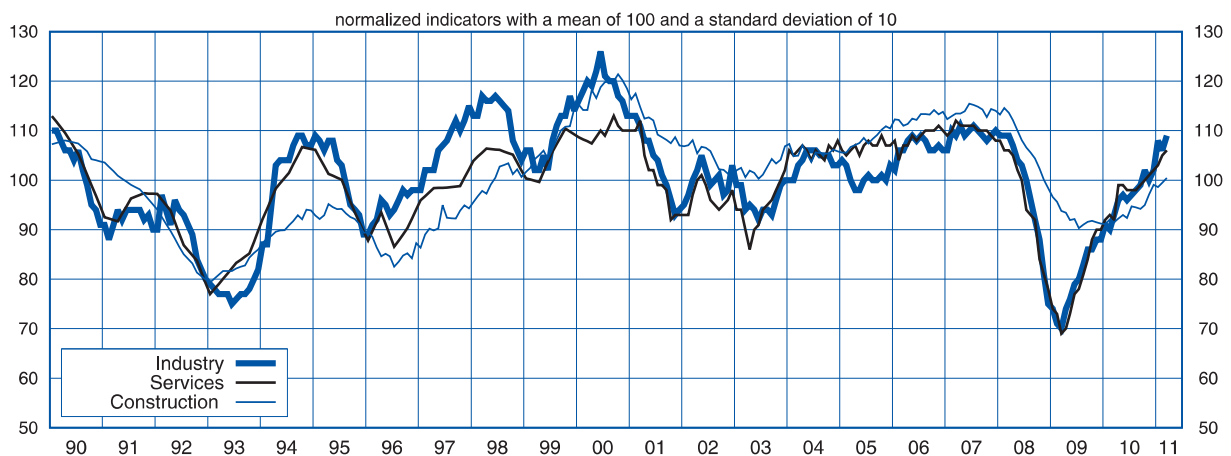
First, activity in certain sectors should rebound after the output difficulties encountered in December: this is the case of civil engineering and of the production of building materials. In both these sectors activity fell sharply in December but increased strongly in January. In the energy sector

output should rebound as forecast, with the after-effect of the rise in refined petroleum products. Next, the business tendency surveys indicate an upturn in activity at the start of 2011, particularly in the manufacturing industry and in services (see *Graph 2*). The latest indicators also point to strong dynamism in world trade. All in all, the output forecasts are revised sharply upwards in the manufacturing industry (+1.5% against +0.5% forecast previously), construction (+0.3% against -0.2%) and other market services (+0.8% against +0.6%).

Additionally, with the lead times required to honour orders placed at the end of December, the 'trailing effect' of the scrappage allowance seems to have persisted in Q1, as witnessed by the boost in car registrations. The after-effect of the end of the scrappage allowance should thus come a little later (see *Household consumption note*). In Q1, household consumption should be more buoyant (+0.5% against +0.1% forecast previously).

Conversely, consumption may drop in Q2 (-0.1% against +0.2% forecast in December), which would take its toll on activity in trade. But world demand for French products should be a little more dynamic. All in all, our growth forecast remains globally unchanged for Q2, at +0.4%. ■

2 - Business climate in the industrial, construction and service sectors



Source: INSEE