

CONJONCTURE IN FRANCE

December 2010

DECOUPLING

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GENERAL OUTLOOK	7
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REVIEW OF THE PREVIOUS FORECAST	15
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FRENCH DEVELOPMENTS

• France's international environment	19
• Foreign trade	22
• Consumer prices	25
• Employment	30
• Unemployment	34
• Wages	36
• Household income	39
• Household consumption and investment	43
• Corporate investment and inventory	46
• Output	49

STATISTICAL FRENCH APPENDIX	57
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Focus

• What are the effects of the rise in food commodity prices on consumer prices ?	28
• INSEE outlook surveys and PMI indicators: advanced tools for monitoring the economic outlook	52

Decoupling

In France as in the Euro Zone, activity slowed down in Q3. Domestic demand was stronger, but the inventory boost was less intense. The contribution of foreign trade to growth was once again negative, due to the strong upturn in imports.

The surveys of purchasing managers indicate that world trade should continue to slow down, as has now been the case for several months. They also report widely contrasted national outlooks.

In Japan, activity is set to fall between now and the end of the year, with the expiry of the scrappage allowance and the slowdown in outlets in the emerging Asian countries. In the United States, in contrast, growth should remain strong, thanks to ever-robust household consumption. In early 2011, continuing budgetary support for households as well as increased recourse to unconventional monetary policy instruments should support domestic demand.

In Europe, activity prospects remain positive for the end of the year, confirming the upturn in domestic demand. But this "mean" trend hides large disparities within the Euro Zone. In H1, Euro Zone growth should be more moderate, due to the slowdown in exports and to the implementation of measures to restore public finances in many countries. A certain drop in household savings rates and the continuing upturn in investment should attenuate this slowdown somewhat, however.

In Q4, activity should increase slightly in France (0.5%), according to the sector outlook surveys. This would appear to reflect the strong situation in services, the acceleration in industrial production and the upturn

in the construction sector. Activity should increase by 0.3% in Q1 2011 and 0.4% in Q2 2011. Over the forecasting period, the French economy should be in line with the growth trend it has been following since it emerged from the recession.

The slow improvement in the labour market situation should continue: 50,000 jobs should be created in H1 2011 in the private sector, after 106,000 in 2010. The unemployment rate should decline slightly through to mid-2011.

Investment should accelerate somewhat, notably in construction. Consumption should continue to grow at a modest pace, in line with the moderate gains in purchasing power. Faced with unemployment that remains high, households should maintain a high level of savings. As a year ago, the consumption profile should be uneven due to the effects of the scrappage bonus: a marked upturn in Q4 before the measure expires and then a fall after.

Our scenario is surrounded by many uncertainties. The resurgence of tensions surrounding sovereign debt could increase uncertainties about the economic situation. If this is the case, growth would be slower than in our scenario. On the other hand, robust domestic demand in Germany or in France could buoy up European growth more. The behaviour of private agents, against a backdrop of fiscal restrictions and greater uncertainties, will also be decisive in coming months. ■

In Q3 2010, the advanced economies slowed down slightly

In Q3, Japan and the United States picked up...

In Q3 2010, growth in all the advanced economies together was 0.6%, after 0.7% in Q2. Domestic demand continued to sustain activity. Activity accelerated in the United States (+0.6% after +0.4%) and in Japan (+0.9% after +0.4%) where consumption was boosted by the upturn in automobile purchases before the end of the scrappage allowance at the start of September.

...while the Euro Zone slowed down

Activity in the Euro Zone slowed down (0.4% after 1.0% in Q2). With growth of 0.7%, Germany continued to be the driving force of the Euro Zone. In France, the growth in activity in Q3 (0.4% after 0.7% in Q2), in line with the forecasts we made in October, was buoyed up by domestic demand (contribution of 0.5 point).

World trade still showing signs of running out of steam

The dynamics of world trade weakened distinctly in Q3: world imports grew by 1.4% after 2.8% in the previous quarter. In particular, activity in China and the emerging Asian countries was less dynamic: in these countries, economic policies tightened and trade outlets slowed down.

Prospects for Q4 are good in the Euro Zone and the United States

The business climate is on a positive trend in the United States and in the Euro Zone...

In November, the business climate continued to improve in the Euro Zone (see Graph 1). Despite slipping slightly in November, it also remained at a high level in the United States. Activity should therefore progress in Q4 at the same rate as in Q3 in the Euro Zone (0.4%) and in the United States (0.6%).

... but activity should decline in Japan

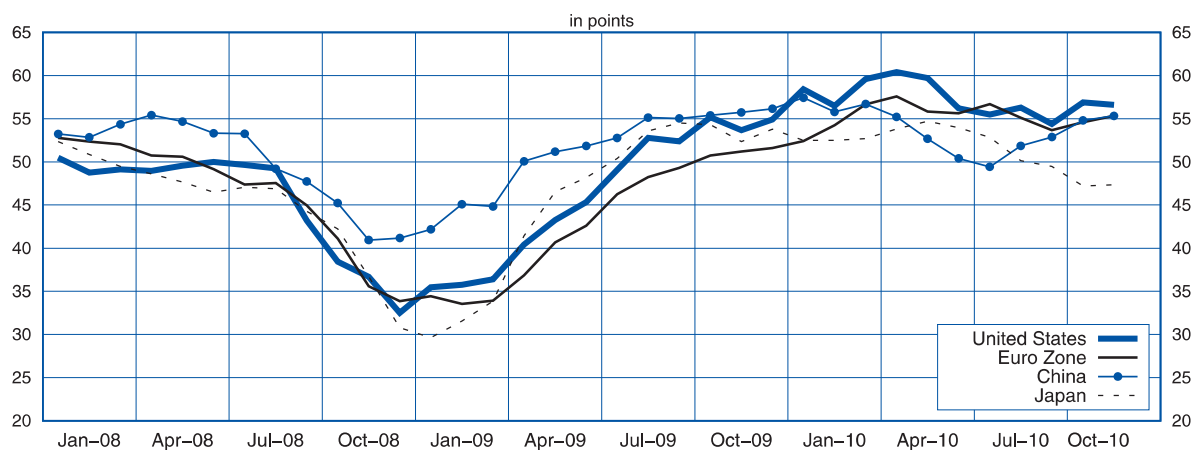
The business climate has been deteriorating sharply since June in Japan (see Graph 1), however, and activity there should be down in Q4 (-0.5%): consumption looks set to suffer a distinct knock-on effect from the end of the scrappage allowance and exports are likely to take a downturn due to the less buoyant environment in Asia as a whole. All in all, the GDP of the advanced economies should be less dynamic in Q4 (+0.4% after +0.6% in Q3).

Slowing down at different rates in H1 2011

Growth stimuli losing force...

Between now and June 2011, three of the growth drivers are set to run out of steam. First of all, fiscal policies are likely to become more restrictive, either because the stimulus measures are becoming less intense (Japan), or because fiscal consolidation policies are gradually being implemented (United Kingdom,

1 - PMI manufacturing output indices: Euro Zone, Japan, China and the United States



Source: Markit

France, Spain or Germany). Next, the impetus from the emerging countries is likely to ease up: in Asia, in the business outlook surveys, purchasing managers have been declaring for several months that the expanding rate of activity is becoming more moderate. Finally, the inventory boost that has contributed strongly to the upturn is set to come to a gradual end in the advanced economies.

...although monetary policies should remain highly accommodating

In the absence of any short-term inflationary risk, accommodating monetary policies should continue to boost activity. In particular, the Fed, which considers that the current low inflation and high unemployment is not in line with its mandate of full employment and moderate inflation, has announced a programme of Treasury security purchases through to June 2011, for an amount of \$600 billion. Over that timescale, the central banks of the main advanced countries are also likely to keep their base rates at very low levels.

Disparated situations in H1 2011

To the time horizon of our forecast, the advanced economies as a whole should grow at a slow rate (+0.4% per quarter), with varied situations. In the United Kingdom, the introduction of fiscal consolidation measures should cause activity almost to stagnate in H1 2011. In the United States, the expected extension of most of the purchasing power stimulus measures, meanwhile, should contribute to limiting the slowdown in activity in H1 2011.

Through to mid-2011, the Euro Zone as a whole should maintain moderate growth

In the Euro Zone, domestic demand: the main boost for activity, and a weak one

Activity in the Euro Zone should slow down slightly in H1 2011 (+0.3% per quarter). The dynamic of domestic demand is unlikely to be enough to entirely offset the slowdown in foreign demand for products from the Euro Zone and the impact of the implementation of budget consolidation measures. Businesses are likely to continue rebuilding their production capacities at a moderate rate. Despite a slightly more buoyant labour market, especially in Germany, household consumption is likely to be hit by the weakness of gains in purchasing power.

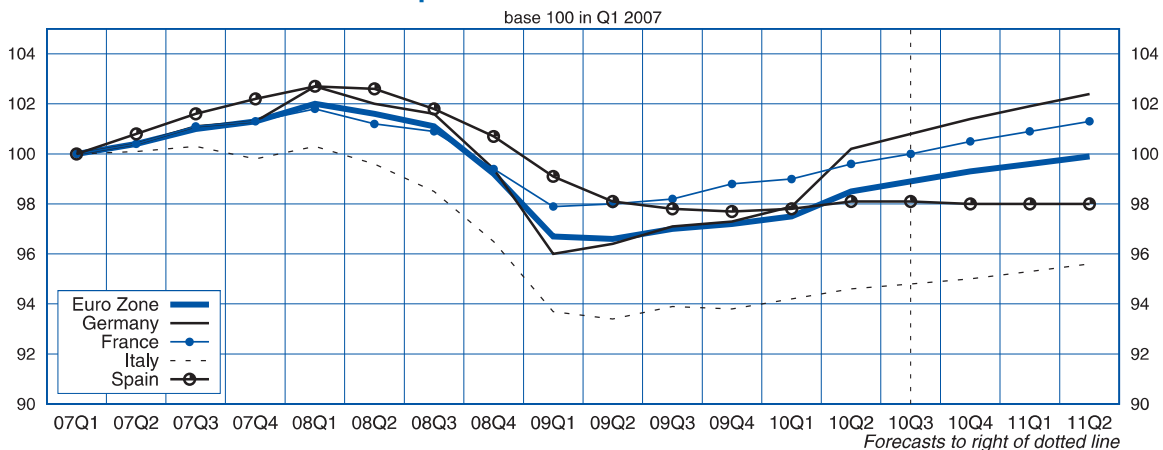
Tensions surrounding European sovereign debt

Certain countries in the Euro Zone could also suffer from the resurgence of concerns about the high level and the rapid rise of their public debt. This could result in rising financing costs, and in a depreciation of the Euro. This uncertain context could weigh on growth prospects in the most vulnerable countries of the Euro Zone.

Persistent differences

In this context, the differences are unlikely to narrow in the Euro Zone (see Graph 2). The Spanish economy should continue to suffer from the consequences of budgetary consolidation measures and is likely to be at a

2 – Disparities increase in the Euro Zone



Source: national statistics institutes, INSEE forecasts

standstill over the three quarters of the forecast. Italy should continue at a slow rate of growth. In contrast, the balancing out of growth in Germany in favour of consumption should allow further strong growth in activity.

In France, growth should be in line with the trend observed since the exit of recession

In France, the outlook surveys are showing some positive signs for the end of the year

In the short term, prospects for activity as shown in the business outlook surveys remain positive (see Graph 3). In services and the manufacturing industry, business climate indicators in November were at slightly higher levels than their long-term average. They still point to an expansion or even acceleration in activity in Q4. The business climate in construction, although still at a low level, has improved slightly since the beginning of 2010.

Slowdown in exports, a boost from domestic demand

In the wake of world trade, foreign demand for French products should slow down, however: until the end of H1, it should evolve at a rate of around +1.0% per quarter, which is below its long-term trend. Also, the positive effects of the past depreciation of the Euro in Q1 2010 should fade out. The boost to growth provided by exports should therefore weaken gradually, but that of domestic demand should continue. Household consumption should continue to progress, with a quarterly profile marked by the effects of the scrappage bonus, and with investment in construction improving slowly (see Graph 4).

Progression in activity still moderate...

In Q4 2010, the French economy should therefore grow at a rate of 0.5%, and over 2010 as a whole, growth in France should stand at 1.6%. In H1 2011, the rate of growth in activity should then weaken slightly to 0.3% in Q1 and 0.4% in Q2. Over the forecasting period, the French economy should therefore continue along the moderate trend it has been on since it emerged from the recession.

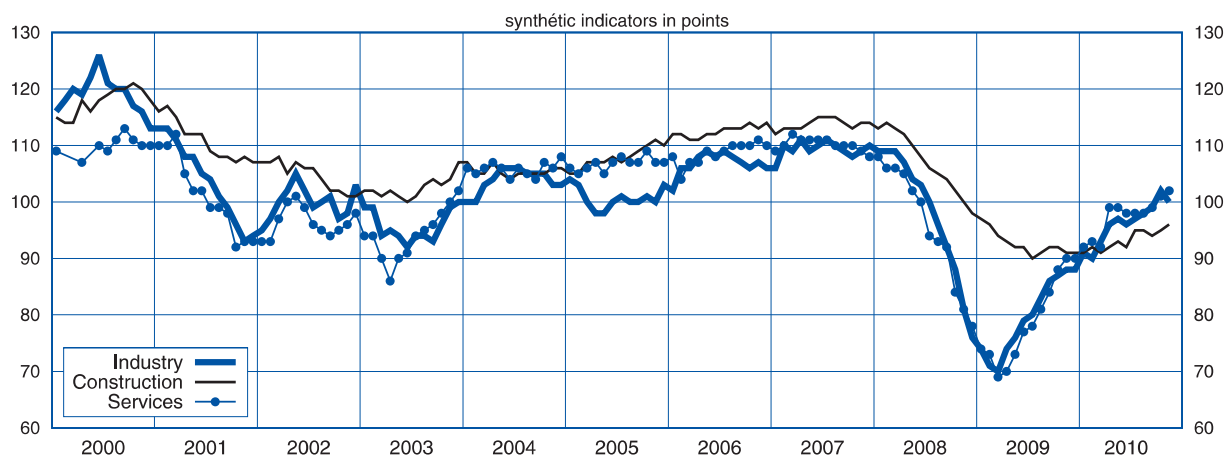
... without inflationary tensions

In France as in Europe, the high level of unemployment and the still-low degree of utilisation of production capacities are limiting inflationary pressures. The recent surge in commodity prices, in particular in food, should nonetheless work its way through into consumer prices. In France, core inflation should therefore rise slightly to 1.1% year-on-year at the end of June 2011. This slight rise should be offset in headline inflation by the slide in the prices of seasonal food products and energy. Headline inflation should stand at 1.5% in December 2010 and 1.4% in June 2011.

Foreign trade should no longer weigh down on growth to the time horizon of the forecast

After a clearly positive contribution to growth in Q2 and Q3 2010, the stocking up trend should ease through to the time horizon of our forecast and imports should slow down. The upward adjustment in stocks had been boosting imports in

3 – Services and industry heading in the right direction, slow recovery for the building trade



Source: INSEE

Q2 and Q3 (+3.9% and 4.1%). Consequently, although exports remained buoyant, foreign trade made a considerably negative contribution to growth. Between now and mid-2011, the gradual easing up of this stocking up trend combined with moderate domestic demand should slow down imports. The contribution of foreign trade should remain negative in Q4 2010, but should then become neutral through to the time horizon of the forecast.

Corporate investment should continue to progress through to mid-2011

Production facilities in greater demand

Corporate investment should accelerate slightly between now and mid-2011. It should benefit from positive activity prospects and the improvement in financing terms. Also, although the capacity utilisation rate has remained significantly below its long-term average, the mobilisation of production capacities is intensifying: the number of companies reporting production bottlenecks has been on the rise since mid-2009 (see Graph 5).

The labour market continues its slow improvement

Market-sector employment continues to improve

Compared to the drop in activity, the adjustment in employment during the crisis remained a moderate one. The upturn observed since the start of 2010 has also been greater than past behaviour might have suggested. To the time horizon of our forecast, employment should continue to be dynamic. Employment should continue to rise at a moderate rate: job creations in the non-agricultural market sector should come to around 51,000 in H2 2010 and 50,000 in H1 2011.

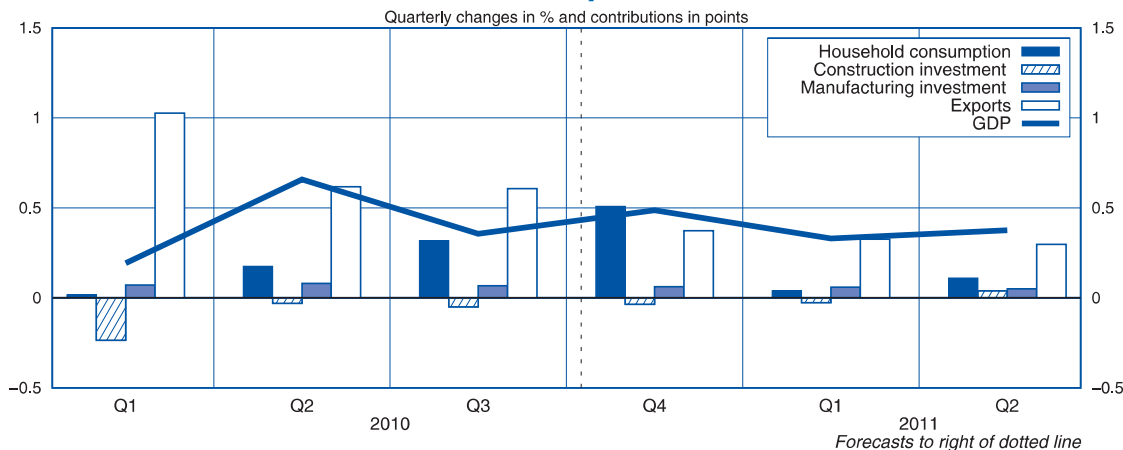
Slight fall in unemployment through to mid-2011

The unemployment rate stood at 9.3% of the active population in Q3 2010 in Metropolitan France (respectively 9.7% including France's overseas departments). It should continue to fall slowly to 9.1% at mid-2011 (9.5% respectively).

Wages rising modestly

The continuing poor situation on the labour market should take its toll on wages: the average wage per head should progress by barely more than inflation through to mid-2011. Gains in real wages should therefore be small, at about 0.1% per quarter.

4 – Growth sustained by domestic demand



Source: INSEE

Household consumption should sustain growth

Small gains in purchasing power

Supported by buoyant earned income, household income should progress by +0.8% in Q4 2010. It should slow down slightly in Q1 and Q2 2011 (+0.6% then +0.7%), under the effect of an acceleration in taxation, in line with more solid income in 2010. Household purchasing power should grow moderately: +0.4% in Q4 2010 after +0.7% in Q3, then +0.2% in Q1 2011 and +0.3% in Q2 2011.

Household consumption affected by jolts caused by the end of the scrappage allowance.

As at the end of 2009, the prospect of the end of the scrappage bonus on 31 December 2010 and of a further tightening of the environmental bonus-malus in 2011 should lead to strong growth in automobile consumption in Q4, and then a backlash in H1 2011.

The saving rates stabilises at a high level

Household consumption should continue to progress strongly in Q4: +0.9%. Then it should slow down in H1 after the expiry of the scrappage bonus: +0.1% over Q1 and +0.2% in Q2 2011. The household saving rates should be at a high level: in a relatively uncertain economic context, households should continue to save as a precaution.

The construction sector on the slow road to recovery

Household investment in housing on the rise

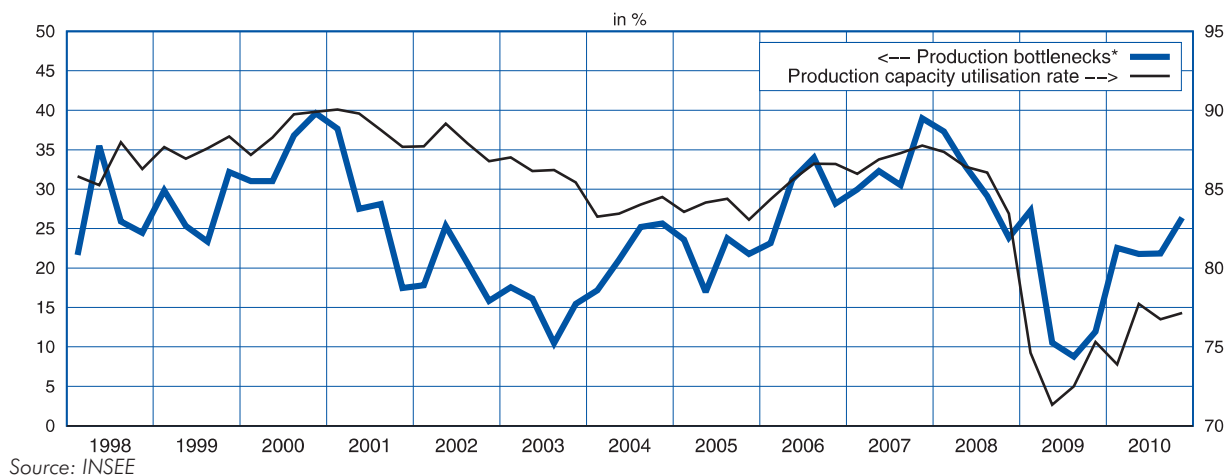
In the building sector, the business climate in the surveys has improved. The trend in new housing starts and buoyant demand for loans would also suggest that household investment in housing should progress over the three quarters of the forecast. In parallel, corporate investment in construction should return to a positive growth rate in Q2 2011. After contracting continuously since Q2 2008, construction activity should therefore return to growth through to the time horizon of the forecast.

Uncertainties: Tensions surrounding European sovereign debt in the Euro Zone, impact of budget consolidation measures

Tensions surrounding European sovereign debt

The month of November 2010 was marked by the resurgence of tensions surrounding European sovereign debt. If these financial tensions were to be accentuated, they could end up weighing down on the financing of economic agents and ultimately on growth in the Euro Zone. The uncertainties of the current economic context could also lead to more wait-and-see behaviour among agents.

5 – Tensions on production capacities in manufacturing industry



Source: INSEE

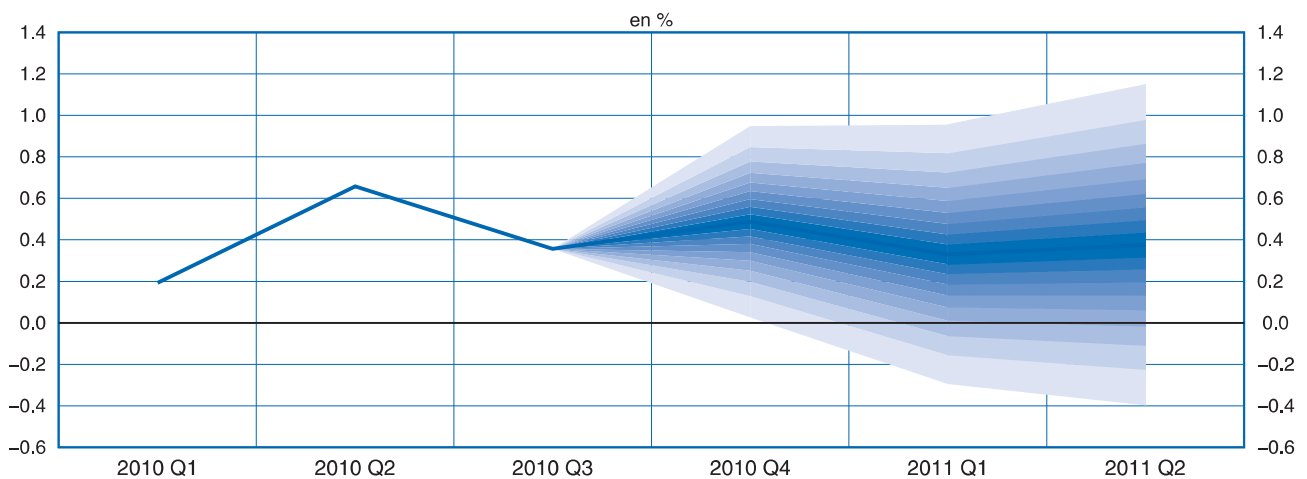
Robustness of demand in the Euro Zone.

Conversely, the robustness of domestic demand, in Germany or in France, may sustain European growth to a greater degree.

Behaviour of private agents in a context of tighter budgets

More globally, while budget policies have been boosting activity until now, the consolidation measures already taken in Spain and yet to come in the United Kingdom, Germany or France, mark a change in direction. The scenario in this Conjoncture in France is based on the assumption that these policies will be slightly offset by the expenditure behaviour of private agents. However, if they do succeed in restoring household confidence in the sustainability of public finances, their restrictive impact on growth might be weaker. Conversely, if the restrictive impact of these policies is not offset by a revival of confidence by private agents, then activity could slow down to a greater extent than that shown in this 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 Q2 2010 has a 50% chance of being between +0.3% (lower limit of the fifth band from the bottom) and +0.7% (upper limit of the fifth band from the top). Likewise, it has a 90% chance of being between +0.0% and +0.9%. In Q1 and Q2 2011, the 90% confidence intervals are respectively [-0.3%; +1.0%] and [-0.4%; +1.1%].

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
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2			
International environment													
Advanced economy GDP	-2.2	0.2	0.2	0.8	0.8	0.7	0.6	0.4	0.4	0.4	-3.6	2.4	1.4
Euro Zone GDP	-2.5	-0.2	0.4	0.2	0.3	1.0	0.4	0.4	0.3	0.3	-4.0	1.7	1.3
Barrel of Brent oil (in dollars)	44	59	68	75	76	79	77	82.7	85.0	85.0	61.5	78.6	85.0
Euro-dollar exchange rate	1.30	1.36	1.43	1.48	1.38	1.27	1.29	1.33	1.33	1.33	1.39	1.32	1.33
World demand for French products	-8.9	-1.7	3.7	3.0	3.4	3.6	1.0	1.0	0.9	1.0	-12.0	10.9	3.8
France - supply and use													
GDP	-1.5	0.1	0.2	0.6	0.2	0.7	0.4	0.5	0.3	0.4	-2.5	1.6	1.3
Imports	-5.8	-3.1	-0.4	2.9	1.8	3.9	4.1	2.1	1.1	1.0	-10.6	8.8	6.5
Household consumption	0.1	0.3	0.2	1.0	0.0	0.3	0.6	0.9	0.1	0.2	0.6	1.7	1.2
Public and NPISH consumption	0.6	0.7	0.7	0.6	-0.1	0.3	0.4	0.3	0.2	0.2	2.6	1.4	0.8
Total GFCF	-2.3	-1.5	-1.5	-0.9	-0.9	0.9	0.5	0.5	0.4	0.7	-7.0	-1.6	1.9
of which: NFEs	-3.1	-1.8	-1.4	-1.0	-1.0	1.2	0.5	0.7	0.7	1.0	-7.9	-1.5	2.6
Households	-2.3	-1.9	-1.9	-1.4	-0.5	0.2	1.0	0.6	0.3	0.4	-8.7	-2.1	1.7
Exports	-7.5	-0.6	1.1	1.3	4.4	2.6	2.5	1.5	1.3	1.2	-12.2	9.6	5.2
Contributions													
Domestic demand excluding change in inventories(**)	-0.3	0.0	0.0	0.5	-0.2	0.4	0.5	0.7	0.2	0.3	-0.5	1.0	1.3
Change in inventories(**)	-0.8	-0.6	-0.2	0.6	-0.2	0.6	0.3	0.0	0.1	0.0	-1.8	0.6	0.5
Net foreign trade	-0.3	0.7	0.4	-0.5	0.6	-0.4	-0.5	-0.2	0.0	0.0	-0.2	0.0	-0.5
France - situation of households													
Total employment (variation at end of quarter)	-157	-71	-30	29	41	62	34	37	24	17	-229	173	-
Non-agricultural market sector employment	-172	-93	-63	-5	17	39	19	32	26	24	-334	106	-
Unemployment rate (quarterly average)	8.6	9.1	9.2	9.6	9.5	9.3	9.3	9.2	9.1	9.1	9.6	9.2	-
Unemployment rate (quarterly average)	9.0	9.5	9.5	10.0	9.9	9.7	9.7	9.6	9.5	9.5	10.0	9.6	-
Consumer price index(*)	0.3	-0.5	-0.4	0.9	1.6	1.5	1.6	1.5	1.3	1.4	0.1	1.5	-
Core inflation(*)	1.7	1.5	2.0	1.8	1.7	1.4	0.8	0.7	0.9	1.1	1.8	1.1	-
Household purchasing power	0.5	0.8	0.6	0.0	0.1	0.5	0.7	0.4	0.2	0.3	1.6	1.4	1.3

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

Review of the previous forecast

In Q3 2010 activity slowed in France: the growth rate settled at 0.4%, as anticipated in the October *Conjoncture in France*. This slowdown affected most of the main sectors, most notably the manufacturing industry. For Q4, our growth forecast is revised very slightly upwards (+0.5% against +0.4% forecast in October), but our scenario has changed little since the October *Conjoncture in France*.

As forecast in the October *Conjoncture in France*, activity experienced a slowdown in Q3

After a dynamic Q2 (+0.7%), activity slowed down in Q3 in France and in the rest of the euro zone. GDP grew by 0.4% in France, as anticipated in the October *Conjoncture in France*. The slowdown affected most of the main market sectors and was particularly visible in the manufacturing industry: after +1.5% in Q2, output stagnated in Q3 (-0.1%), whereas we had anticipated a slight rise (+0.5% forecast in October).

In construction, output fell once again in Q3 (-0.4% against -0.1% forecast), but this slight setback does not alter the diagnostic of a gradual stabilisation of activity in this sector. It is indeed very limited compared with the sharp drops witnessed up to Q1 2010. The market services sector

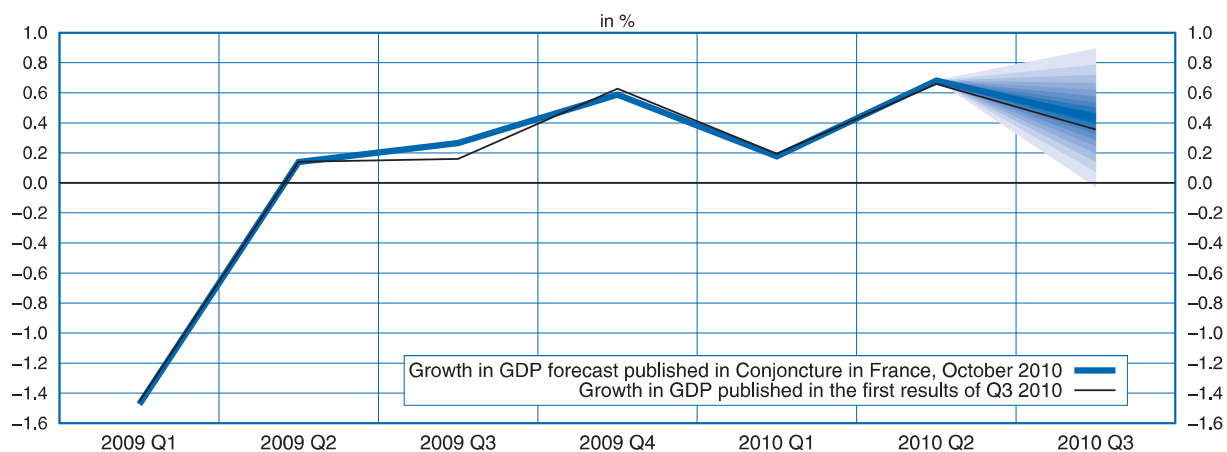
remained dynamic (+0.8% against +0.7% forecast): it has been the main source of growth in France since the end of 2009.

Demand still strong, imports very dynamic

Final domestic demand excluding inventories remained dynamic in Q3 (+0.5% against +0.4% forecast). The rise in consumption was slightly higher than forecast (+0.6% against +0.4% forecast), with a sharp rise in its manufacturing component, notably leather and textiles, but also automobiles and housing equipment. Elsewhere, the upturn in total investment hinted at in Q2 was confirmed (+0.5%, in line with the forecast). In the area of non-financial enterprises, investment rose by 0.5% (+0.6% forecast). But although their investments in non-energy industrial goods and in services continued to pick up, those in construction fell sharply once again (-2.0% against -0.9% anticipated).

The buoyancy of domestic demand clearly sustained imports: the increase in imports was higher than expected (+4.1% against +2.1% forecast). Even though exports also enjoyed a sharp rise (+2.5% against +2.2% forecast), the overall contribution of foreign trade to GDP growth was negative (-0.5 point), where we expected it to be neutral. This negative contribution is partly offset by the positive contribution of inventory

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



Source: INSEE

Review of the previous forecast

change. So the French economy is still benefiting from a trend towards restocking after the extensive destocking during the crisis.

No major revision of our forecast for Q4 2010

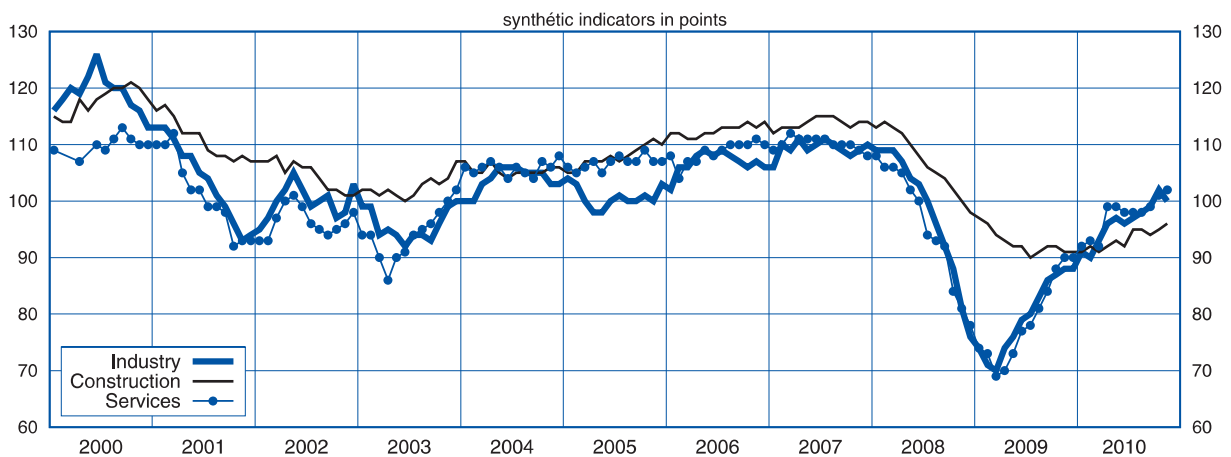
In Q4, our growth forecast is revised very slightly upwards, to +0.5% against +0.4% previously. However, over 2010 as a whole, the growth forecast remains unchanged, at +1.6%. Our scenario barely changes, except in households' consumption and energy demand.

The slight revision upwards of activity for Q4 essentially stems from market services. On the one hand, activity in trade (+0.9% against +0.6% forecast in October) should be boosted by strong automobile consumption before the end of the scrappage bonus. On the other hand, activity in other market services is revised upwards (+0.8% against +0.6%). In this sector the composite

indicator has continued to move up in recent months (see *Graph 2*). On the demand side, this revision should find its counterparty in investment in services, which has rebounded sharply over the last few quarters, among both businesses and households. Conversely, energy sector output should be severely affected by the October strikes in refineries.

In the manufacturing industry, the business climate has stayed at around its long-term average. Activity in this sector should thus grow at a moderate rate (+0.5%, forecast unchanged). Last, in the construction sector the climate is still hesitant but has remained within a growth tendency since the start of the year. This is why the October scenario of a gradual stabilisation of activity in the construction industry has been maintained, even though investment and output in this sector may fall back slightly further in Q4.■

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



Source: INSEE