

International developments



Oil and raw materials

American oil production put to the test by falling prices

In Q3 2015, the price of North Sea oil fluctuated between \$45 and \$50 per barrel of Brent, against a backdrop of supply surplus. In November, the price hovered around \$45.

According to data from the International Energy Agency (IEA), the gap between supply and demand narrowed significantly in Q3 and this convergence is likely to continue through to mid-2016. Output is expected to come to a standstill in the United States, the consequence of a fall in the number of new rigs. A supply surplus is expected to last until mid-2016 however, while stocks of crude are already very substantial, particularly in the United States.

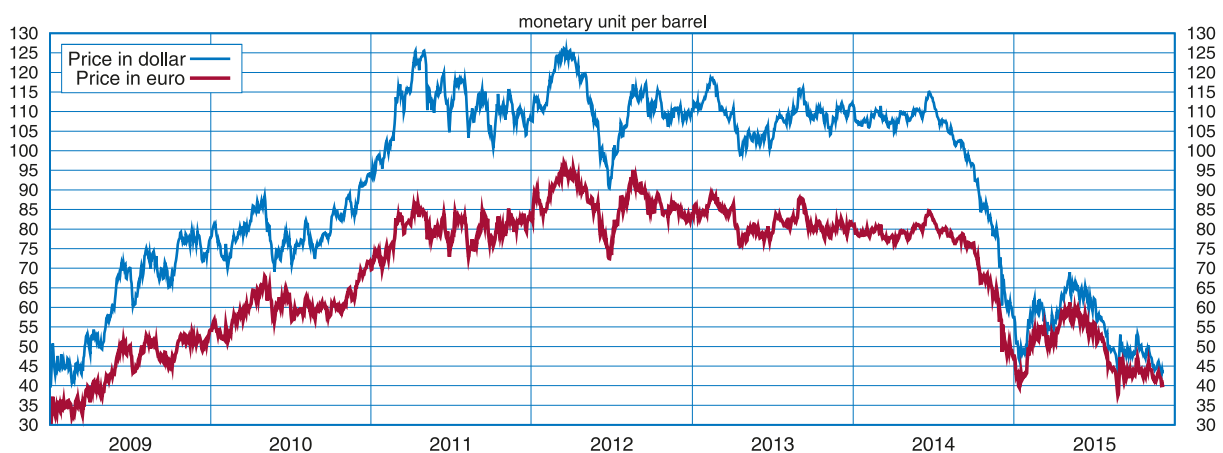
The conventional assumption of a stable oil price at \$45 between now and mid-2016 is subject to two main uncertainties. Firstly, the resilience of the American sector to low prices is uncertain. Our scenario includes a slight decline in American production but it may eventually adjust significantly downward, following the slump in the rig count. Secondly, Iran's output may increase significantly up to mid-2016 with the end of the embargo, leading to a rise rather than a stabilisation of OPEC's output as a whole.

Since the beginning of 2015, the price of oil has been way below last year's level

In H1 2015, the price of oil (Brent) fluctuated between \$45 and \$65 (*Graph 1*). In Q3 2015 the price dropped a further notch, hovering between \$45 and \$50. In November and early December it fluctuated around the low end of this range. A new price equilibrium is emerging as uncertainties affect demand and the physical market remains in surplus. Stocks of crude are thus continuing to swell, particularly in the United States.

At global level, the gap between supply and demand narrowed in Q2 and Q3 2015. Although remaining at a high level, American production began to drop in Q2 2015, partially offset by a rise in Q3: with oil at less than \$50 per barrel, the profitability of the new American rigs is not guaranteed and has led to a fall in the number of new rigs (*Graph 2*). Conversely, OPEC's output continued to grow until Q3 2015, particularly in Saudi Arabia and Iraq.

1 - Price of Brent in € and in \$



Source: Macrobond

International developments

The imbalance expected to diminish slightly through to mid-2016

Worldwide supply is expected to come to a standstill over the coming quarters. It should stand at 96.2 million barrels per day (Mbpd) by mid-2016, 0.2 Mbpd less than its level in summer 2015 (data adjusted for seasonal variations, *Graph 3*). On the one hand, American supply is likely to fall again. On the other hand, OPEC supply is only expected to increase moderately in Q4 2015 and then in H1 2016: in the short term, Iraq in particular cannot sustain the pace of production achieved in the summer.

According to IEA forecasts, demand is expected to increase slightly in Q4 2015, thanks to the OECD countries. It is expected to pick up more significantly in H1 2016, mainly due to the expected rebound in demand in China. Thus the gap between supply and demand should continue to narrow.

Uncertainty surrounding supply in 2016

The price of a barrel of crude oil in this forecast is conventionally maintained at \$45, close to its November average. Price risks are significant: upside if American output falls more than expected and downside if Iranian output picks up more quickly than anticipated.

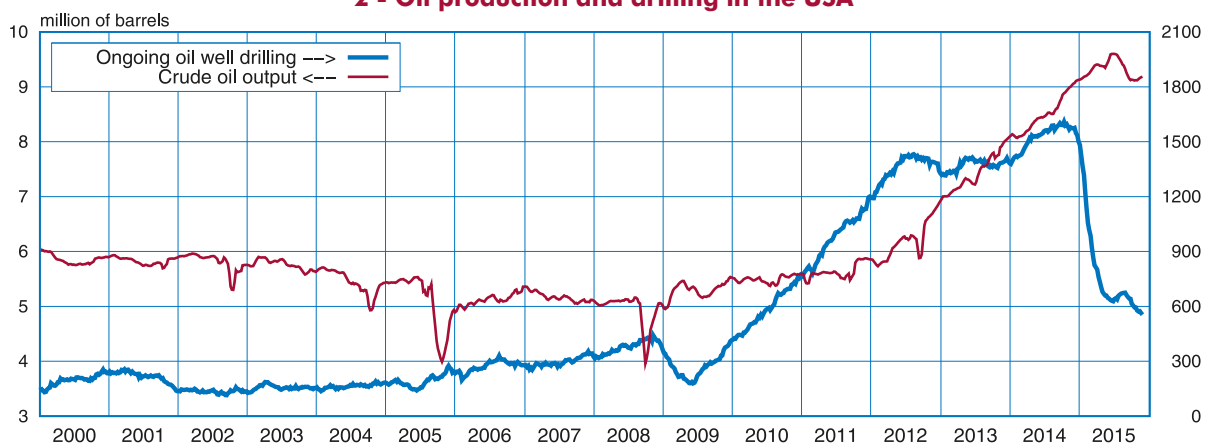
For its part, American output fell in Q2 2015 and is likely to fall again through to Q2 2016. But the extent of the decline still appears moderate compared to the recent fall in the rig count. The increase in rig productivity and operators' good financial coverage has enabled production to be maintained. Nevertheless, the short term break-even point for American unconventional rigs is around \$70 per barrel. The United States may play its role of swing producer by reducing production more significantly between now and mid-2016. The supply surplus would then decrease further.

Conversely, with the lifting of the embargo decided in the nuclear power agreements of July 2015, Iranian production may increase far more than expected and reach 3.6 Mbpd by March 2016 (against 2.9 Mbpd in October 2015); in this case, the surplus would remain high.

A sharper fall in industrial commodity prices than in agricultural commodity prices

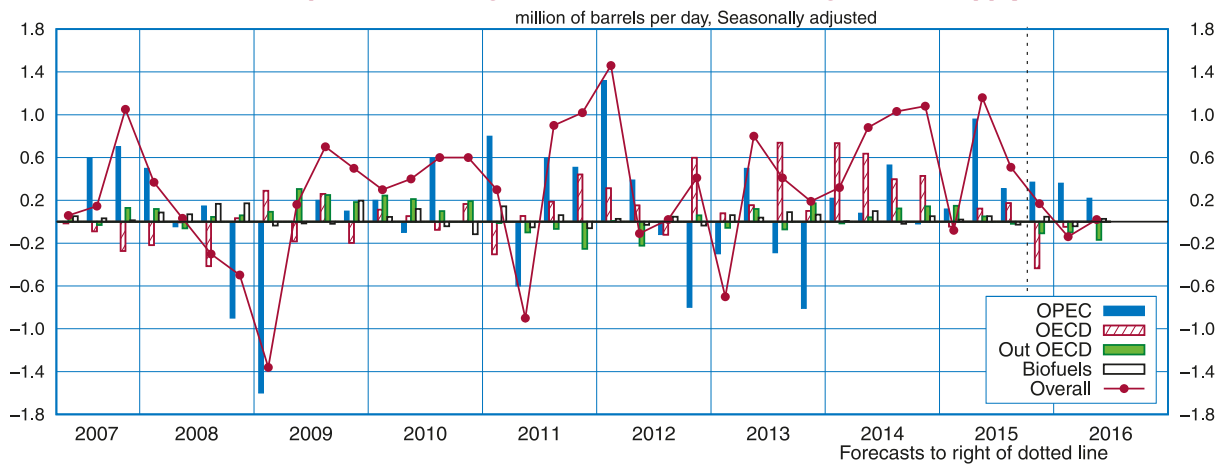
In Q3 2015, prices in Euros of commodities excluding energy continued to fall: -6.5% after -1.4% in Q2 (*Graph 4*). The prices of industrial commodities fell sharply (-10.1%): prices of non-ferrous metals fell by 12.8% and those of ferrous metals fell by 8.8%. The decline was less marked in agricultural raw materials (-5.0%). The price of food commodities fell by 1.2%. ■

2 - Oil production and drilling in the USA

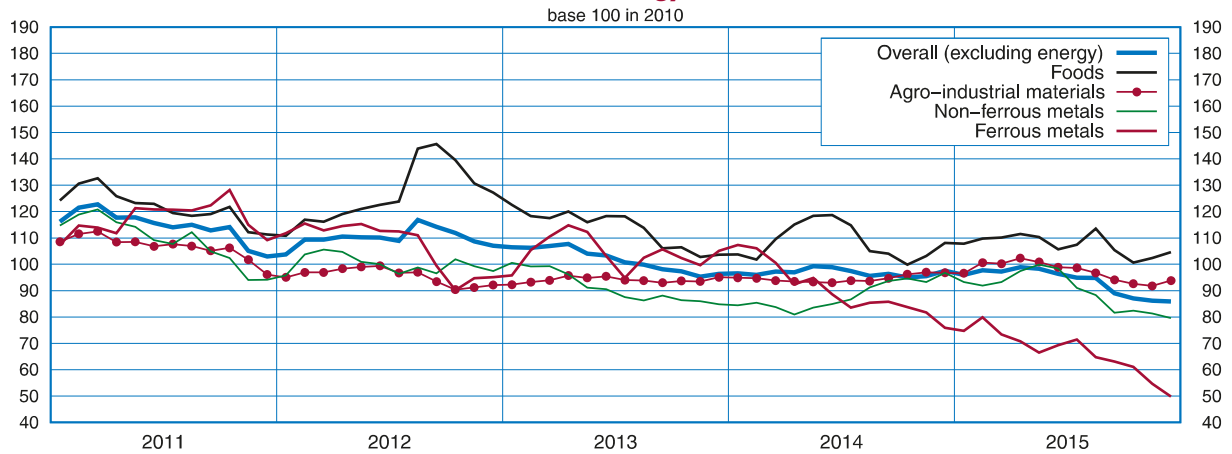


Source: International Energy Agency (IEA), Baker Hughes

3 - Principal contributing factors to the variation in global oil supply



4 - Prices of non-energy commodities



Financial markets

Global monetary policies diverge, but rates converge in Europe

The divergence between the monetary policies of the American Federal Reserve (Fed) and the European Central Bank (ECB) is likely to widen over the coming months. The Fed is expected to tighten its policy slightly by raising its key interest rate before Q2 2016, a decision grounded in the country's buoyant labour market and prospects of inflation getting close to the target of 2%. Meanwhile, the ECB announced a ramp-up of its quantitative easing programme at the meeting of its Governing Council on 3 December. This divergence is likely to keep the Euro close to its lowest level against the dollar since 2003, at around \$1.08 to the Euro. The financial fragmentation of the Eurozone has continued to ease in terms of both credit to businesses and sovereign yields. The Eurozone credit market is returning to growth after several years of decline, in particular in Italy and Spain. At the same time, bank borrowing rates charged to enterprises are not only falling, but also converging. The sovereign yields of Eurozone countries have remained relatively low since the start of 2015. Since the summer, France's 10-year bond yield has virtually stabilised at around 1%.

The Fed expected to raise its key interest rate moderately

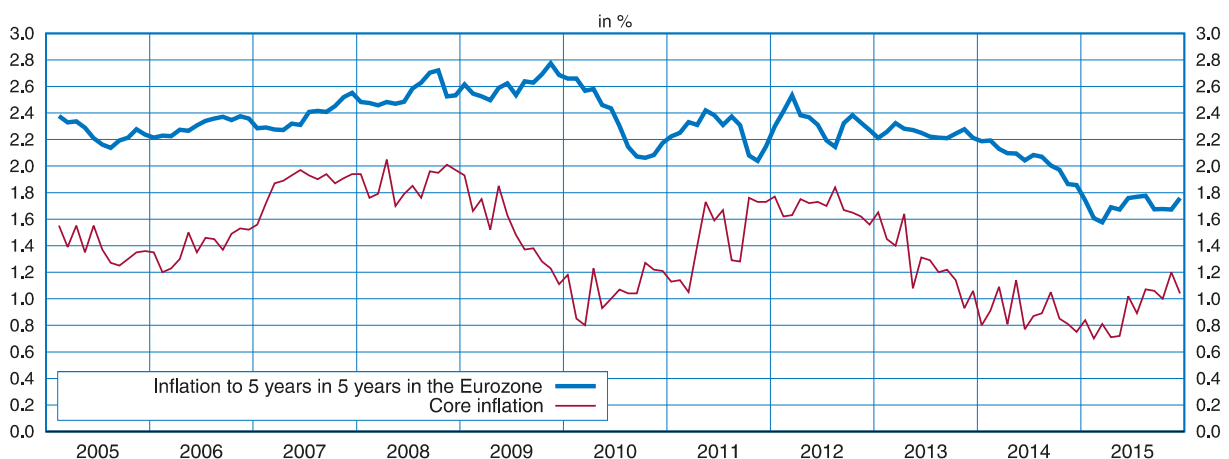
The Fed should raise its key interest rate from 0.25% to 0.50% by June 2016. This quantitatively modest rise would be the first since 2008. It is justified by the vigorous health of the American labour market – unemployment stood at just 5.0% in October – and the country's short-term inflation prospects. Indeed, while current inflation is still low due to the slump in oil prices, this effect is likely to be only temporary: core inflation, which excludes energy prices, is close to the Fed's target of 2%.

Faced with persistently low inflation, the ECB ramps up its quantitative easing programme

The low level of inflation in the Eurozone has led the ECB to step up its monetary easing policy. Since the start of this year headline inflation has remained close to zero, while core inflation has hovered below 1%. Medium-term inflation forecasts as measured on the financial markets are maintained at between 1.6% and 1.8%, lower than the ECB's target of 2% (Graph 1).

This further easing has been given concrete form by the prolongation of the asset purchase programme beyond the period initially planned (March 2017 instead of September 2016). The decision has also been made to further reduce the deposit facility rate, which was already negative.

1 - Inflation expectations in the Eurozone



Source: Macrobond

Sovereign yield spreads stabilising

The yield spreads between sovereign debt levels in the Eurozone – excluding Greece – have been stable overall since the start of 2015 (*Graph 2*). Greece's financing cost is still far higher than that of the other countries in the zone, at around 7 points above the German yield; however, it did come down in Q3 2015. German and French yields rose in May, after a dip in April. They have been virtually stable since the summer, at around 0.5% for the German 10-year sovereign yield and 1.0% for the French sovereign yield.

Credit picking up and private rates converging in the Eurozone

In the Eurozone, outstanding loans to businesses are growing slightly at the end of 2015, after falling for several years (*Graph 3*). In France credit is continuing to improve (+3.3% in Q2 and +3.6% in Q3 2015). In Italy and Spain, outstanding loans may progress once again in early 2016 if the current trends continue. The upswing in credit

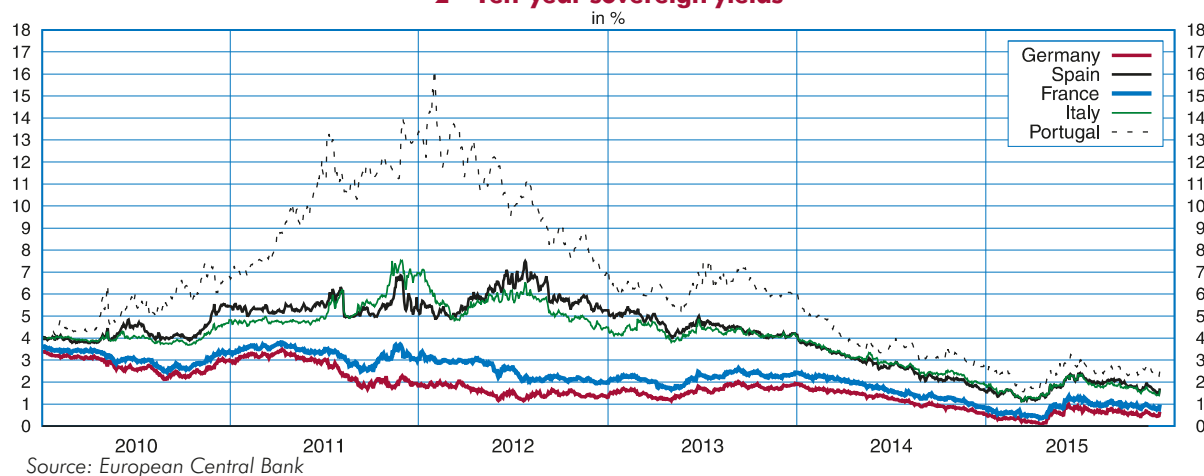
market volumes has been accompanied by a drop in interest rates in both these countries. The borrowing costs of enterprises in the peripheral countries are continuing to converge with those of the Eurozone's core countries (*Graph 4*).

The summer's stock market turmoil has eased

Since September the Shanghai stock exchange has stabilised to a level close to that at the start of the year, after falling back sharply over the summer. The EM MSCI, the benchmark index for the stock markets of emerging countries, was directly affected by this Chinese turmoil: in October the MSCI index in dollars was 10% below its level of January 2015, although this drop can partly be explained by the depreciation of emerging currencies against the dollar.

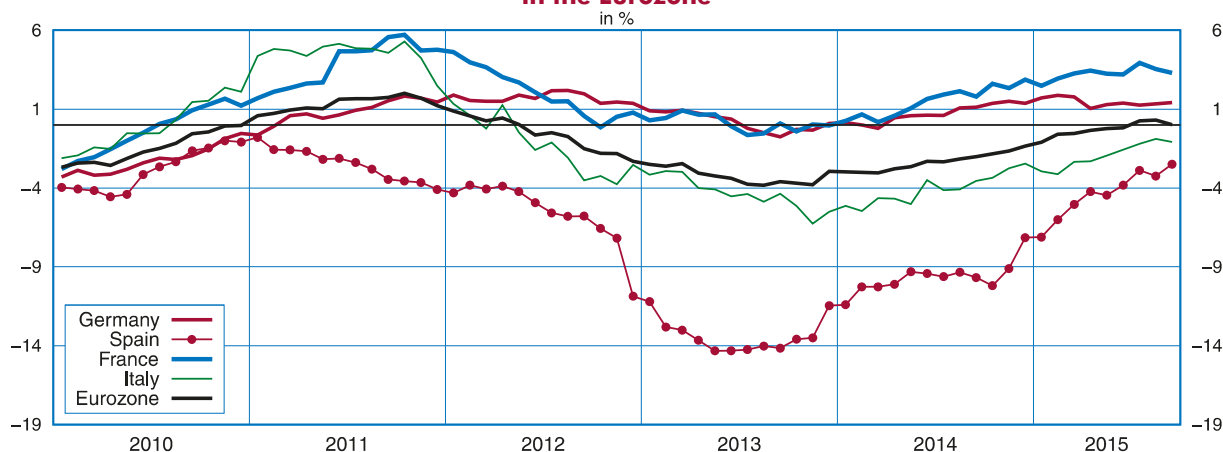
In the advanced economies the stock markets are generally on the rise again after being adversely affected by the turmoil on the emerging markets in summer. In addition to this upturn, the stock market indices are less volatile than they were.

2 – Ten-year sovereign yields



Source: European Central Bank

3 – Annual growth rate of the volume of outstanding loans to non-financial corporations in the Eurozone



Source: European Central Bank

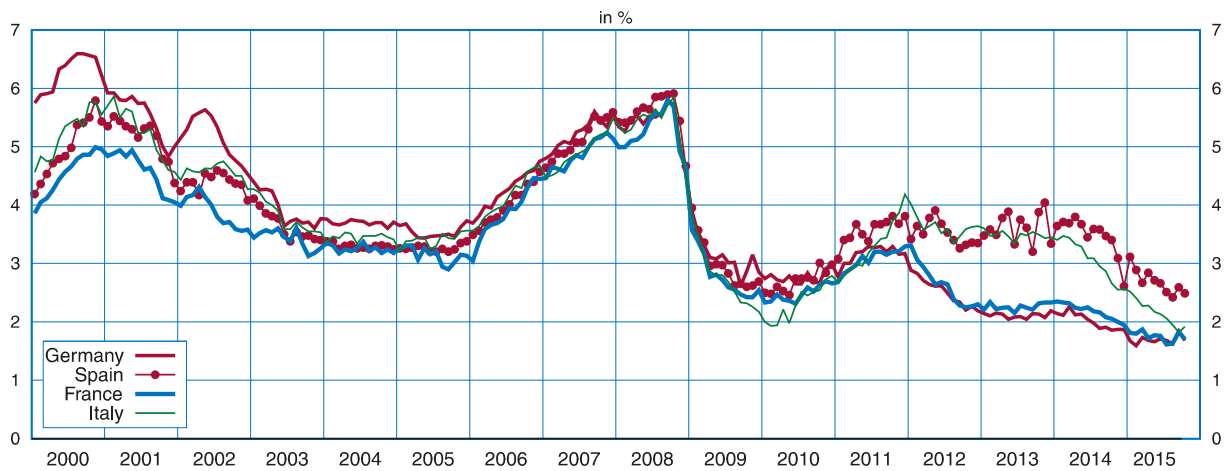
International developments

The stability of the Euro closely dependent upon monetary policy announcements

Since the ECB first implemented its quantitative easing policy, the Euro has almost stabilised against the dollar: it has hovered between \$1.05 and \$1.15 over this period. Additionally, France's real effective exchange rate rose slightly in Q3 2015 because of the depreciation of the Russian rouble and the Chinese yuan (*Graph 5*).

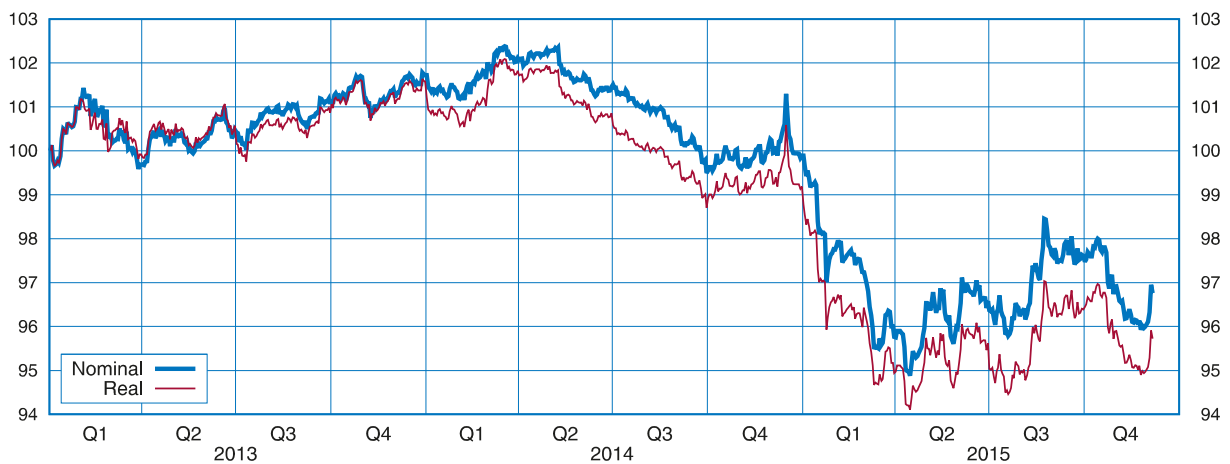
The rise in the American rates (if confirmed), combined with the ramped-up quantitative easing policy decided by the ECB on 3 December 2015, should result in the Euro remaining close to its lowest level since 2003. In this issue of *Conjoncture in France*, the conventional assumption of exchange rate stability through to mid-2016 gives rates of \$1.08, £0.72 and ¥133 to the Euro. On this assumption, the effective exchange rate should slip back slightly in Q4. ■

4 - Rate of interest on new loans to non-financial enterprises



Source: Macrobond

5 - Effective exchange rate for France



Sources: European Central Bank, INSEE calculations

Eurozone

More uniform growth within the Eurozone

In Q3 2015 activity slowed down slightly in the Eurozone (+0.3% after +0.4%), due in particular to Germany (+0.3% after +0.4%), Italy (+0.2% after +0.3%) and Spain (+0.8% after +1.0%). Activity should pick up slightly through to Q2 2016 (+0.4% per quarter), in the wake of domestic demand driven by the gradual recovery of employment and investment. On average over the year, growth should reach +1.5% in 2015, after +0.9% in 2014. The improvement has been broadly achieved in 2015 for France, Italy and Spain, driven in particular by the upturn in household purchasing power and, consequently, by household consumption, but also by the recovery of investment in Italy. For its part, Germany should almost fully maintain the momentum regained in 2014 (+1.5% after +1.6%). By mid-2016, the growth overhang for the Eurozone should be +1.2%.

In Q3 2015, activity slowed down slightly

In the Eurozone, the upturn weakened slightly in Q3 2015, with activity growing by +0.3% after +0.4% in Q2. With the exception of France – where temporary factors led to a stagnation in activity in Q2 – activity in the main Eurozone countries slowed down slightly in Q3, particularly in Italy (+0.2% after +0.3%), Germany (+0.3% after +0.4%) and Spain (+0.8% after +1.0%). This decline was due in particular to a setback in

Eurozone exports, which should be temporary. Additionally, in Spain, the catch-up momentum in investment in capital goods is fading.

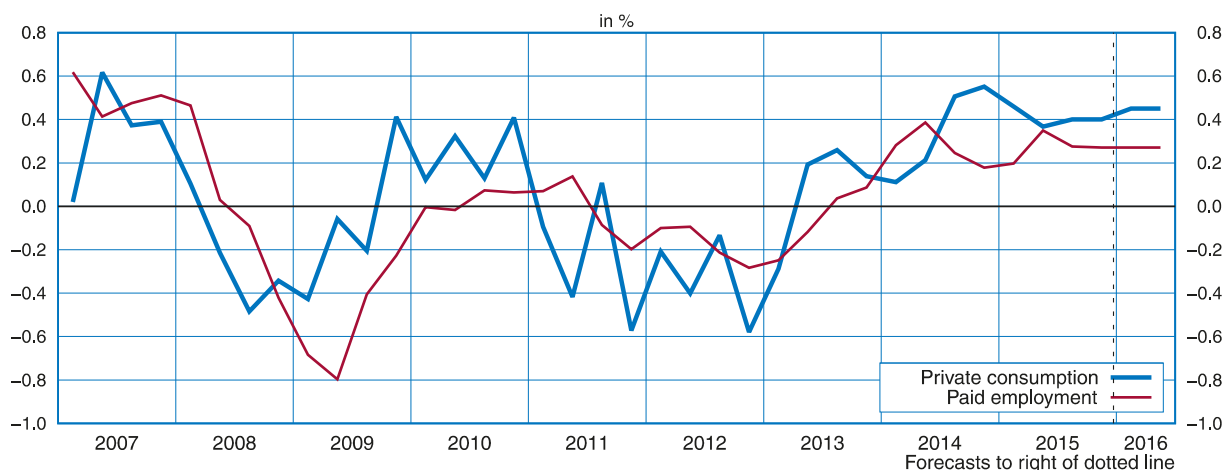
Activity expected to pick up slightly, driven by household consumption

The business climate remains positive and in Q4 2015 activity is expected to return to the pace it showed at the beginning of the year (+0.4% per quarter). It should be driven primarily by private consumption (+0.4% per quarter through to mid-2016), itself boosted by purchasing power gains. On the one hand, employment should continue to grow at a relatively fast pace through to Q2 2016 (+0.3% per quarter, *Graph 1*), as it has for over a year. As a result, unemployment should fall again: in Q2 2016, the unemployment rate should settle at 10.4% (against 11.5% at the end 2014). On the other hand, household purchasing power is likely to be buoyed up by the gradual upturn in wages, and by the knock-on effect of the recent drop in oil prices.

Investment likely to rise again in Q4

Investment in capital goods is also expected to contribute to the pick-up in domestic demand. After two sluggish quarters, it should grow by 1.2% in Q4 2015, then 1.0% per quarter in early 2016. Investment should recover in Italy and remain vigorous in Spain, albeit at a slower pace. The

1 - Payroll employment and private consumption



Sources: National Statistical Institutes, INSEE forecasts

International developments

additional depreciation allowance schemes should also sustain investment in capital goods in France and Italy.

Investment in construction is also expected to rise gradually: after a stable period at the end of 2015, it should increase by 0.4% per quarter in early 2016. It should grow at a sustained pace in Spain and more moderately in Germany, whereas it should stabilise in France and Italy.

Exports expected to rebound

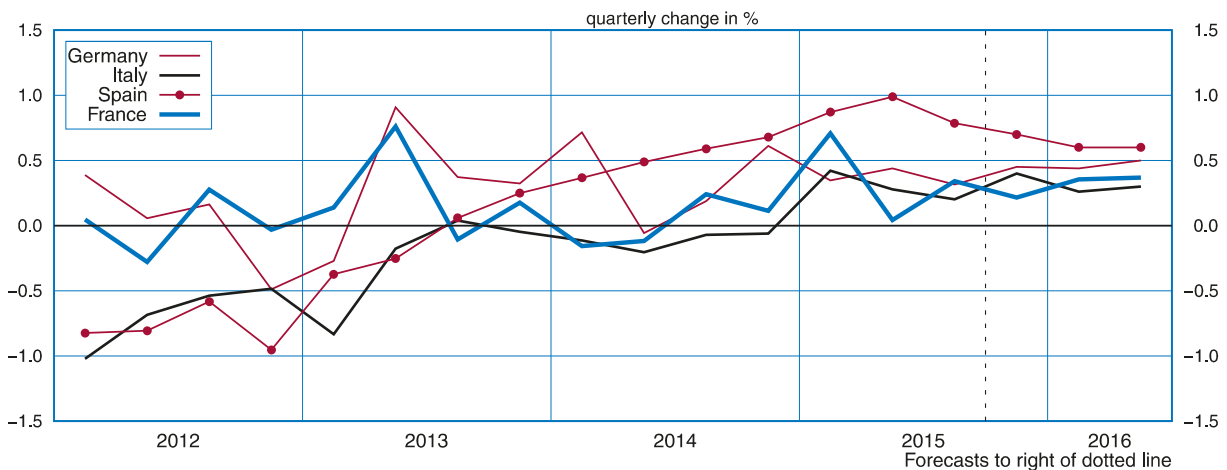
Eurozone exports are expected to bounce back in Q4 2015 (+1.3% after +0.2%). In early 2016, they should continue to benefit from the past depreciation of the Euro and rising world demand, and should grow by 1.0% per quarter. Imports should pick up in Q4 (+1.2% after +0.9%), then remain vigorous in H1 2016 (+1.1% per quarter), in the wake of domestic demand. The contribution of foreign trade to growth should therefore be slightly positive in Q4 2015 (+0.1 points), in

reaction to Q3, and then become neutral in H1 2016. All in all for 2015, exports should grow by 5.0% (after +4.1% in 2014) and imports should increase by 5.3% (after +4.5% in 2014), contrasting with the smaller rise in world trade, expected to be +1.2%.

The cyclical divergences between Eurozone countries decrease

With the end of Spain's catch-up dynamic (+0.7% in Q4 2015 then +0.6% per quarter in early 2016), growth in the main Eurozone countries should gradually converge, signalling a more uniform spread of the Eurozone recovery (*Graph 2 and Box*). In particular, the Italian economy is expected to grow at a comparable pace (between +0.3% and +0.4% per quarter) to that expected in France (+0.2% in Q4, then +0.4% per quarter) and in Germany (+0.4% in late 2015 and early 2016, then +0.5% in Q2 2016). ■

2 - GDP growth in the Eurozone



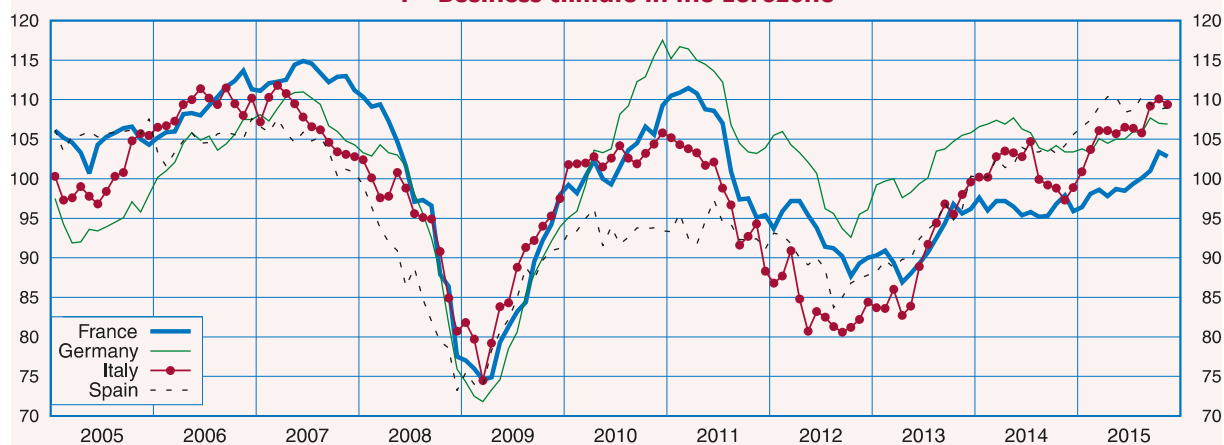
From deviations in business climates to growth differentials

The business climates estimated and published by the European Commission (DGECFIN) are homogenised. This standardisation covers each country's long-term mean and standard deviation. This makes it possible to compare the business outlook of several countries (*Graph 1*). However, deviations cannot be interpreted directly in the same way that activity growth differentials are measured in the national accounts. On the one hand, long-term growth is not the same in all countries. For example, according to Rioust de Largentaye *et al.*,¹ since 2000 the reference to 100 in the business climates represents a quarterly average growth of +0.4% in Germany, +0.3% in France and

+0.1% in Italy. On the other hand, the relationship between the business climate and activity does not necessarily remain stable over time. In Germany, for example, activity is relatively disappointing given the business climate that has prevailed for the past three years (*Graph 2*), probably reflecting the sharp decrease in its potential growth due to its demographic growth. All in all, although the business climate is weaker in France than in the other leading Eurozone countries, growth in the French economy remains comparable to that of these countries, since the potential of the economy is slightly higher, due in particular to France's demographics. ■

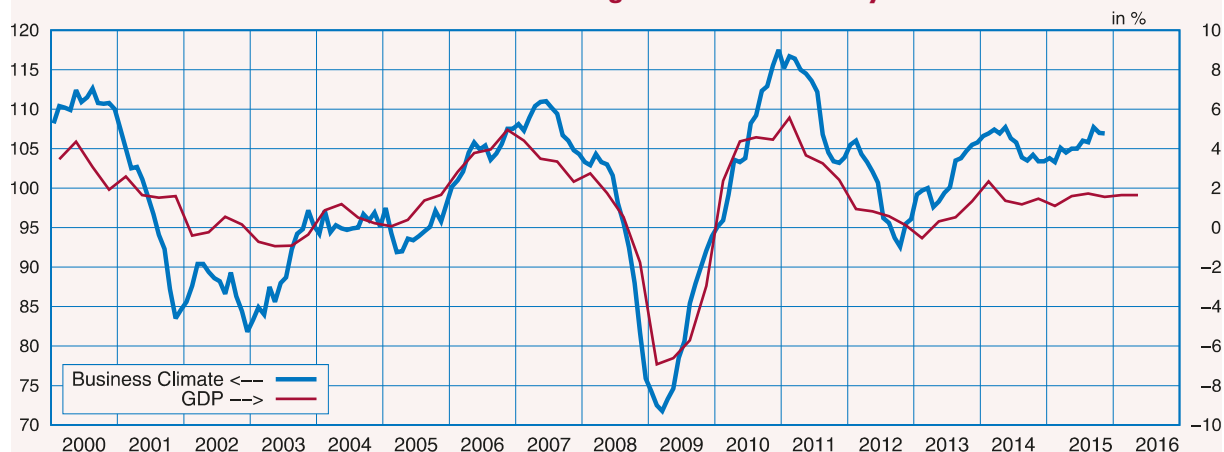
T. Rioust de Largentaye and D. Roucher, « Comment traduire les climats des affaires en termes de croissance ? », *Trésor-Éco* n°151, August 2015.

1 - Business climate in the Eurozone



Source: European Commission (DG-ECFIN)

2 - Climate and Change of GDP in Germany



Sources: Destatis, European Commission