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Obstacles gradually receding

Expectations of a slight recovery in global activity were confirmed in summer 2014. The developed economies are still being led by the Anglo-Saxon countries, which seem to have found the road to robust growth. Growth in the Eurozone has been very moderate (+0.2%), with virtual stagnation in Germany and Italy, while activity in France has turned out to be slightly more buoyant than expected and the upturn in Spain has continued. Japan is back in recession, while the emerging economies continue to progress more slowly than their long-term trend, with a notable slowdown in China, Brazil and Russia.

Data on the economic climate in autumn suggest stable overall growth for Q4 2014, before a more significant improvement in H1 2015. The recovery in the United States and the United Kingdom should remain solid, driven by vigorous household expenditure and strong productive investment. In the Eurozone, a number of obstacles to growth receded in autumn. The depreciation of the Euro has taken hold since summer and is cause for a certain amount of optimism among exporting firms. The fall in oil prices has gathered pace in Q4 and has already triggered a small oil countershock, bringing positive effects on household purchasing power and on the financial situation of businesses. As taxes seem likely to weigh less heavily on households, the purchasing power of household income should accelerate, leading to stronger growth of consumption over the coming quarters.

Aside from these factors which are common to the Eurozone as a whole, several obstacles that have been more specific to the French economy since 2012 could start to fade away. First, the significant adjustment to housing expenditure should come to an end over the next half-year; and so, without actually getting out of its rut, the construction industry should be much less of a burden on overall activity than before. Next, the business climate has improved in recent business tendency surveys and the financial situation of companies will get better in early 2015 with the ramp-up of the CICE tax credit and the introduction of the "Responsibility and

Solidarity Pact", allowing firms to boost their productive investment expenditure slightly.

The removal of these obstacles should lead to a gradual pick-up in the French economy. However, its profile is likely to be affected by the vagaries of the weather, with heating expenditure down sharply in autumn and, in reaction, likely to rebound in winter. All in all, the French economy should grow only slightly in Q4 2014 (+0.1%), but more in Q1 2015 (+0.3%) and in Q2 (+0.3%). After three years of very moderate growth (+0.4%), the growth overhang for 2015 should be higher by the middle of the year, at +0.7%.

This slight pick-up in activity and the development of measures to stimulate employment growth are likely to soften the decline in market-sector employment in the course of H1 2015. When the non-market sector is included, overall employment should progress slightly (+18,000 over the half-year). As the labour force is set to rise slightly faster however, the unemployment rate should climb again to reach 10.6% in France by mid-2015.

One major uncertainty in this scenario is corporate investment, both in France and in the Eurozone. If the autumn's improved demand perspectives were to continue, companies might accelerate their expenditure more sharply. Conversely, if the confidence of business leaders were to falter, their wait-and-see attitude could adversely influence their expenditure decisions even further. Also, by convention, the oil price has been stabilised in this forecast at around its last known level (\$70); but its new equilibrium price may not yet have been reached and it may continue to fall over the coming months, bringing about the positive effects of an oil countershock; on the other hand, the price could rise again sharply if the members of OPEC were to agree on a cut in production in one of their next meetings. This uncertainty leads to another one, that surrounding headline inflation, which should remain very low over the forecasting period; although there is a significant risk of negative inflation, it does not necessarily signal deflation. ■

Activity in the advanced economies gained momentum in Q3 2014

Activity in the advanced economies gained momentum in Q3 2014

In Q3 2014, the advanced economies picked up once again (+0.5% after +0.4%), although this growth was slightly weaker than forecast in the October 2014 issue of *Conjoncture in France* (+0.6%). The American economy resumed its rebound after the one-off decline at the start of 2014 (+1.0% after +1.1%) and British growth remained robust (+0.7% after +0.9%). In the Eurozone, GDP grew moderately again (+0.2% after +0.1%). However, GDP in Japan slipped back once more (-0.5% after -1.7%).

GDP grew moderately again in the Eurozone

In Q3 2014, the Eurozone GDP rose by 0.2%. Spain (+0.5%) and France (+0.3%) were the main contributors to this growth, while activity progressed only moderately in Germany (+0.1%), partly due to the atypical calendar of school holidays, and shrank once again in Italy (-0.1%). On average in the Eurozone, household consumption was the principal driver of activity (+0.5%) and was particularly vigorous in Germany and Spain.

The emerging economies maintained moderate growth

In the emerging economies, activity continued to grow moderately in Q3 2014 (+1.3% after +1.4%) as compared to its average growth level (+1.7% per quarter between 2000 and 2010). Activity stood still in Brazil and Russia and slowed down again in China, although Chinese GDP growth, at around 7% for the year, is still higher than elsewhere.

In France activity picked up in Q3 2014

In Q3, activity in France grew (+0.3%) more sharply than expected (+0.1% in the October issue of *Conjoncture in France*). After a Q2 that was adversely impacted by an unusually high number of long weekends, manufacturing output rebounded (+0.5% after -0.8%). Production increased sharply in market services (+0.5% after 0.0%), as did activity in trade (+0.8% after +0.2%), mainly due to highly volatile international trade. Furthermore, energy production accelerated (+2.2% after +1.0%), resulting in a return to normal for heating expenditure. However, activity in construction contracted sharply once again (-1.0% after -1.4%), both in building and in civil engineering.

World trade and lower oil prices set to boost activity through to mid-2015

World trade should be fairly dynamic through to mid-2015

World trade picked up sharply once again in Q3 2014 (+2.0% after +0.7%). Most notably, imports in emerging countries rebounded, partly in reaction to the decline of H1. In Q4 2014 the first indicators available suggest growth in world trade of around +1.0%. In H1 2015, trade should again progress by 1.0% per quarter, which is slightly below its pre-crisis trend (+1.3% on average between 2000 and 2008), mainly driven by the emerging countries.

In a slow physical market, the oil price has fallen sharply

Since July 2014 the price of oil has fallen significantly, from \$111.80 a barrel in June (€82.20) to \$78.40 (€62.90) at the end of November, its lowest level since September 2010. This is partly the result of falling tensions in the physical market, with world demand slowing as supply increases significantly. The decline also stems from a downward revision of expectations: the trend in demand, particularly from China and the emerging countries, does seem to be lastingly weaker than the forecasts of H1 2014. The easing of geopolitical tensions affecting oil-producing countries (Iraq, Libya, Russia) has probably also contributed to the fall in prices. By mid-2015 demand is unlikely to have grown much, against a sluggish economic backdrop in the emerging countries. Through to mid-2015, the conventional assumption that the price of oil should hover around its last known level (\$70 per barrel) has been retained.

The business outlook set to remain positive in the advanced economies through to mid-2015

Sustained growth set to continue in the Anglo-Saxon countries

In the advanced economies the overall economic climate, which had improved sharply in summer 2013, has worsened slightly but nevertheless remained positive in November 2014. Activity should keep a growth rate close to that of Q3, in the order of 0.4% to 0.5% by mid-2015. In the United States, activity should grow solidly (+0.6% then +0.7% per quarter), boosted by robust private demand: consumption should continue to take advantage of falling unemployment and steady purchasing power, while corporate investment should remain strong, sustained by sound business prospects. In the United Kingdom growth is likely to be weaker (+0.5% per quarter through to mid-2015), mainly because household consumption should slow down as precautionary savings drop less sharply and property wealth effects are mitigated. The Japanese economy should recover slightly in Q4 2014 (+0.4%) but is unlikely to pick up in H1 2015. Although consumption should rise again (+0.3% then +0.4% per quarter), it will not make up for the slump caused by the 3% VAT hike.

The emerging economies still slowing

Despite previous depreciations of their currencies, activity in the emerging countries is likely to maintain a moderate pace over the coming quarters. The business tendency surveys have stayed low. In China, investment should continue to slow down and consumption should only grow moderately. Additionally, activity is likely to remain poor in several major emerging countries such as Brazil and Turkey, where domestic demand has been affected by the tightening of monetary policy further to the sharp depreciation of these countries' currencies. In Russia activity should also suffer due to the higher rates granted in order to halt the capital flight caused by the Ukrainian crisis and economic sanctions.

By mid-2015, a little momentum should be restored in the Eurozone

Rather like the speed of recovery, there are divergences between the monetary policies of the advanced countries

After six years of non-standard monetary policies, as announced, the Federal Reserve has put an end to its quantitative easing programme and has started to prepare for an increase in rates against a backdrop of robust recovery and a regularly improving labour market. In the United Kingdom, the prospect of a rise in base interest rates is also imminent. At the same time the Eurozone is confronted with weak inflation. In reaction, the European Central Bank has initiated its bond repurchasing programme and its longer-term refinancing operation announced in June and September, and is working on further potential measures. Lastly, in order to escape its long-lasting deflationary spiral and shore up an economy that has once again gone into recession, the Bank of Japan has announced a new acceleration of its monetary base.

Credit market still sluggish in the Eurozone

In certain Eurozone countries the credit market is still sluggish, partly due to the ongoing shift towards debt reduction among non-financial private agents, but also the poor transmission of the ECB's increasingly accommodating monetary policy. A large proportion of European banks - particularly in the peripheral countries - are still refinancing with the ECB using the cash borrowed in the longer-term refinancing operations of end 2011, early 2012 and autumn 2014. The banking sector remains fragile in certain countries, although the stress tests in November 2014 have been positive overall. Similarly, the money market has shown signs of improvement since the start of 2014 (daily volumes traded rising sharply) but exchanges are still being made preferentially between banks in the "core" countries, to the detriment of those in the peripheral nations.

General outlook

The business tendency surveys showing a slight slowdown among our main Eurozone partners

In the main Eurozone countries, the business climate as tracked by the business tendency surveys has fallen since summer, after recovering for a year (Graph 1). The business climate in services is still clearly in the expansion zone but the composite indicators have declined once again in industry and the retail trade. Activity in the Eurozone should continue to grow moderately at the end of 2014 (+0.2%). In Q1 2015, activity is likely to pick up overall in the Eurozone (+0.4%), mainly driven by Germany, and should then progress at a pace more in line with its recent trend (+0.3%). Growth should be sustained in Spain while the Italian economy should continue to stagnate.

Consumption likely to be more buoyant in the Eurozone

Encouraged by the introduction of a minimum wage in Germany and new measures to support household income, household consumption should pick up in Q1 2015 (+0.5%), particularly in Germany (+0.7%). Although these one-off factors will dissipate, consumption should still continue to progress in Q2 (+0.4%), stimulated by the gradual recovery of household purchasing power brought about by the upturn in employment or lower tax burdens, depending on the country.

Investment set to pick up a little in the Eurozone

Investment should regain a little vitality in the Eurozone (+0.2% per quarter on average through to mid-2015). Productive investment should accelerate slightly in the Eurozone as a whole, thanks to a modest upturn in demand prospects and the recent rise in the production capacity utilisation rate. Furthermore, the construction sector should gradually stop hindering investment in Spain and in France.

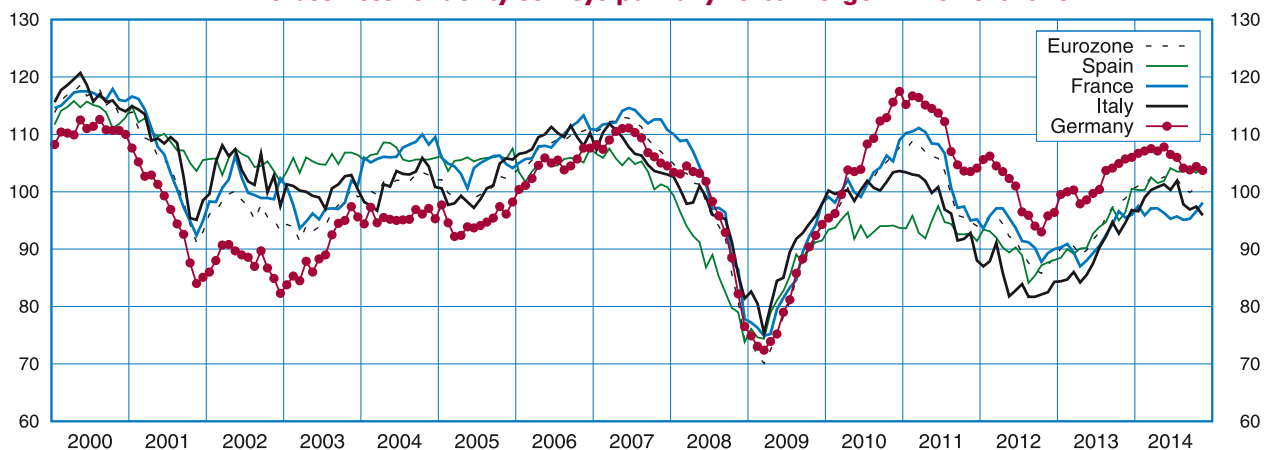
Activity in the Eurozone also sustained by lower oil prices and the depreciation of the Euro

Lastly, activity in the Eurozone should also be boosted by external factors: foreign trade is likely to contribute positively to Eurozone growth via the recent currency depreciation, while the fall in oil prices should bolster the purchasing power of agents.

French exports buoyed by the recent depreciation of the Euro

Under the effect of renewed growth among our economic partners, world trade should grow by around 1% through to mid-2015. Correlatively, world demand for French products should also rise by 1.0% per quarter in Q4 2014 and in H1 2015. Briefly driven by the expected return to normal of aeronautical deliveries at the end of 2014, French exports should increase sharply in Q4 (+1.4%), then grow at a level similar to that of world trade in H1 2015 (+1.1% then +1.0%), as the positive effects of the recent depreciation of the Euro offset the trend losses in market share.

1 - The business tendency surveys partially re-converge in the Eurozone



Source: European Commission

In France, activity set to slow at end 2014 then return to stronger growth in early 2015

The business climate in France improved significantly in November

After recovering markedly across all sectors in summer 2013, the business climate in France remained below its long-term average (around 95) until spring 2014, and then deteriorated again in summer 2014. In November it improved sharply, by 3 points (to 98), thereby wiping out the summer slump. This improvement in the business climate can be found in the business tendency surveys of almost all sectors (*Graph 2*). The composite indicator thus almost returned to its long-term average in industry (to 99) and to a slightly lower level in the retail trade (to 96). In the building sector, it fell slightly more (to 90), but the clear improvement in the opinion of business leaders in November seems to indicate a favourable turning point, after a marked deterioration phase. The business climate for the service sector is virtually stable (at 94) and has varied little since September 2013.

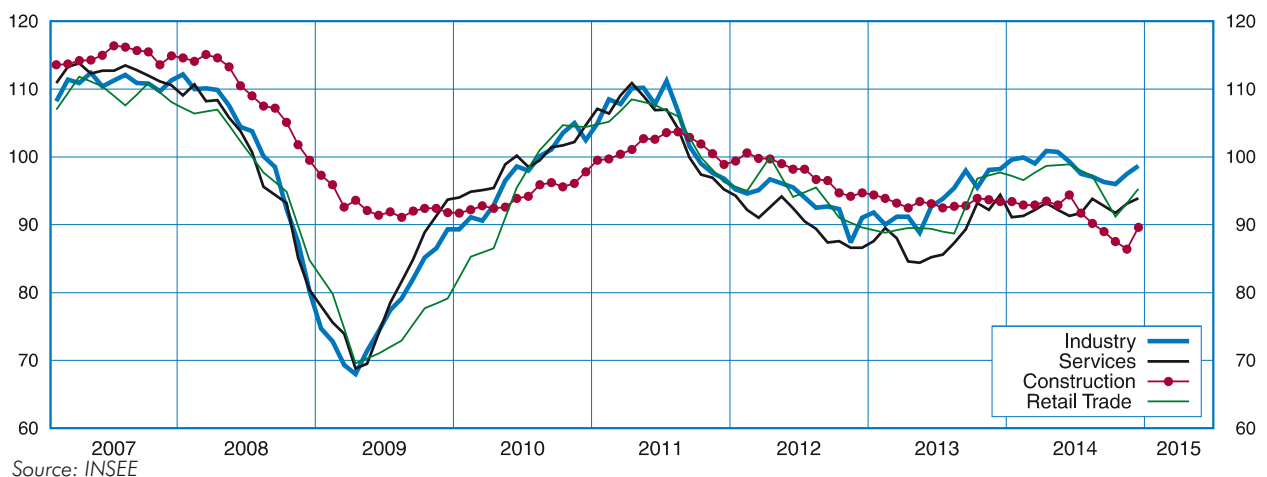
Manufacturing production should grow moderately over the coming quarters

More specifically, in manufacturing the responses given about past production improved in October and November, and the corresponding balances of opinion returned to a level very close to their long-term average. Manufacturing output should therefore grow in Q4, albeit at a very moderate pace (+0.2%). The balance of opinion on production expectations also picked up sharply, to above the long-term average, suggesting an acceleration in Q1 2015, although again a moderate one (+0.4%) as order books are still not considered full enough.

The French economy should pick up momentum a little in H1 2015

According to the service-sector business leaders surveyed in November, the climate is still fairly gloomy and activity in market services is likely to grow at a rate similar to the average since 2010 (+0.4% per quarter on average). Energy production should fall back sharply in Q4 2014 (-1.0%), as the mild weather in October and November limited heating expenditure. Assuming that heating expenditure returns to normal at the start of 2015, energy production should rebound in Q1 2015 (+1.7%) before stabilising in Q2 (-0.1%). Lastly, the decline in activity in construction should slow somewhat through to mid-2015 (-1.0% in Q4 2014 then -0.7% and -0.5% in H1 2015). Building permits stabilised in 2014, and investment in residential construction should follow suit. However, the outlook in non-residential construction and civil engineering is set to remain gloomy. All in all, the French economy is likely to progress only slightly in Q4 (+0.1%) before building up a little momentum in H1 2015 (+0.3% per quarter).

2 - The business climate in France improved significantly in November



General outlook

Annual growth overhang of +0.7% in mid-2015

In mid-2015, the annual growth overhang for GDP should stand at +0.7% after three very lacklustre years (+0.4% in 2012, 2013 and 2014). The expected pick-up in activity is likely to be driven by manufacturing (overhang of +1.0% in mid-2015 after +0.3% in 2014) and a rebound effect in energy production (overhang of +2.2% in mid-2015 after -2.1% in 2014).

The CICE tax credit and the Responsibility and Solidarity Pact should soften the downturn in market sector employment through to mid-2015

After rising significantly in the previous quarter, temporary employment fell back sharply in Q3 2014 leading to another decline in market sector employment (-55,000 jobs). Employment should fall back further in Q4 (-15,000 jobs) then in early 2015, but the pick-up in activity and the effects of the tax credit for competitiveness and employment along with the Responsibility and Solidarity Pact should slow the decline (-11,000 in H1 2015; *Graph 3*).

Total employment rising slightly through to mid-2015 thanks to non-market sector jobs

After +58,000 jobs in 2014, non-market sector employment is likely to slow down slightly in H1 2015 (+19,000 jobs), mainly reflecting job creations in the public sector (excluding subsidised contracts). The number of beneficiaries of subsidised contracts should however grow slightly (+19,000 in H1 2015 after +9,000 in H2). For the economy as a whole employment looks set to stagnate in 2014 (after +50,000 jobs in 2013) and 18,000 jobs should be created in H1 2015.

Unemployment set to rise slightly through to mid-2015

The unemployment rate settled at 10.4% of the labour force on average in Q3 2014 (9.9% in Metropolitan France), after 10.1% the previous quarter. Over the coming quarters, the expected increase in employment is unlikely to be enough to absorb the growth of the labour force and so the number of unemployed should rise slightly.

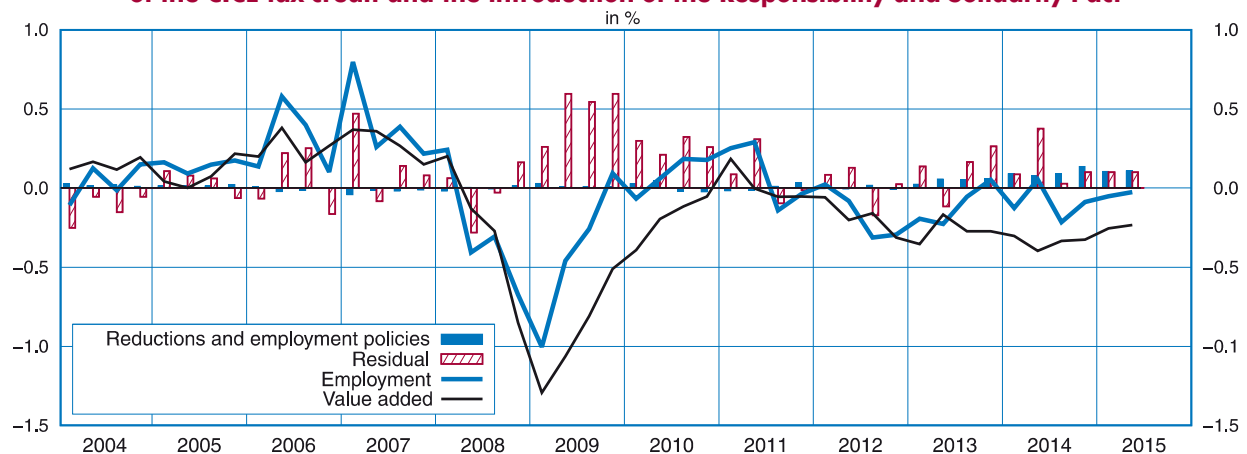
The unemployment rate should stand at 10.6% in mid-2015.

Inflation still very low through to mid-2015

In November 2014 consumer prices rose by 0.3% year-on-year. Headline inflation should be virtually nil through to mid-2015 (*Graph 4*). Indeed, the effects of the VAT rise on 1st January 2014 should no longer be visible in

(1) Core inflation is adjusted for the theoretical impact of the VAT rise if this rise had been fully and immediately passed on to prices. In practice this rise has only been passed on gradually and the adjustment resulted in a drop in core inflation during the first months following the VAT rise. Conversely and by virtue of an «exit from year-on-year figures» effect, this adjustment will increase core inflation at the start of 2015.

3 - The decline in market sector employment should ease through to mid-2015, helped by the ramp-up of the CICE tax credit and the introduction of the Responsibility and Solidarity Pact



Source: INSEE

year-on-year inflation. The fall in oil prices should be partly offset by the increase in taxes on fuel and gas and the rise in electricity prices; energy inflation should remain negative through to mid-2015.

Core inflation at its lowest level since 1990

In November core inflation fell to its lowest level (-0.2% over one year) since the beginning of the series in 1990. It will likely pick up in January 2015 (+0.3%), mainly because of the adjustments made in order to measure it at constant legislation¹. Excluding these effects, core inflation should remain stable at a low level (+0.1% in June 2015).

Household purchasing power on the rise

Real wages set to slow in early 2015

Growth in the average wage per head in the market sectors looks to have slowed over the year (+0.6% in H2 after +1.0% in H1). Given the low level of inflation, high unemployment and a smaller than usual increase in the minimum wage on 1st January 2015 (+0.9%), nominal wages should slow down slightly in H1 2015 (+0.4%). The same is likely to be true of real wages: the growth overhang for the average wage per head in mid-2015 should be +0.7%, against +1.0% one year earlier.

Recovery of purchasing power

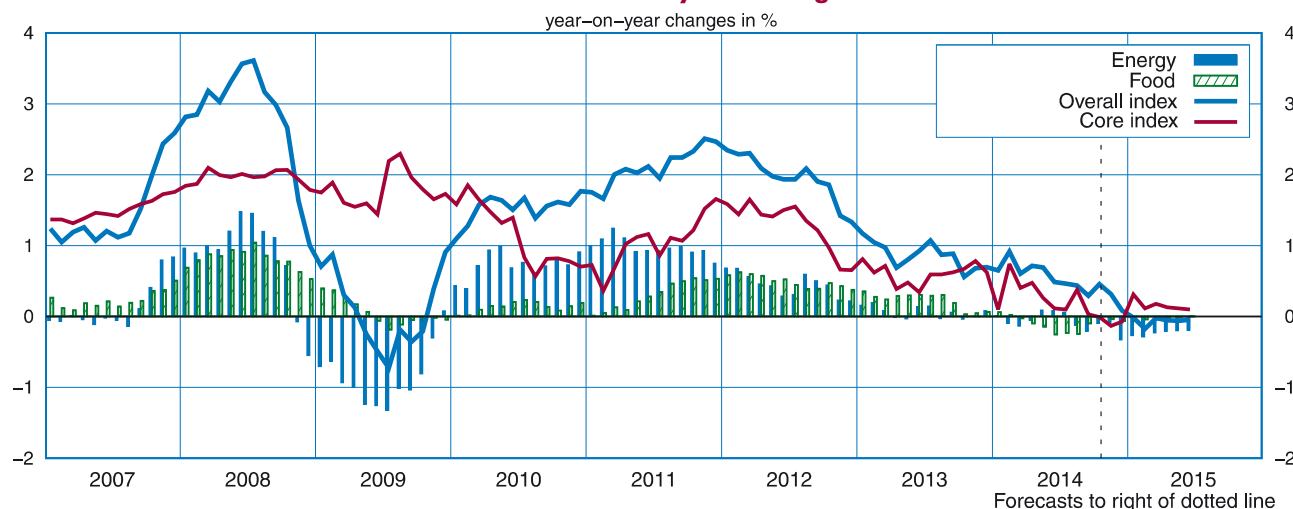
After stagnating in 2013, the purchasing power of household income appears to have picked up in 2014 (+1.2%, *Graph 5*) due to faster growth in earned income (+1.3% after +0.9%) and slower growth in the tax burden (+2.0% after +4.2%) and despite the slight downturn in social benefits (+2.5% after +2.8%). However, in H2 2014 purchasing power should slow down (+0.3% half-year-on-half-year, after +1.4%), mainly because of the acceleration of taxes further to the new tax measures which increase tax yields at the end of the year. At the start of 2015, taxes should fall back, while earned income should continue to rise regularly and hence purchasing power should recover fairly sharply (+1.0% over the half-year).

Household consumption likely to progress through to mid-2015, in line with purchasing power

Apart from one-off jolts caused by heating expenses...

In Q4 2014, household expenditure looks to have slowed once again (+0.1% after +0.2%), with lower energy expenditure due to the very mild autumn and weaker spending on automobiles. In Q1 2015, assuming temperatures return to normal, the rebound in energy expenditure should lift household consumption somewhat (+0.4%). It should then stay stable (+0.3%), sustained by the rise in purchasing power.

4 - Inflation should remain very low through to mid-2015



Source: INSEE

General outlook

... household consumption should be in line with household purchasing power

All in all, from mid-2014 to mid-2015, household consumption should grow by 1.0%, slightly less than household purchasing power (+1.3%), and the household savings ratio in mid-2015 should stand at 16.0%, slightly above its level of end 2014 (15.7%). The quarter-by-quarter profile of the savings ratio is likely to be more uneven, due to energy spending on the one hand and in order to smooth income-tax increases on the other.

Investment showing weak growth over the coming quarters

Towards a stabilisation of household investment

Household investment looks to have fallen back sharply again in Q4 2014 (-1.3%). The stabilisation of building permits in 2014 would seem to point to a similar stabilisation of investment in H1 2015. Over 2014 as a whole, household investment should drop sharply (-6.3% after -3.1% in 2013) and its growth overhang in 2015 should stand at -3.1% in the middle of the year.

Corporate investment should rise slightly through to mid-2015

Despite the very low real interest rates, corporate investment is set to rise only slightly through to mid-2015, in line with the modest demand prospects and a weak production capacity utilisation rate. On average in 2014, corporate investment is set to fall by 0.2% (after -0.6% in 2013), with the deterioration in construction investment almost offset by the slight rise in other expenditures. For 2015, the mid-year growth overhang should be zero.

The corporate margin rate should pick up sharply by mid-2015

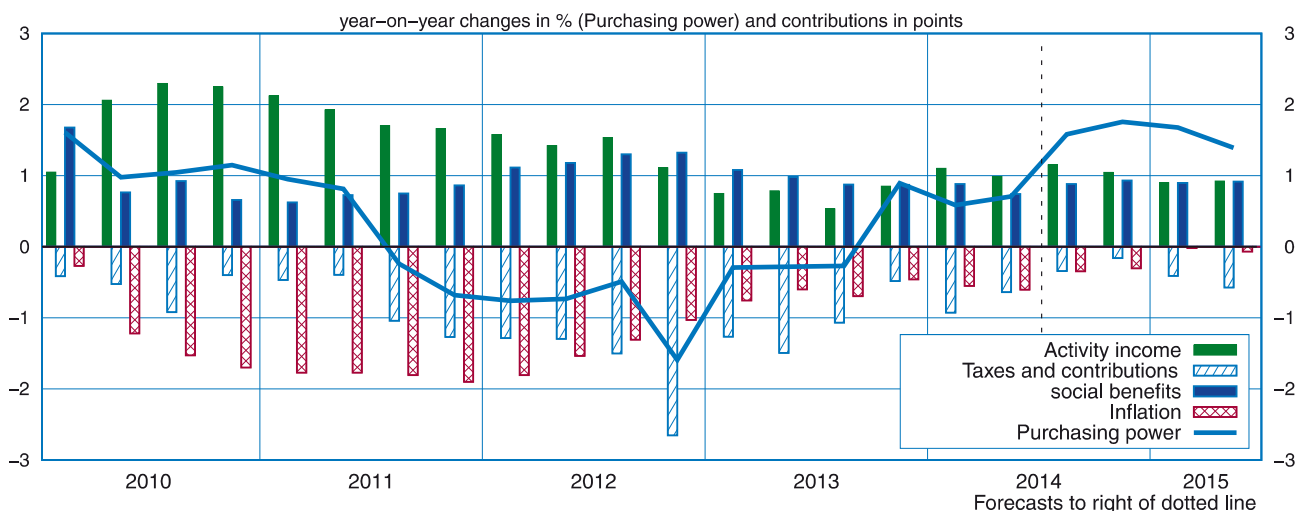
At end 2013, the margin rate of non-financial companies slipped to its lowest level since 1985. It has only picked up slightly in 2014, despite the positive effects of the CICE tax credit, as progress in real wages should be higher overall than productivity gains. By mid-2015, the margin rate should pick up sharply thanks to the ramp-up of the CICE and the introduction of the Responsibility and Solidarity Pact, but also because wage growth is likely to slip back.

Uncertainties: oil prices and French corporate investment

Oil price and exchange rate

In this scenario the price of oil and the exchange rate of the Euro are fixed at respectively \$70 and \$1.23/€, thereby limiting energy inflation and sustaining exports. But in a context where supply is outstripping demand, the fall in oil prices may not yet be over. If it were to continue it would sustain household purchasing power and boost the margin rate of companies. Conversely, geopolitical instability or any reaction from the main producing countries to the slide in oil prices could lead to a reversal of the recent trend. Similarly, exchange-rate variations could either negatively impact or sustain French competitiveness.

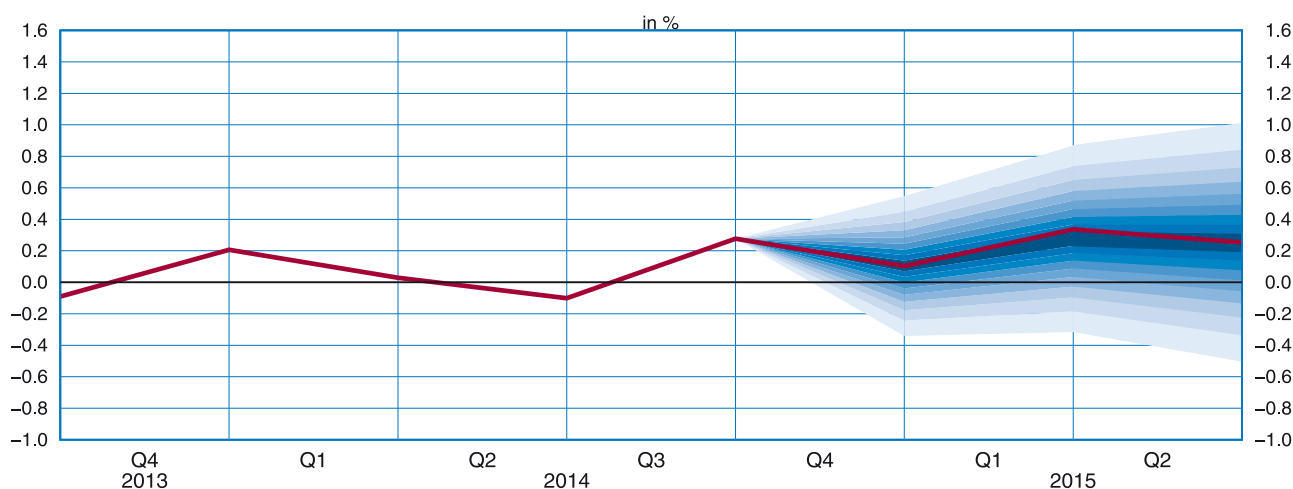
5 - Household purchasing power set to pick up in 2014



French corporate investment

In this scenario French corporate investment in capital goods and in services is unlikely to progress much through to mid-2015. This diagnostic stems from the fact that, having held up better than expected to the deterioration of its determinants, French corporate investment now has no need to catch up. A more pessimistic diagnostic would indicate the lack of an upturn in growth or even a drop in investment among French companies. Conversely, the expected improvement in the financial situation of companies thanks to the ramp-up of the CICE and the introduction of the Responsibility and Solidarity Pact could result in a sharper acceleration in productive investment in France. ■

6 - Fan chart for Conjoncture in France



How to read it: the fan chart plots 90% of the likely scenarios around the baseline forecast (red 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 *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 Q4 2014 has a 50% chance of being between -0.1% (lower limit of the fifth band from the bottom) and +0.3% (upper limit of the fifth band from the top). Likewise, it has a 90% chance of being between -0.4% and +0.6%. In Q12015, the 90% confidence intervals is [-0.2% ; +0.8%].

Source: INSEE

Effects of the recent Euro depreciation and oil price drop

Since summer 2014 the Euro has depreciated against the dollar, sliding from 1.37 dollars to the Euro on average in Q2 to 1.33 dollars in Q3 (a fall of 3.4%). In early December it stood at around 1.23 dollars to the Euro (for a decline overhang of 6.4% in Q4). The fall in terms of real effective exchange rate is less pronounced (-1.7% in Q3 then a decline overhang of 1.0% in Q4) because the Euro has depreciated far less against the other currencies. Over the same period, the price of oil has fallen sharply, from \$109.80 per barrel on average in Q2 to \$78.40 in November, its lowest level since September 2010.

The drops in the exchange rate and the oil price in H2 2014 will have a positive impact on activity as of Q4. The effect of these two trends is estimated at more than 0.1 extra GDP growth points per quarter through to mid-2015, i.e. a cumulative effect of 0.4 points over the period, half coming from the lower effective exchange rate and half from the drop in oil prices. The cumulative effect is estimated at a drop in inflation of 0.5 points in June 2015.

Over the forecasting period, variations in the Euro and the oil price constitute an uncertainty in the scenario of this issue of *Conjoncture in France*. The price of Brent (\$70 per barrel) and the foreign exchange rates have been frozen by convention in our forecasts (in particular, 1.23 dollars to the Euro). A further drop of \$10 would boost growth by 0.1 points by Q2 2015 and would lower inflation in June by 0.2 points. Similarly, assuming that the Euro depreciated again by about 7% against the dollar and that the real effective exchange rate continued to fall at a rate of 1.7% per quarter, growth would climb by 0.1 points by Q2 2015 and the June 2015 inflation figure would be 0.1 points higher.

The effects of the simultaneous Euro depreciation and oil price drop are beneficial for activity and ambiguous for prices

For an oil-importing country like France, a significant drop in the price of oil generates a fall in inflation in the short term, resulting in higher household consumption since households have greater

purchasing power («first round effects»). The drop in oil prices also spreads to producer prices via intermediate consumptions, and to wages via the price-wage loop («second round effects»); it boosts corporate margins thanks to improved terms of trade. External effects are also added to these domestic mechanisms: the oil-exporting countries suffer due to a reduction in their resources and their demand for French products thus diminishes. However, the increase in activity in the other importing countries benefiting from lower oil prices leads them to increase their imports. Due to the structure of France's foreign trade, it is this second effect that wins the day: French exports rise, driven by more buoyant world demand.

Similarly, the depreciation of the Euro brings about a positive medium-term effect on activity. Indeed, the depreciation of a currency acts directly on the prices of traded goods: it raises the prices of imports whilst improving the competitiveness of exports. It therefore weighs down on the volume of imports and sustains the volume of exports. The effect of the depreciation on trade in value can however be ambiguous, depending on whether the price effect or the volume effect prevails. Generally speaking, the impact is more gradual on volumes traded than on prices.

Therefore, a depreciation of the Euro and falling oil prices produce beneficial effects on activity. However, these two trends have opposing effects on prices, so much so that their combined effects on inflation is ambiguous: a Euro depreciation raises the cost of imports, provoking a rise in headline inflation; conversely, a pronounced drop in oil prices causes a short-term drop in energy inflation («first round effects») and, in the longer term, in all consumer prices, as companies pass on their lower producer prices to their sale prices («second round effects»).

The depreciation of the Euro and the fall in the oil price since summer should boost French growth by about 0.4 points by Q2 2015

Since summer 2014 the Euro has depreciated against the dollar, sliding from 1.37 dollars to the Euro on average in Q2 to 1.33 dollars in Q3 (a fall of 3.4%). In early December it stood at around 1.23 dollars to the Euro (for a decline overhang of 6.4% in Q4). The fall in terms of real effective exchange rate is less pronounced (-1.7% in Q3 then a decline overhang of 1.0% in Q4) because the Euro has depreciated far less against the other currencies. This fall has been caused, among other things, by the easing measures in the ECB's monetary policy in order to combat the low level of inflation in the Eurozone, while the Fed, on the other hand, was putting an end to its asset purchase programme: after a first cut from 0.25% to 0.15% in June, the ECB slashed its base rate to 0.05% in early September. It has also started to implement the securities purchases announced in September, along with targeted longer-term refinancing operations. Over the same period the oil price has fallen sharply, from \$109.80 per barrel on average in Q2 to \$78.40 in November, its lowest level since September 2010. This fall has partly been the result of the easing of tensions in the physical market, with fairly weak demand and relatively abundant supply. Growth in demand is below 0.4 million barrels per day as a quarterly average, a rate lower than that observed since 2010. On the supply side growth has been higher on average than demand since summer 2013. As well as this easing in the physical markets, the slide in prices is the result

of a downward revision of expected demand, most notably from China and the emerging countries, which looks to be lower than the forecasts in H1 2014.

The fall in the effective exchange rate in Q3 2014 is likely to produce tangible effects on export volumes and on activity as of Q4, bearing in mind the time-lag for demand to adjust to its price.¹ As for the fall in oil prices, this is unlikely to have any significant effect on growth until Q1 2015, as the price of Brent in Euros only fell slightly between Q2 (€80.00 per barrel on average) and Q3 2014 (€77.10) due to the depreciation of the Euro against dollar, before slumping in Q4 (€64.10 overhang in Q4). This sharp fall in Q4 should affect activity in early 2015: on the one hand the process whereby a drop in oil prices spreads to activity is generally slower than that associated with a rise, because of the short-term asymmetry between the reaction of fuel prices and margin behaviours, and on the other hand there is the usual time-lag between income variations and consumption behaviours. The effect of these two trends is estimated at more than 0.1 extra GDP growth points per quarter through to mid-2015, i.e. a cumulative effect of 0.4 points over the period.² The effect is likely to come in equal proportions from the two shocks. For prices, it is the oil effect that is dominant: in all, the combined impact of the two decreases on inflation is estimated at -0.5 points in June 2015.

Over the forecasting period, variations in the Euro and in oil prices constitute an uncertainty

The price of oil and the exchange rate have been frozen by convention in this forecast at around their last observed values; the assumptions retained are \$70 per barrel and 1.23 dollars to the Euro. Future variations in oil prices and the exchange rate therefore constitute an uncertainty.

Against a backdrop of abundant supply and weak demand, the price of oil could continue to fall; conversely, the price could quickly rise again if the producing countries agreed to cut world supply. A further drop of \$10 a barrel would boost growth by 0.1 points by Q2 2015 and inflation would fall by a further 0.2 points.

Similarly, the Euro could continue its depreciation throughout the forecasting period. Indeed, faced with the risk of long-term low inflation in the Eurozone, the ECB might decide to step up its monetary easing policy in the coming months, which would cause the Euro to depreciate further. A 7% drop against the dollar would lead to a decline in the real effective exchange rate of about 1.7% per quarter; in this case growth would be 0.1 points higher in Q2 2015 than in our scenario and the year-on-year change in consumer prices in June 2015 would be 0.1 points greater. ■

(1) Borey G. and Quille B., 2013, "How to explain the recent shift in balance-of-trade trends in Europe?", *Conjoncture in France*, June, pp. 19-40, INSEE.

(2) This estimation was performed using variants from the Mésange and NiGEM models. For further details, see «Quels effets de la baisse récente de l'euro ? », *Note de conjoncture*, June 2010, pp. 59-60, INSEE and "The effects of a rise in oil prices on activity", *Conjoncture in France*, March 2011, pp. 16-17, INSEE

Key figures: France and its international environment

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

| | 2013 | | | | 2014 | | | | 2015 | | 2013 | 2014 | 2015 |
|---|------------|------------|-------------|------------|------------|-------------|------------|------------|------------|------------|------------|------------|------------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | | | |
| International environment | | | | | | | | | | | | | |
| Advanced economy GDP | 0.4 | 0.5 | 0.7 | 0.6 | 0.3 | 0.4 | 0.5 | 0.4 | 0.5 | 0.4 | 1.4 | 1.8 | 1.5 |
| Eurozone GDP | -0.4 | 0.3 | 0.2 | 0.2 | 0.3 | 0.1 | 0.2 | 0.2 | 0.4 | 0.3 | -0.4 | 0.8 | 0.9 |
| Barrel of Brent oil (in dollars) | 113 | 103 | 110 | 109 | 108 | 110 | 104 | 79 | 70 | 70 | 109 | 100 | 70 |
| Euro-dollar exchange rate | 1.32 | 1.31 | 1.32 | 1.36 | 1.37 | 1.37 | 1.33 | 1.25 | 1.23 | 1.23 | 1.33 | 1.33 | 1.23 |
| World demand for French products | 0.9 | 2.4 | 0.9 | 0.2 | 0.4 | 0.4 | 1.3 | 1.0 | 1.0 | 1.0 | 3.1 | 2.8 | 3.3 |
| France - supply and use | | | | | | | | | | | | | |
| GDP | 0.0 | 0.7 | -0.1 | 0.2 | 0.0 | -0.1 | 0.3 | 0.1 | 0.3 | 0.3 | 0.4 | 0.4 | 0.7 |
| Imports | 0.4 | 2.0 | 0.9 | 0.4 | 0.7 | 0.3 | 1.1 | 0.5 | 0.7 | 0.8 | 1.9 | 2.9 | 2.3 |
| Household consumption | 0.2 | 0.3 | 0.0 | 0.4 | -0.4 | 0.3 | 0.2 | 0.1 | 0.4 | 0.3 | 0.3 | 0.3 | 0.9 |
| Public and NPISH consumption | 0.5 | 0.7 | 0.3 | 0.5 | 0.4 | 0.5 | 0.8 | 0.3 | 0.4 | 0.4 | 1.9 | 2.0 | 1.4 |
| Total GFCF | -0.4 | 0.3 | 0.0 | -0.1 | -0.7 | -0.8 | -0.6 | -0.4 | -0.2 | -0.1 | -0.8 | -1.7 | -1.1 |
| <i>of which: NFEs</i> | -0.6 | 0.4 | 0.3 | 0.7 | -0.6 | -0.5 | -0.1 | 0.0 | 0.1 | 0.1 | -0.6 | -0.2 | 0.0 |
| <i>Households</i> | -0.3 | -0.4 | -1.0 | -1.8 | -1.9 | -1.9 | -1.7 | -1.3 | -0.7 | -0.1 | -3.1 | -6.3 | -3.1 |
| <i>General government</i> | 0.0 | 0.6 | 0.7 | -0.1 | 0.2 | -0.7 | -1.2 | -0.6 | -0.8 | -0.6 | 1.1 | -0.6 | -2.4 |
| Exports | 0.3 | 3.0 | -0.7 | 1.1 | 0.5 | -0.1 | 0.5 | 1.4 | 1.1 | 1.0 | 2.4 | 2.2 | 3.1 |
| Contributions (in point) | | | | | | | | | | | | | |
| Domestic demand excluding change in inventories * | 0.1 | 0.4 | 0.1 | 0.3 | -0.3 | 0.1 | 0.2 | 0.1 | 0.2 | 0.3 | 0.5 | 0.3 | 0.6 |
| Change in inventories * | -0.1 | 0.0 | 0.3 | -0.3 | 0.4 | -0.1 | 0.3 | -0.2 | 0.0 | 0.0 | -0.2 | 0.3 | -0.1 |
| Net foreign trade | 0.0 | 0.2 | -0.5 | 0.2 | -0.1 | -0.1 | -0.2 | 0.2 | 0.1 | 0.0 | 0.1 | -0.2 | 0.2 |
| France - situation of households | | | | | | | | | | | | | |
| Total employment | -17 | -25 | 22 | 70 | 4 | 28 | -33 | 2 | 11 | 7 | 49 | 2 | |
| Non-agricultural market sector employment | -29 | -46 | 2 | 3 | -14 | 7 | -55 | -15 | -8 | -3 | -69 | -77 | |
| Unemployment rate Metropolitan France ** | 9.9 | 10.0 | 9.9 | 9.7 | 9.7 | 9.7 | 9.9 | 10.0 | 10.1 | 10.2 | 9.7 | 10.0 | |
| Unemployment rate France ** | 10.3 | 10.4 | 10.3 | 10.1 | 10.1 | 10.1 | 10.4 | 10.4 | 10.5 | 10.6 | 10.1 | 10.4 | |
| Consumer price index *** | 1.0 | 0.9 | 0.9 | 0.7 | 0.6 | 0.5 | 0.3 | 0.1 | 0.0 | 0.0 | 0.9 | 0.5 | |
| Core inflation *** | 0.7 | 0.3 | 0.6 | 0.6 | 0.4 | 0.1 | 0.0 | -0.1 | 0.2 | 0.1 | 0.6 | 0.2 | |
| Household purchasing power | 1.2 | 0.3 | -0.3 | -0.3 | 0.9 | 0.5 | 0.5 | -0.2 | 0.8 | 0.2 | 0.0 | 1.2 | 1.2 |

Forecast

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

(**) For annual data, unemployment rate is that of the last quarter of the year

(***) Year-on-year on the last month of the quarter and annual averages

GDP: Gross Domestic Product

GFCF: Gross Fixed Capital Formation

NFE: Non-financial enterprise

NPISH: Non-profit Institutions Serving Households

How to read it: 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