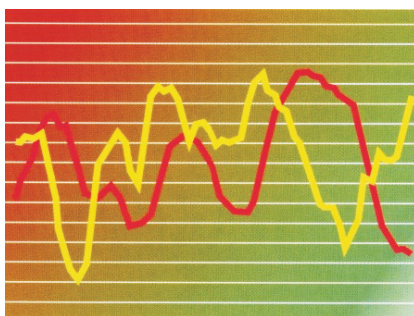


# CONJONCTURE IN FRANCE



OCTOBER 2016

## The outlook for Europe holds up amid political uncertainties

*In spring 2016, growth in the advanced economies varied widely. It was quite disappointing in the United States, but turned out to be more vigorous than expected in the United Kingdom, ahead of the vote on the country's exit from the European Union. Similarly, although the scenario of a self-sustaining recovery has been confirmed for the Eurozone overall (+0.3%), the French economy remained at a standstill (-0.1%) after a dynamic start to the year. Among the emerging countries, the slowdown the Chinese economy has been suffering since 2010 seems to have been checked, thanks to an expansionary fiscal and monetary policy; the commodity exporting countries have profited from the stabilisation of their prices, particularly Russia and Brazil.*

*In H2, demand from the United States is expected to rise again, thanks to an upswing in productive investment, while demand in the emerging countries is expected to continue to improve gradually. However, political uncertainty has grown and is casting a dark shadow over the economic outlook in Europe: the British referendum in favour of Brexit, a new wave of terror attacks in France and Germany, the difficulty in forming a new government in Spain and the forthcoming constitutional referendum in Italy. In the Eurozone, this greater uncertainty does not seem to have undermined the business climate or household confidence, and growth is expected to hold up (+0.3% in Q3, then +0.4% in Q4). It should be sufficient for employment to continue to grow and for unemployment to fall further, albeit only slightly. On its side, British growth is expected to see a downturn as the uncertainty concerning the country's institutional future is likely to lead to investors adopting a wait-and-see attitude, in spite of the favourable effect on exports of a marked depreciation of the pound.*

*In France, growth is expected to be modest in Q3 (+0.2%) before picking up in Q4 (+0.4%). On average over the year, 2016 (+1.3%) should be comparable to 2015 (+1.2%). After a period of stops and starts in H1, household consumption is expected to rise in line with purchasing power gains, which are expected to reach an average of +1.8% over the year (after +1.6% in 2015). In addition, the fall in household investment expenditure on housing is coming to an end. After a dip in the spring, corporate investment is expected to regain momentum in H2, as financing conditions remain largely favourable, due on the one hand to lower interest rates and on the other to a recovery in the margin rate. The upturn in activity has led to an increase in market-sector employment, which has also been stimulated by measures to reduce the cost of labour and boost the employment intensity of growth. All in all, 165,000 jobs are expected to be created over the course of 2016. This should be enough for the unemployment rate to fall again, to 9.8% of the French labour force by the end of the year, compared to 9.9% mid-2016 and 10.2% at the end of 2015.*

*Two main uncertainties surround this scenario. The first concerns forthcoming political events on both sides of the Atlantic before the end of the year; their outcomes could well generate even more uncertainty and therefore an even greater tendency to wait and see on the part of investors. The second issue is specific to the French economy: the expected rebound in exports could be bigger than anticipated, partly making up for earlier disappointments, or conversely could once again fail to boost growth. ■*

---

## World trade disappointed again in Q2 2016

*Activity picked up slightly in the emerging economies, but their imports rebounded only moderately*

In Q2 2016, the emerging economies regained a modicum of vigour, although growth remained moderate. Chinese GDP picked up, thanks to an upswing in industrial activity. The recession eased in Brazil and the Russian economy almost stabilised. Nonetheless, the emerging economies' imports only bounced back moderately (+0.9%) after plummeting in Q1 (-2.2%).

*The advanced economies improved less than expected*

In Q2 2016, GDP in the advanced economies grew 0.3%, lower than the 0.5% forecast in the June issue of *Conjoncture* in France and slower than the average quarterly pace over the last three years. Activity in the United Kingdom was surprisingly buoyant (+0.7% after +0.4%), thanks to an upturn in industry, but growth in the United States was disappointing (+0.4% after +0.2%) and has weakened again in Japan (+0.2% after +0.5%).

*Activity slowed in the Eurozone*

In the Eurozone, economic activity slowed in Q2 2016 (+0.3% after +0.5%), as forecast in the June issue of *Conjoncture* in France. Growth remained solid in Germany (+0.4% after 0.7%) and vigorous in Spain (+0.8% after +0.8%), but faltered in Italy (0.0% after +0.3%) and in France. All in all, undermined by the almost universal contraction in productive investment, imports in the advanced economies remained flat in Q2 2016 (+0.1% after +0.2%) and world trade only bounced back weakly (+0.3% after -0.6%).

---

## In France, activity stalled in Q2

In France, activity stalled in Q2 (-0.1% after +0.7%), a slowdown that was much more marked than anticipated in the *Conjoncture* in France of June 2016 (+0.3% after +0.6%). Manufacturing output saw a substantial fall (-0.9% after +0.1%), and was curbed in particular by industrial action in refineries and the chemical industry. On the demand side, household consumption levelled off (-0.1%) after a very strong quarter (+1.1%), as spending on services fell back far more than expected. Likewise, corporate investment contracted due to the after-effect of a drop in purchases of manufactured goods and an unexpected downturn in investments in services, after several quarters of vigorous growth. Finally, hampered among other things by weak demand from its partners, French exports remained sluggish (+0.2% after -0.4%) despite the delivery of several large shipbuilding contracts.

---

## Commodity prices remain low and interest rates fall again in the Eurozone

*The price of Brent crude oil remains low*

In Q2, in spite of a substantial fall in North American production, oil supplies continued to outstrip demand, as they have since the beginning of 2014. In H2 2016, the gap between supply and demand should narrow, notably because OPEC is envisioning scaling back its production, but stocks are expected to remain high, thereby limiting the pressure on prices. The price of a barrel of Brent crude is expected to stabilise at around \$50.

*Monetary policies should continue to diverge on either side of the Atlantic*

Monetary policies on either side of the Atlantic are expected to diverge even further through to the end of 2016. On the one hand, the American Federal Reserve will very likely raise its base rates again, spurred by a core inflation rate that has risen above the target of 2% since the beginning of the year. On the other hand, faced with a pro-Brexit outcome in the referendum, the Bank of England (BoE) has eased its monetary policy by reducing its base rate and relaunching its asset purchase programme. Similarly, inflation remains very low in the Eurozone and the ECB is pursuing its accommodating monetary policy.

*After the pro-Brexit vote, sovereign yields have plummeted, but the Euro has barely appreciated*

European sovereign yields have all slipped back in the wake of the Brexit referendum and the BoE's announcements: the French 10-year bond yield reached an all-time low at about 0.2%. However, the real effective exchange rate of the Euro has hardly moved, with the strong appreciation against the pound being offset by the depreciation against the yen and the emerging currencies.

## Global activity expected to pick up moderately in H2 2016 with trade gaining a little momentum

*The emerging economies should continue to accelerate gradually*

The business climate has recovered somewhat in the emerging economies, reaching its highest level for almost two years (*Graph 1*). Growth is expected to rise gradually, while still remaining lower than that of the 2000s. In China, activity is expected to grow at the same rate as in Q2. It should be driven by investment in construction, thanks to the increase in credit afforded by the easing of monetary policy and the fiscal stimulus measures announced at the beginning of the year. In Russia, activity should stabilise by the end of the year. In Brazil the recession should ease considerably.

*Activity is expected to pick up in the United States, while slowing sharply in the United Kingdom*

In the advanced economies, activity is expected to pick up a little in H2. In the United States, growth should increase with the end of a period of running down stocks and a timid upturn in corporate investment. In Japan, activity should regain a little momentum, driven by household consumption. On the other hand, the business climate in the United Kingdom deteriorated this summer after the vote to leave the European Union and activity is expected to slow sharply in H2, although without actually shrinking.

## In H2 2016, growth in the Eurozone should hold up amid political uncertainties

*Consumption is expected to be boosted by new purchasing power gains*

In H2, inflation should remain limited and the buoyancy of the job market should be accompanied by an acceleration in wages in the Eurozone, in particular in Germany, generating further purchasing power gains. Additionally, household confidence in the economic situation does not seem to have been affected by July's wave of terror attacks in France and Germany. Consumption should therefore regain momentum in H2 (+0.4% per quarter), after disappointing in Q2 (+0.2% after +0.6%).

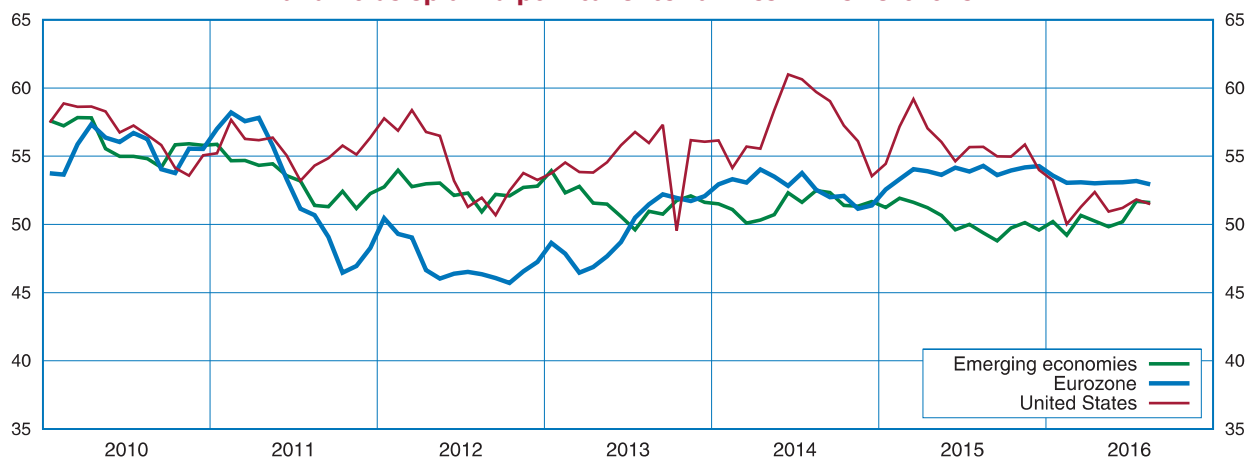
*Investment should recover, productive investment in particular*

On the corporate side, the business climate is holding up in the Eurozone in spite of rising political uncertainty. After an unexpected dip in Q2, particularly in Germany, corporate investment is expected to recover in H2 2016, once again sustained by the improvement in credit terms and self-financing capacities. Capital investment in particular is expected to be reinvigorated in the Eurozone countries, as the capacity utilisation rate has risen in industry.

*The recovery in demand in the USA and the emerging countries should offset the slowdown in British demand*

After a buoyant showing in Q2, especially in Spain, Eurozone exports are expected to slow down a little in Q3, although they should still grow substantially over the whole of H2, in line with world demand for Eurozone goods. The effect of the British slowdown is expected to be more than offset by demand from the United States and the emerging economies. All in all, growth in the Eurozone should hold up in H2 (+0.3% in Q3 and +0.4% in Q4) with very similar growth rates in Germany, Italy and France.

**1 – The business climate is improving in the emerging economies and holds up amid political uncertainties in the Eurozone**



Source: Markit

## French exports expected to bounce back moderately

In H1 2016, French exports were even more disappointing than global demand (−0.4%, then +0.2%), in spite of the delivery of some large contracts, due notably to weak civilian aviation exports, which seem to have been hindered by sourcing issues. In the second part of the year, exports are expected to rebound moderately (+0.1%, then +0.8%), in particular in the aeronautical sector. However, they are likely to be held back by the backlash of the delivery of a number of large shipbuilding contracts and a fall in agricultural sales due to poor harvests.

## French growth is expected to improve gradually in H2

*The business climate remains slightly above its average over the last year*

After remaining more or less stable from September 2013 to February 2015, at around 94, the business climate in France improved steadily in 2015: over the last year it has remained slightly above its long-term average (Graph 2), a level compatible with annual GDP growth rate of about +1.4%.

*The effect of the strikes in spring is likely to fade, but accommodation and food services are still expected to suffer due to fears linked to recent terror attacks*

Manufacturing output is expected to bounce back strongly in Q3 (+1.0% after −0.9%) with, in particular, a recovery in activity for refineries and the chemical industry, after the spring strikes. For Q4, the positive outlook for activity in September suggests a further increase (+0.4%). In services, output should pick up in the sectors affected by the one-off events of the spring (after-effect of the Euro 2016 football ticket sales in the entertainment services sector, transport strikes). However, in accommodation and food services, where activity shrank unexpectedly in Q2, the rebound is expected to be limited by a renewed lack of foreign tourists after the July terror attacks.

*Activity should barely accelerate in 2016*

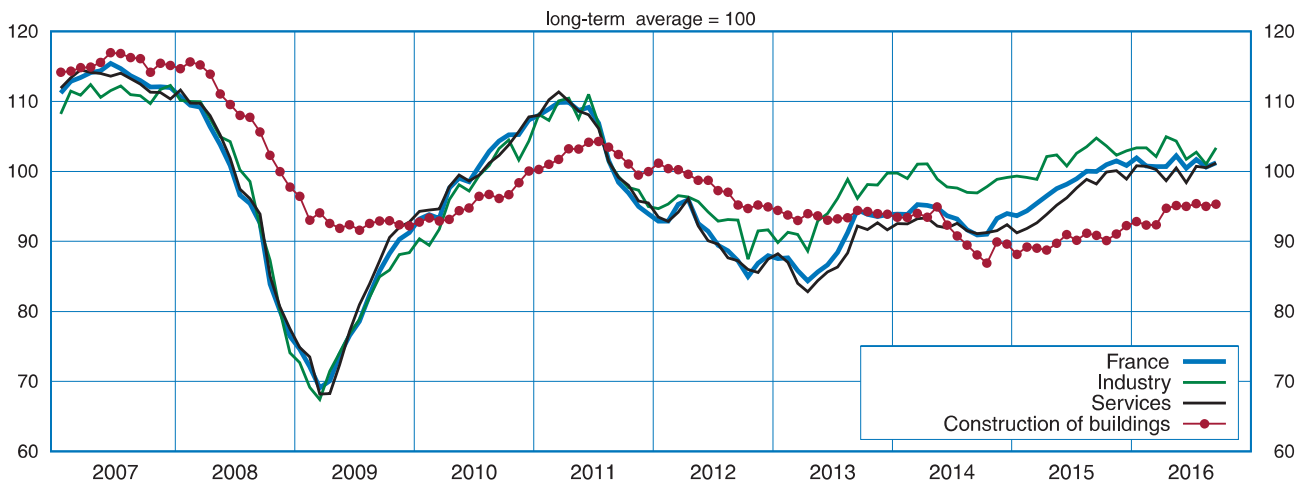
All in all, after the quarterly ups and downs, GDP is expected to maintain a pace of growth over the entire second half of the year comparable to that of H1 (+0.2% in Q3, then +0.4% in Q4). Growth should therefore reach +1.3% on average over the year as a whole, comparable to that of 2015 (+1.2%). Imports (+2.1%) are expected to be driven by relatively buoyant domestic demand while exports are likely to be sluggish (+0.7%): foreign trade is expected to drag down growth once again (−0.4 points).

## Market-sector employment should not weaken and unemployment is expected to continue to fall moderately in H2

*Market-sector employment is expected to increase by 0.7% in one year*

Market-sector payroll employment continued to grow in Q2 (+30,000 jobs), as forecast in the June issue of *Conjoncture in France*. As the prospects for employment remain favourable in the business tendency surveys, it should not weaken in H2 (+66,000). All in all, net job creations in the market sector are expected to come to about 117,000 in 2016 (or +0.7% year-on-year), after +97,000 in 2015. Since last year, they have been driven by the recovery in

### 2 – In France, the business climate is stable, slightly above its long-term average



Source: INSEE

activity and the various measures to reduce the cost of labour that have boosted the employment intensity of growth: CICE (competitiveness and employment tax credit), PRS (responsibility and solidarity pact) and hiring premium for SMEs.

*In spite of the reduction in subsidised non-market employment, total employment should grow solidly once again*

In the non-market sectors, employment is expected to slow down considerably in H2 (+4,000 jobs after +25,000 in H1) due to an expected drop in the number of subsidised employment contracts, in particular in the “emplois d’avenir” programme. Including agricultural and self-employed jobs, total employment is set to increase by 165,000 jobs in 2016 (after +157,000 in 2015).

*Unemployment is expected to fall slightly again*

In Q2 2016, the unemployment rate stood at 9.9% of the French labour force, down 0.5 points year on year. In H2, the expected rise in employment should be slightly greater than that of the labour force, itself held back slightly by the increase in the number of unemployed in training, and so the unemployment rate is expected to fall again, to 9.8% by the end of 2016, compared to 10.2% a year earlier (Graph 3).

### Purchasing power and consumption expected to see solid growth in 2016

*Inflation is expected to rise a little due to energy prices*

In September, inflation remained low (+0.4% year on year). Through to the end of the year, due to energy prices, it is expected to rise slightly, to +0.6% in December, reaching the same level as core inflation. The latter is expected to remain very low: firstly, the inflationary effect of the past depreciation of the Euro is fading, and secondly, the past fall in commodity prices is expected to continue to have a knock-on effect on the prices of goods and services.

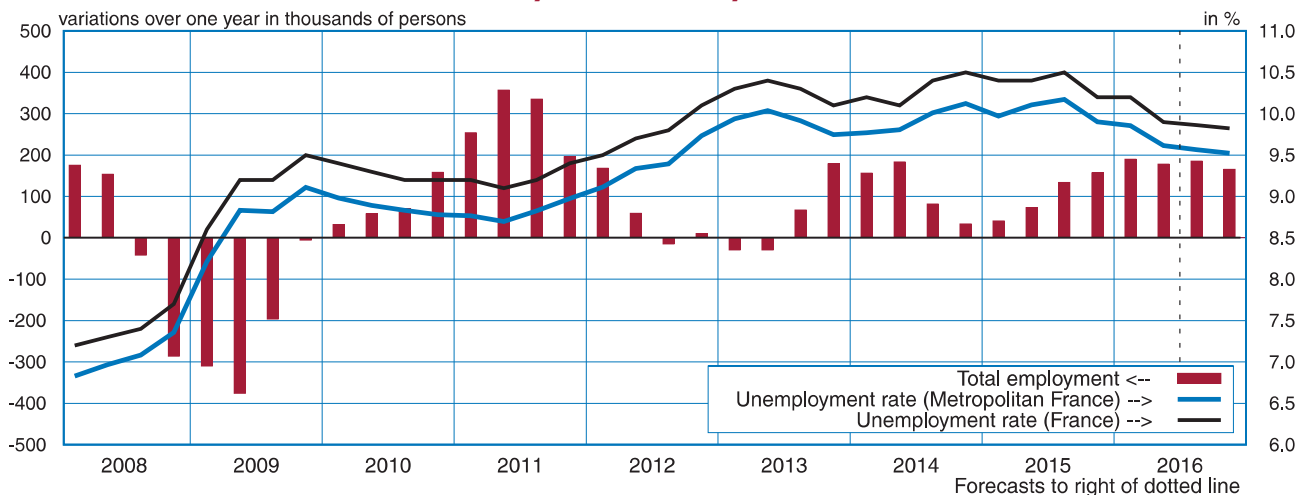
*Household purchasing power is expected to continue growing solidly in 2016*

In 2016, wages in the market sectors are expected to slow only a little (+1.5% after +1.6% on average over the year), only partly passing on low past inflation. In the public sector, wages are expected to rise slightly due to the rise in the index point on 1<sup>st</sup> July. Overall, in 2016, household purchasing power should continue to accelerate, rising to +1.8% (after +1.6% in 2015 and +0.7% in 2014). This extra growth is likely to be the result, among other things, of smaller increases in taxes (+0.9% after +1.7%) and the pick-up in market-sector employment (+0.9% on average after 0.0%).

*On average over the year, household consumption is expected to grow slightly less quickly than purchasing power*

Household consumption stalled in Q2 (-0.1%), mainly to counterbalance the strong growth in Q1 (+1.1%). Driven by purchasing power gains, it is expected to regain some momentum in H2 (+0.1% in Q3, then +0.5% in Q4). On average over the year, household consumption (+1.5%) is expected to grow slightly less quickly than real income and the savings ratio should increase slightly (+0.3 points to 14.8%).

### 3 – The increase in employment should enable another fall in the unemployment rate to 9.8% by the end of the year



Source: INSEE

## Investment should regain some vigour after a downturn in the spring

*Household investment is set to rise weakly again*

After several years of decline through to 2015, household investment on new housing has been virtually unchanged since the beginning of 2016, the improvement in sales taking some time to work its way through. In H2 2016, it is expected to rise weakly once again (+0.1% to +0.3% per quarter) so that on average over the year it should have stopped falling (+0.2% after -0.8%).

*The improvement in financing conditions continues to encourage corporate investment*

After increasing strongly for two quarters, corporate investment fell back in the spring for the first time since the beginning of 2014; many firms brought their purchases forward as they prepared for the end of the additional depreciation allowance, initially scheduled for 15 April, but finally postponed until 2017. Conditions remain favourable nonetheless: the margin rate has recovered and is expected to remain a little below its pre-crisis level, while the cost of borrowing has fallen sharply. In H2 2016, corporate investment could gradually regain its vitality. On average in 2016, it is set to increase by 3.6%, a rise not seen since 2011.

*Public investment ceases to hold back activity*

Public investment is expected to increase moderately in 2016 (+1.6%), after two years of sharp decline (-5.8%, then -3.9%). This improvement is likely to reflect that of spending on civil engineering, in line with the electoral cycle in local authorities and an easing of the effects of cuts in government grants.

## Uncertainties: political issues and the ability of French exports to bounce back

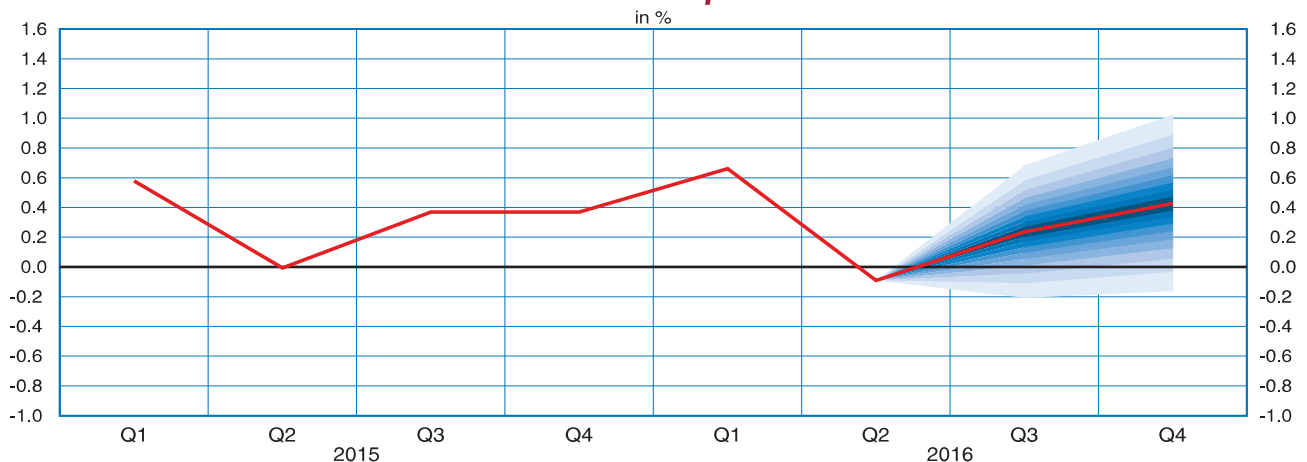
*Political uncertainty in both the United States and Europe*

Even before the French and German elections in 2017, the end of 2016 will be marked by several major political events on both sides of the Atlantic: the formation of a government in Spain, the constitutional referendum in Italy and the American presidential election. Each of these events could generate uncertainty and cause investors to adopt a wait-and-see stance. Elsewhere, the uncertainties relating to the concrete consequences of Brexit have decreased, but the triggering of the exit process could well revive them.

*Scale of the rebound in French exports*

In spite of the delivery of some large contracts, French exports were a serious disappointment in H1 considering the increase in demand for French goods. In the scenario adopted here, they should recover moderately, in particular in the aeronautical sector. Nonetheless, they could see a surprising increase, making up for the disappointment of the beginning of the year – or else they could disappoint again, which would raise questions about the French economy's ability to restore its competitiveness. ■

### 4 – Fan chart associated with the Conjoncture in France of October



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 estimate that will be published in the quarterly accounts for Q3 2016 has a 50% chance of being between 0.0% (lower limit of the fifth band from the bottom) and +0.4% (upper limit of the fifth band from the top). Likewise, it has a 90% chance of being between -0.2% and +0.7%.

Source: INSEE