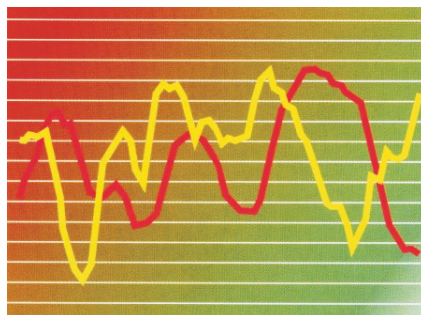


CONJONCTURE IN FRANCE



OCTOBER 2015

Demand still encouraging but activity growing in fits and starts

Growth remained strong in the advanced economies in Q2 2015. Activity picked up sharply in the United States and the United Kingdom, while forecasts for an upturn in the Eurozone were borne out (+0.4%); French growth was the only disappointment in the zone, grinding to a halt after an upbeat start to the year. However, activity slumped once again in Japan, and the emerging economies continued to slow, as in China, or even remain in recession, as in Brazil and Russia.

The cyclical data collected over the summer point to a widening gap in H2 between the advanced economies and commodity-exporting countries, mainly because of the further drop in the prices of oil and commodities. The business climate remains positive in the advanced countries. In the USA and the UK, growth should be sustained by buoyant private demand, mainly stimulated by an acceleration in the purchasing power of income.

Growth in the Eurozone is likely to improve gradually (+0.4% in Q3 then +0.5% in Q4). Exporters should continue to benefit from a Euro that is far weaker than it was last year. Household consumption is expected to gather pace thanks to the further drop in oil prices and the improved labour market situation. Lastly, corporate investment should pick up, remaining particularly vigorous in Italy and Spain.

In France, the drop in industrial output in spring and early summer should only be a temporary one, but is still likely to affect the pace of GDP growth in Q3 (+0.2%); this growth should then pick up in Q4 (+0.4%), bringing growth for the year to +1.1% (after +0.2% in 2014). After some jolts in H1, household consumption should return to a growth level in line with gains in purchasing power, which is likely to pick up sharply over the year as a whole

(+1.7% after +1.1%). However, household investment in housing is set to continue its slide and to take its toll on activity as a whole. After a rise in H1, corporate investment should accelerate moderately in H2: financing conditions have improved with the rise in corporate margins and easier access to credit thanks to monetary policy measures. Above all, corporate demand prospects are brightening, as evidenced by an improved business climate across virtually all sectors since the start of the year – with the notable exception of construction.

The upturn in activity is bringing with it a rise in market employment, which has also benefited from the tax credit for encouraging competitiveness and jobs (CICE) and the Responsibility and Solidarity Pact, both of which have boosted growth in employment. Additionally, subsidised employment contracts in the non-market sectors should remain buoyant. All in all, almost 120,000 jobs should be created in the course of 2015, enough to offset the increase in the labour force, while the unemployment rate should remain stable in H2, standing at 10.3% in France (including the overseas departments).

There are two main uncertainties in this forecast. On the foreign demand side, the slowdown in the emerging countries could take a heavier toll than expected, particularly if it were to undermine the confidence of business leaders in Europe. And regarding French businesses, industrial activity has been disappointing since spring considering the components of demand and the improved business climate: while a moderate rebound is expected, activity may either continue to disappoint or, in reaction, pick up more sharply than forecast. ■

The cyclical divergence between advanced and emerging economies widened in Q2 2015

The slowdown in the emerging economies once again caused a decline in world trade

In Q2 2015, the emerging economies continued to slow, most notably in China. Recession-hit Brazil and Russia saw activity shrink even further. All in all, imports by the emerging economies stagnated and world trade declined overall once again (−0.3% after −1.4%).

Growth remained robust in the advanced economies

GDP in the advanced economies grew by 0.4% in Q2 2015, a rate comparable to that of the last two years. Activity picked up particularly sharply in the USA (+1.0%) after a difficult start to the year due to the harsh winter (+0.2%), and also grew strongly in the UK (+0.7% after +0.4%). Activity fell back in Japan, however (−0.3% after +1.1%), once again because of a fall in consumption.

The Eurozone recovery continued

In the Eurozone, activity made solid progress in Q2 2015 (+0.4%, as forecast in the June 2015 issue of *Conjoncture in France*), most notably in Germany (+0.4% after +0.3%), Italy (+0.3% after +0.4%) and above all Spain (+1.0% after +0.9%), although French growth was disappointing.

In France, activity stalled in Q2

Activity in France slowed sharply in Q2 (0.0% after +0.7%) – more than predicted in June's *Conjoncture in France* (+0.3% after +0.6%). Industrial output slipped back unexpectedly (−0.7% after +1.2%), mainly due to the decline in production of refinery products and transport equipment. This surprise was evidenced in the strongly negative contribution of change in inventories to growth (−0.5 points). The other components of demand were more in line with expectations: household consumption slowed sharply (0.0% after +0.9%), notably under the effect of an energy expenditure backlash, while the contribution of foreign trade to growth was positive (+0.4 points) due to the strong progress made in aeronautical and naval exports.

The slowdown in the emerging economies has brought turmoil to the financial markets and a new drop in commodity prices

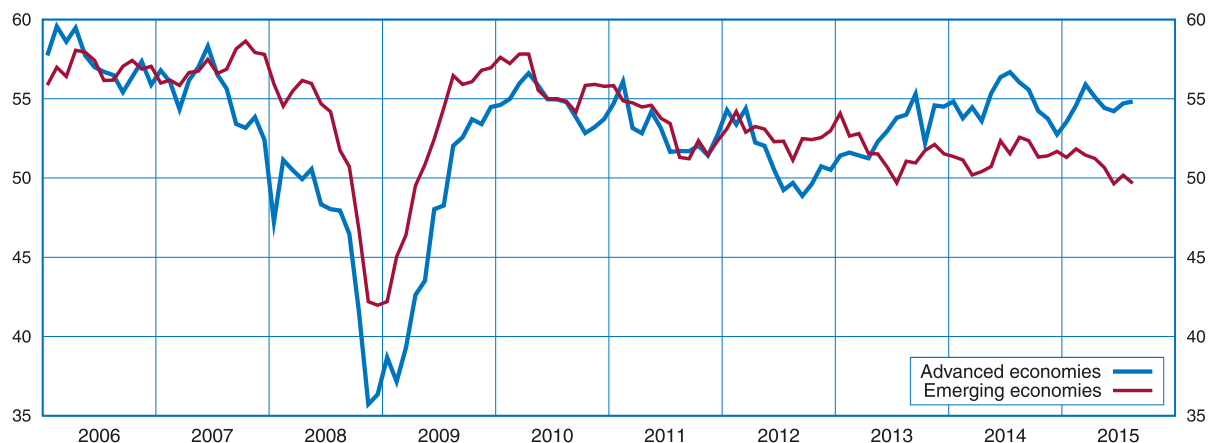
Financial market volatility increased in summer

The summer of 2015 was marked by turmoil on financial markets. This reflects a growing awareness of the sharper-than-expected slowdown in the emerging economies, particularly China. In June and then August, the Chinese stock market indices slumped, wiping out the sharp rise seen in H1 2015. This correction affected all the main stock exchanges of the advanced countries and led to a rise in their volatility. In parallel, the main emerging currencies depreciated.

Oil and commodity prices fell back once again

Faced with the prospect of a sharp slowdown in China, the prices of industrial commodities (rubber, copper, aluminium, lead, nickel, etc.) fell back in summer, while oil prices plummeted once again after recovering slightly in spring. For the purposes of this forecast, the price of a barrel is set at \$50.

1 – Business climate: the cyclical divergence between advanced and emerging economies widens



Sources: Markit

The business climate is positive in the advanced economies but deteriorating in the emerging countries

The chill wind persists in the emerging economies

In most of the main emerging countries the business climate remains poor (*Graph 1*). In China, activity is set to decline once again, mostly because investment is likely to slow further: as an annual average, growth should be lower than in 2014, which was already the weakest year since 1990. Commodities-exporting countries such as Brazil and Russia are likely to continue to suffer due to declining prices. All in all, imports by the emerging countries should recover slightly in H2 but fall back sharply as an average over the year (-1.4% in 2015 after +3.5% in 2014), for the first time since 2009.

The upturn looks to be sound in the advanced economies

Conversely, the economic climate in the advanced economies remains positive in H2 2015. In the USA and the UK, consumption should once again drive activity as household purchasing power gets a boost from the pick-up in wages. In Japan, the business tendency surveys point to a moderate rebound in activity, spurred by domestic demand. Lastly, the Eurozone recovery seems to be well underway. All in all, the advanced economies should drive world trade, which is set for a moderate rebound in H2.

Through to the end of 2015, the Eurozone is expected to withstand the turmoil from the emerging economies

Diverging American and European monetary policies

After six years of stability at a minimal rate, the American Federal Reserve is set to raise its base rates slightly by the end of the year, bearing in mind the inflation perspectives and the improved labour market. In the Eurozone, however, the European Central Bank has been implementing huge asset purchase measures since March, including government debt. These operations have lowered sovereign yields and, above all, have eased access to credit for private agents.

Investment fuelled by improved credit conditions, especially in southern Europe

For the first time in over three years, outstanding loans to Eurozone companies rose in summer 2015. The upturn in credit in the Eurozone has come hand in hand with sustained growth in productive investment in 2015, particularly in Spain (+9.6%) and Italy (+8.0%).

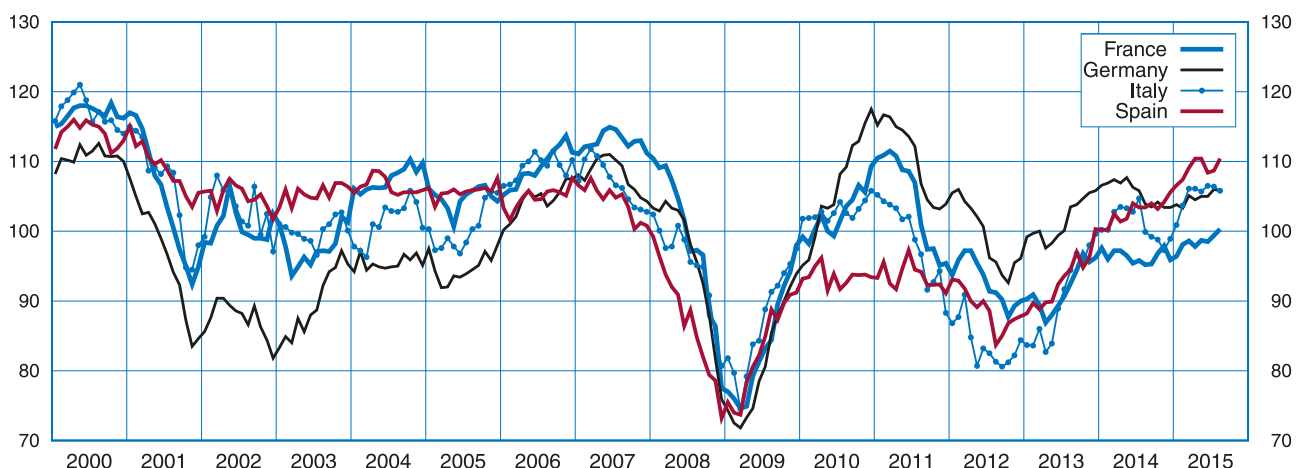
Exports standing up to the demand shock from the emerging economies

In H1 2015, exports from the Eurozone remained vigorous, despite the contraction of world trade: intra-European trade remained robust and the depreciation of the Euro led to market share gains. In H2, the foreign exchange effects should ease somewhat and exports are likely to slow. Over the year as a whole, strong exports (+4.8% after +3.9%) and imports driven by domestic demand (+4.9% after +4.2%) are likely to be in stark contrast with the slowdown in world trade (+1.4% after +3.3%).

Eurozone growth should remain solid through to the end of the year

In the main Eurozone countries the business climate is still positive, particularly in Italy and Spain, where it is at its highest levels since 2007 (*Graph 2*). Boosted by falling oil prices, the ongoing recovery of employment and the pick-up in wages,

2 – The business climate remains encouraging in the Eurozone



Source: European Commission

household purchasing power should progress strongly, thereby encouraging household consumption. Activity in the Eurozone is expected to grow gradually: +0.4% in Q3 then +0.5% in Q4. With the exception of Spain which should continue to grow very rapidly (+0.9% per quarter in H2), the pace of growth in the main countries is likely to be fairly even, a sign that the recovery is spreading across the Eurozone.

French exports likely to slow, but still sustained by demand from other European countries

Due to the geographical profile of French exports, world demand for French products was much more buoyant than world trade as a whole in H1 2015. Exports also benefited from the previous depreciation of the Euro and the exceptionally large aeronautical and naval deliveries. In H2, exports are likely to slow in reaction to this, although they should remain dynamic (+0.7% in Q3 then +1.2% in Q4). Over the year as a whole, French exports should pick up sharply (+6.5% after +2.4%), growing significantly faster than world demand for French products (+3.7% after +3.1%). As the French economy is growing more slowly overall than those of its main trading partners, imports should be less buoyant than exports, so that the contribution of foreign trade should end up being slightly positive in 2015 (+0.1 points).

The French upturn coming in fits and starts

In France, it is the turn of the business climate in services to take off

After remaining stable at around 94 from September 2013 to February 2015, the business climate in France improved in spring, mainly spurred by industry and trade. Since June, it has been the turn of the business climate in market services to progress, and in September it has returned to a level close to its long-term average (Graph 3). However, it is still poor in building and civil engineering. In all sectors, the business climate is at its long-term average in September, the highest for four years.

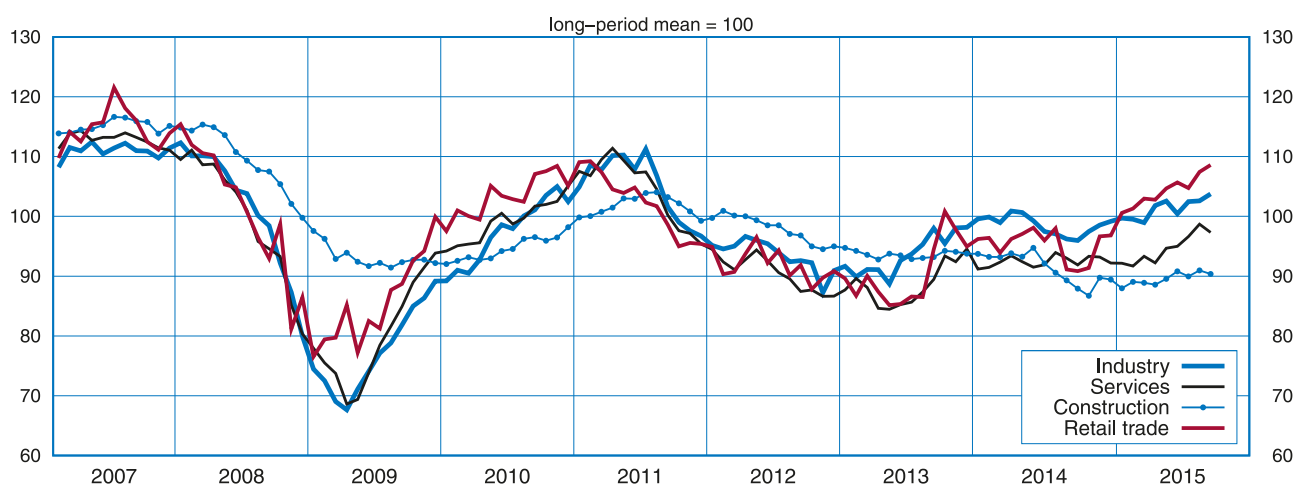
Manufacturing output went through a shaky patch in early summer but should recover quickly

While the business climate in industry remained positive, manufacturing output declined sharply in June and July. However, this should only be a wobble, partly caused by an accumulation of temporary factors (strikes and technical shutdowns in refineries, atypical calendar effects). The positive business climate, and in particular good activity prospects, suggests a recovery from summer through to the end of the year. The quarterly profile of manufacturing output should therefore be uneven: after +1.2% in Q1 2015 and -0.7% in Q2, the decline should ease in Q3 (-0.2%), before output increases again at the end of the year (+0.5%).

French growth set to reach +1.1% on average in 2015

All in all, quarterly jolts aside, GDP in H2 2015 should keep to a similar pace to that of H1 (+0.2% in Q3 then +0.4% in Q4). Growth should thus reach +1.1% as an average over the year (after +0.2% in 2014). Like last year, French GDP is expected to increase less than the Eurozone average (+1.6% after +0.9%), mainly due to the decline in investment in construction.

3 – In France, it is the turn of the business climate in services to take off



Source: INSEE

Market-sector employment likely to rise again

The CICE and the Responsibility and Solidarity Pact boosting growth in employment

After a slight downturn in Q1 2015, market-sector employment rebounded in Q2. Prospects in terms of numbers of people in employment are improving in the business tendency surveys, and market-sector employment should continue to pick up in H2 (+25,000 jobs). All in all, an increase of 41,000 jobs is expected in 2015 (after -63,000 in 2014), boosted by more sustained activity and the extra jobs provided by the tax credit for encouraging competitiveness and jobs (CICE) and the Responsibility and Solidarity Pact.

Total employment likely to accelerate sharply in 2015

As in 2014, employment in the non-market sector should rise sharply (+55,000), in large part thanks to subsidised employment contracts (+35,000). All in all, employment should gain 116,000 jobs in 2015 (after +24,000 in 2014).

Unemployment set to remain stable in H2 2015

In Q2 2015, the unemployment rate stabilised at 10.3% in France (including the overseas departments). In H2, the expected rise in employment should be sufficient to offset the increase in the labour force, so that unemployment rate remains stable at 10.3% (against 10.5% at end 2014).

Low inflation through to end 2015

Under the effect of the latest drop in oil prices, headline inflation went back to zero in August. However, core inflation continued its recovery, standing at +0.6% in August (against -0.1% in December 2014), affected among other things by the past depreciation of the Euro which raised the prices of imported goods. Headline inflation is only likely to pick up slightly by December, to +0.3%. At the same time, core inflation should stabilise (+0.7% at end 2015), with the low production capacity utilisation rate, the slight re-appreciation of the Euro and the high unemployment level all limiting inflationary pressure.

Purchasing power and consumption regaining momentum in 2015 to reach their highest point since 2007

Nominal wages expected to remain buoyant in 2015

In Q2 2015, the average wage per capita in nominal terms slowed, after a dynamic Q1 (+0.1% after +0.8%). In H2 2015, wages should continue to adjust with a time lag to the previous weakness of inflation, and progress in wages should only be modest (+0.2% per quarter). All in all in 2015, nominal wages are set to increase at the same pace as in 2014 (+1.6%).

The increase in household purchasing power in 2015 should be the sharpest since 2007

In 2015, the purchasing power of household income is likely to continue to pick up, to +1.7% (after +1.1% in 2014 and -0.1% in 2013), which would be its highest rise since 2007. It is likely to be driven mainly by the increase in earned income (+1.5% after +1.4%) and by the rebound in property income (+1.0% after -2.2%).

Household consumption likely to remain strong in H2

After the sharp rebound in Q1 (+0.9%), household consumption stagnated in Q2, mainly in reaction to heating expenditure. Driven by purchasing power gains, it should remain buoyant in H2 (+0.4% per quarter). Over the year as a whole, household consumption is expected to grow almost in line with purchasing power (+1.6% on average over the year after +0.6% in 2014) and the savings ratio is likely to remain stable at around 15.2%.

Housing construction still taking its toll on growth, but the freeze on corporate investment set to thaw

Despite positive signals, household investment likely to decline further

New housing sales have increased since the end of 2014 and the number of building permits, which reached a low point at the start of 2015, has since picked up, particularly for individual dwellings. Given the production lead times in the sector, household investment is likely to slip back again in H2, although less sharply (-1.0% then -0.6%, after -1.5% in Q2).

Corporate investment set to accelerate moderately

The freeze on corporate investment looks likely to thaw: domestic and foreign demand prospects are more encouraging, the margin rate improved significantly at the start of the year thanks to the CICE, the Responsibility and Solidarity Pact and lower oil prices, and external financing conditions have eased further. These improvements are reflected in the business tendency surveys: business leaders in

industry and services say they are more likely to invest in H2. So after a slight rise in Q2 (+0.3%), corporate investment should accelerate moderately in H2 (+0.5% then +0.6%). Over the year through to end 2015, it should increase by 2.1%, against +0.3% at end 2014 (Graph 4).

Uncertainties: slowdown in emerging countries and rebound in industrial activity

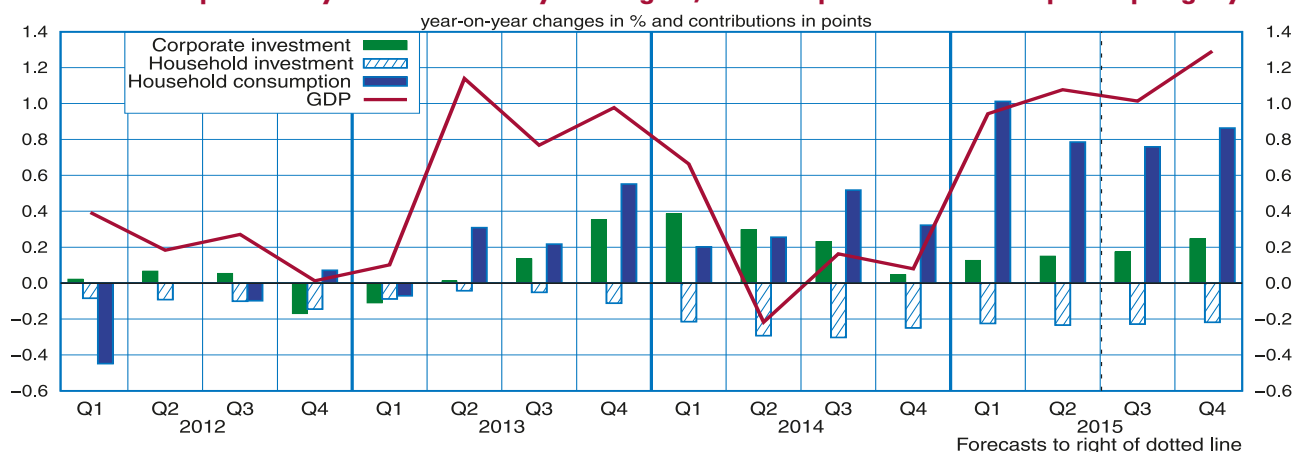
Uncertainties on financial markets and slowdown in emerging countries

In this scenario, the Fed raises its rates before the year-end, stock market volatility remains under control and the advanced economies continue to withstand the negative demand shock from the emerging economies. However, only trade channels are considered here. If further stock market volatility or concerns over the emerging economies were to undermine the confidence of European entrepreneurs, the momentum of recovery in the Eurozone could come to a halt. Conversely, if these uncertainties were to dissipate quickly, activity would pick up more sharply than forecast, via more robust investment.

Rebound in manufacturing output

After a shaky patch in June and July, this scenario is banking on a moderate rebound in manufacturing output from summer onwards, bearing in mind the positive business climate in this sector. But production might turn out to be more dynamic or, conversely, could once again be more disappointing than the business tendency surveys would lead us to expect. ■

4 – Consumption likely to sustain activity once again, while corporate investment picks up slightly



Source: INSEE