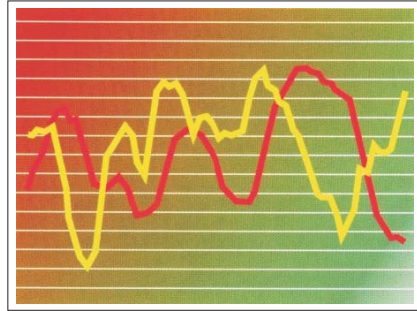


# CONJONCTURE IN FRANCE



OCTOBER 2011

## Economic recovery on hold

Over the summer 2011, the economic climate deteriorated sharply in all the advanced economies. Since June, the business climate has significantly worsened in France in the industry, services and trade sectors, and the indicators available in September all point to a turning point in the economic situation.

Activity had already slowed in the advanced economies in Q2: the global growth rate was only 0.1%, against a backdrop of virtual stagnation in world trade. The slowdown observed in spring originated from the consequences of the earthquake in Japan and the rise in prices of commodities. It probably also stemmed from the more restrictive orientations adopted by economic policies: measures to quell inflationary overheating in the emerging countries; budgetary consolidation strategies in the advanced economies. But the temporary nature of some of these shocks suggested the possibility of a rebound in H2.

Events over the summer have wrecked this scenario. In the Eurozone there has been rising uncertainty since early summer, fuelled by the sovereign debt crisis. This has led to a sharp drop in stock-market indices, particularly among financial institutions. Lastly, the succession of adverse shocks has taken its toll on the expectations of business leaders, and growth prospects to the end of the year have been significantly revised. In Q3, the available data suggest a slight rise in activity in the advanced economies, among other things thanks to a "technical" rebound in consumption. But, devoid of any momentum, these economies look set to stagnate in Q4.

France would appear to have joined this global trend. GDP growth should stand at 0.3% in Q3, then 0.0% in Q4. The dynamic of investment and employment which has constantly driven the recovery since mid-2009 is likely to wea-

ken considerably in H2 2011. Investment is set to slow due to dwindling export opportunities and against a backdrop of increasing uncertainty. And the market sectors are likely to create only 24,000 jobs in H2, against 112,000 in H1. The unemployment rate should therefore rise once again, despite increasingly widespread recourse to subsidised employment contracts over the rest of the year.

The only support to activity is household consumption, which should rebound in Q3, after the brief downturn observed in Q2. It should then show moderate growth in Q4, in line with purchasing power. The savings ratio of French households is likely to be maintained at a high level.

The scenario set out in this Point de conjoncture is surrounded by major uncertainties. The biggest one is the European crisis and its spread to the real economy. There are no tangible signs as yet of a generalised tightening of the financing conditions of private agents in Europe, mainly because of the intervention of central banks in order to provide the financial system with liquidity. The scenario presented here does not assume any aggravation of financial tensions by the end of the year; but a seizure of the economy's financing channels cannot be ruled out, and this would cause an even sharper slowdown in demand.

On the other hand, the implementation by these countries of measures to restore economic agents' confidence in the soundness of the world financial system could have a positive effect on expectations. Additionally, once certain supply constraints have been eased, a decline in oil prices could buoy up activity in the advanced economies and soften the blow of deteriorating business activity. ■

## In Q2 2011, activity only grew slightly in the advanced countries

*Consumption ground to a halt in the advanced economies, partly due to one-off factors*

In Q2 2011, activity in the advanced economies was virtually stagnant, with progress limited to 0.1%. The Japanese economy continued to suffer the consequences of the earthquake of 11 March (-0.5% after -0.9%). Activity was also sluggish in the United States (+0.3%), in the United Kingdom (+0.2%) and in the Eurozone (+0.2%). Household consumption was particularly weak in these three zones. Generally speaking, purchasing power gains were cut back by the rise in inflation and, in certain countries, by budgetary consolidation measures. Furthermore, the break in Japanese supply chains brought with it a slowdown in automobile purchases, particularly in the United States. Lastly, French household consumption suffered the after-effects of the end of the scrappage allowance. As these factors are temporary in nature, there is potential for a "technical" rebound in Q3.

*World trade slipped back*

The low level of domestic demand in the advanced economies caused their imports to slow. In parallel, imports in the emerging countries stalled, particularly in Asia: on the one hand, the earthquake in Japan slowed trade down in this zone; and on the other hand the tightening of monetary policy in these countries took its toll on their domestic demand. All in all, world trade contracted (-0.6%) in Q2 2011, for the first time since mid-2009 (see Graph 1).

*Generally low levels of activity in the Eurozone*

In the Eurozone, activity stagnated in Germany and France and low growth levels were registered in Spain and Italy. In both France and Germany, activity was heavily penalised by the marked downturn in household consumption.

## Financial turmoil

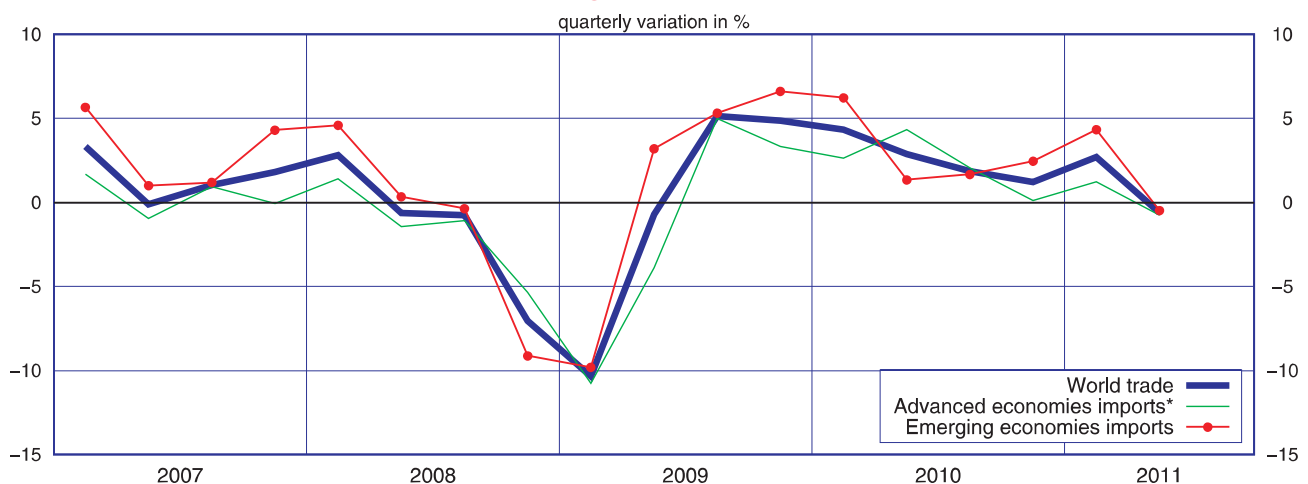
*Certain slowdown factors in Q2 set to ease in H2...*

Some of the shocks that contributed to the slowdown in the world economy in Q2 should gradually dissipate in H2. For example, as the prices of commodities stabilise, inflation should start to come down in the advanced economies at the end of the year. Similarly, after the earthquake of 11 March, Japanese production capacity swiftly got back on track and should rebound sharply in Q3 (+1.0% after -0.5%).

*... but a new spike in uncertainty over the summer*

However, the summer of 2011 was marked by a new rise in uncertainty, fuelled by concerns surrounding sovereign debt in Europe and the revisions of certain national accounts, in particular in the United States. In the Eurozone, the financing conditions of several States have deteriorated significantly. In the United States, the revision of past growth figures raised doubts about the American economy's ability to rebound. These uncertainties have led to a rise in tensions on the money markets in the Eurozone, a massive drop in world stock market prices and a global increase in risk aversion, affecting economic prospects for

**1 - World trade grinds to a halt in Q2 2011**



\* OECD less Turkey, Mexico, Korea, CEEC

Source: Centraal Planbureau

the end of the year. Faced with this situation, the central banks are once again introducing unconventional instruments: the American Federal Reserve has announced a programme extending the maturity of its holdings of securities, and the European Central Bank is implementing actions for the purchase of sovereign bonds.

### The advanced economies set to register weak growth over the rest of the year...

#### The business climate on the slide in the advanced economies

Against this backdrop of growing tension, the business climate in the advanced economies deteriorated sharply over the summer months (see Graph 2). The business climate indicator is still slightly above the expansion threshold in the United States and in Japan, but below in the Eurozone. This being the case, the advanced economies are unlikely to gain any real momentum in H2.

#### World trade at a standstill

The emerging economies should also continue to falter, mainly due to a further tightening of national monetary policies in the face of inflationary pressure. Under these conditions, world trade is unlikely to rebound by the end of the year: it should stagnate in Q3 and decline slightly in Q4.

#### The American economy not yet back to its pre-crisis growth rate

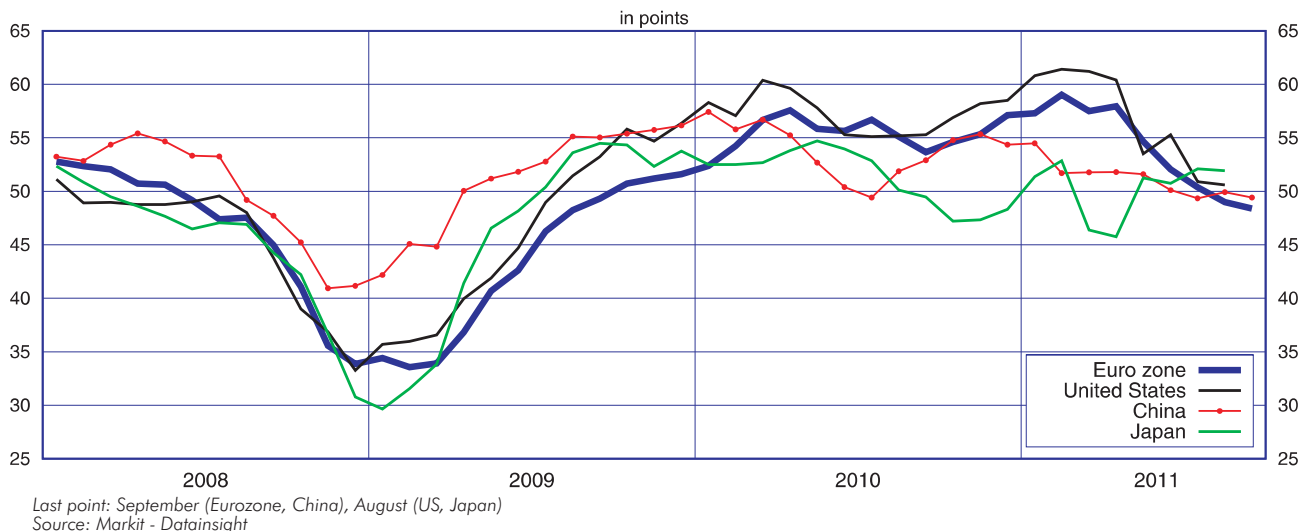
In the United States, activity should progress at a modest rate, penalised among other things by the fall in local government expenditure. It should pick up somewhat in Q3 (+0.4% after +0.3%), according to the data on industrial output and retail sales, available until August. Activity is likely to be buoyed up by a slight rebound in household consumption, particularly in automobiles. American growth should then fall back slightly in Q4 (+0.3%). The drop in the net worth of American households caused by losses on the stock markets is likely to take its toll on American household consumption.

### ...and activity stagnating in the Eurozone

#### The rebound in domestic demand in France and Germany should sustain activity somewhat in the Eurozone in Q3

After a decline in Q2, French and German household consumption should rebound in Q3. In Germany, car registrations saw a sharp increase in July and August. However, in a very uncertain climate, investments in capital goods are set to slow. But domestic demand should nonetheless progress overall in the Eurozone, thereby offsetting the slowdown in exports in Q3. Activity is thus set to continue growing slowly in Q3 (+0.1%). It should then stagnate in the last quarter of the year.

## 2 - Decline in business tendency surveys results



### Italy and Spain heading for recession in H2

Within this context of a general slowdown, marked differences can still be observed across the Eurozone. While activity should still hold up in Germany and in France, particularly in Q3 (+0.3%), Italy and Spain are set to go into recession (respectively -0.1% and -0.2% per quarter in H2).

### Activity likely to be sluggish in France for the rest of the year

#### In France, the business tendency surveys showing a clear decline

The business climate - plotted by the business tendency surveys - has declined sharply in most of the main economic sectors since June. In the manufacturing industry, global prospects fell sharply in September in the eyes of entrepreneurs, down to their lowest level since July 2009 (see Graph 3). But, personal production expectations declining since April, remained close to their long-term average in September. Industry entrepreneurs have also indicated a slowdown in their past activity, although the balance of opinion is still well above its long-term average.

#### Activity should temporarily rebound in Q3

Despite the worsening business climate, several factors are likely to contribute to a slight rebound in total output in Q3 in France. After declining in Q2, output in the manufacturing industry should stabilise in Q3: in the automobile industry, activity should bounce back after a marked drop in March and April. Energy production should also increase: it slipped back in April owing to unusually high temperatures, but should return to more normal levels. Activity in the trade sector, which was penalised in Q2 by the decline in household consumption, should see an upturn in Q3. All in all, activity should pick up slightly in Q3 (+0.3%).

#### Growth of 1.7% in 2011 as an annual average

Activity is likely to stagnate in Q4 in line with the deteriorating business climate, especially business prospects. Over 2011 as a whole, growth should stand at 1.7%, slightly higher than in 2010.

### A slowdown in job creations

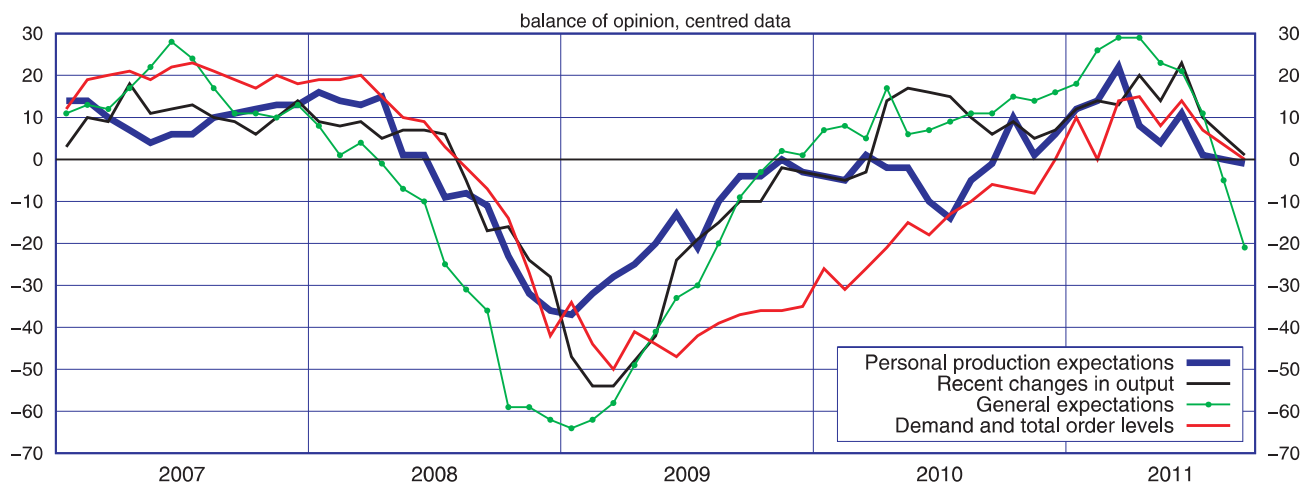
#### The slowdown in activity has put a brake on market-sector job creations

Sustained by dynamic activity in Q1, net job creations in the non-agricultural market sector were strong in H1 (+ 112,000). With the slowdown in activity that began in Q2 and is set to continue in H2, the rate of job creations should drop sharply: only 24,000 jobs created in the market sectors in H2. Total employment should nonetheless be sustained by increased recourse to subsidised employment contracts in H2 2011.

#### Slight rise in the rate of unemployment

The rate of unemployment stood at 9.1% of the active population in Q2 2011 (respectively 9.6% including overseas departments). It should rise slowly towards the end of the year to reach 9.2% in Q4 (9.7% including overseas departments).

### 3 - Decline in the business climate in the manufacturing industry in France



Source: INSEE

## Moderate gains in purchasing power

### *Inflation stabilising*

The rise in the prices of commodities observed up to April 2011 should continue to spread to consumer prices. In particular, the rise in food prices is likely to continue until December 2011. The inflationist impact of food prices should however be offset by the fall in energy prices. The year-on-year growth in consumer prices should reach a peak of 2.5% in October before dropping slightly to 2.3% in December 2011. Core inflation is set to pick up, reaching 1.6% at the end of December 2011, after 1.2% in August.

### *Moderate gains in real wages*

With the new rise in inflation, the indexation mechanisms should bring about a rise in nominal wages over the year. Additionally, the introduction of a bonus paid to employees of companies that have increased their dividends should sustain wages in H2. In 2011, the growth rate of the average wage per head should therefore be the highest observed since 2008, but this is likely to be eaten away partially by the growth in inflation in 2011.

### *Pick-up in purchasing power gains in 2011*

In 2011 household income should be sustained by the growth in payroll. However, taxes are set to rise sharply owing to the rebound in income in 2010 and partly due to the removal of tax loopholes voted in for the Finance Law, which should mainly come into play in H2. The acceleration of gross disposable household income in 2011 (+3.5% after 2.0%) should also be offset by the new rise in inflation: all in all, household purchasing power is set to rise by 1.3% in 2011 after 0.8% in 2010.

## Rebound in household consumption in H2

### *Household consumption catches up slightly in H2*

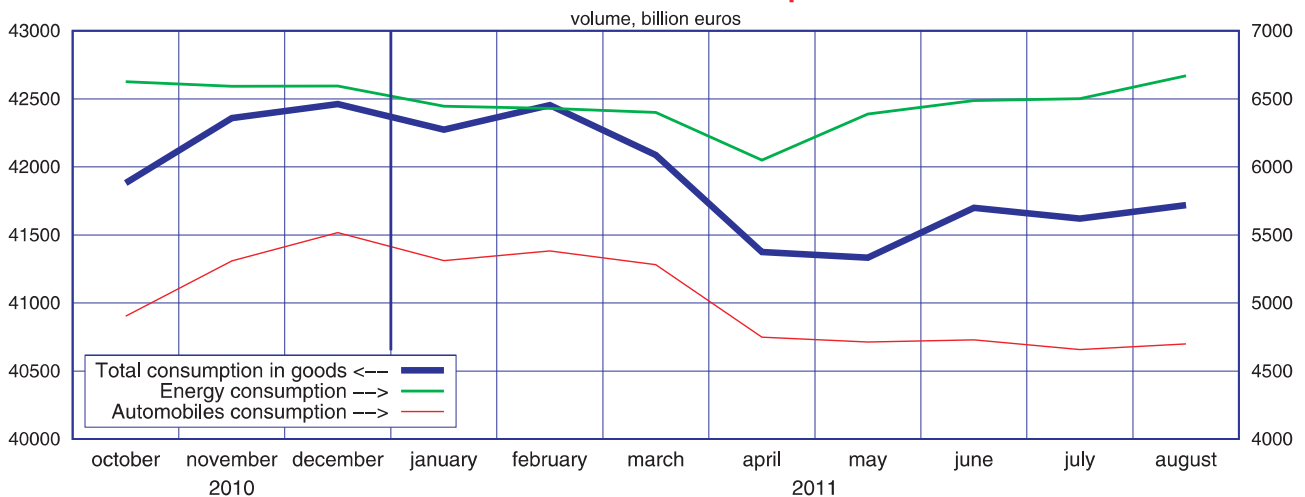
Household consumption fell back sharply in Q2 (-0.7%), penalised both by the drop in energy consumption because of the particularly clement weather in April and by the decline in automobile consumption after the expiry of the scrappage allowance scheme. Household consumption should rebound in H2 (+0.5% in Q3 then +0.3% in Q4), but without fully making up for the decline in Q2. In particular, car purchases should stay at levels below their average (see Graph 4). The savings ratio should therefore stabilise at around 16.5% in H2, a higher level than that observed in 2010.

## Investment slower over the rest of the year

### *Stabilisation in the corporate investment rate in H2*

There are as yet no tangible signs of restrictions on credit to companies. However, the fast-rising uncertainties and deteriorating business prospects are likely to cause entrepreneurs to reduce their investment expenditure. Corporate invest-

### 4 - Rebound in household consumption in Q3



ment should therefore be sluggish over the rest of the year (+0.3% then +0.1%), and, after climbing sharply since the end of 2009, the investment rate should stabilise in H2.

*The improvement in the construction industry unlikely to last*

Collective and individual housing starts experienced solid growth towards the end of 2010, before returning to low levels in Q3. Bearing in mind the lead times in the sector, output in construction should once again rise sharply in Q3 before stagnating in Q4.

### Slightly negative contribution of foreign trade to growth

*Weak growth of exports*

Due to the weak demand for French products, particularly in Spain and Italy, exports are unlikely to grow substantially in H2. French domestic demand should however remain relatively dynamic; as a result, the contribution of foreign trade to growth should be slightly negative over the forecasting period.

### Uncertainties: Consequences of financial turmoil, decline in oil prices, dynamism of the emerging economies

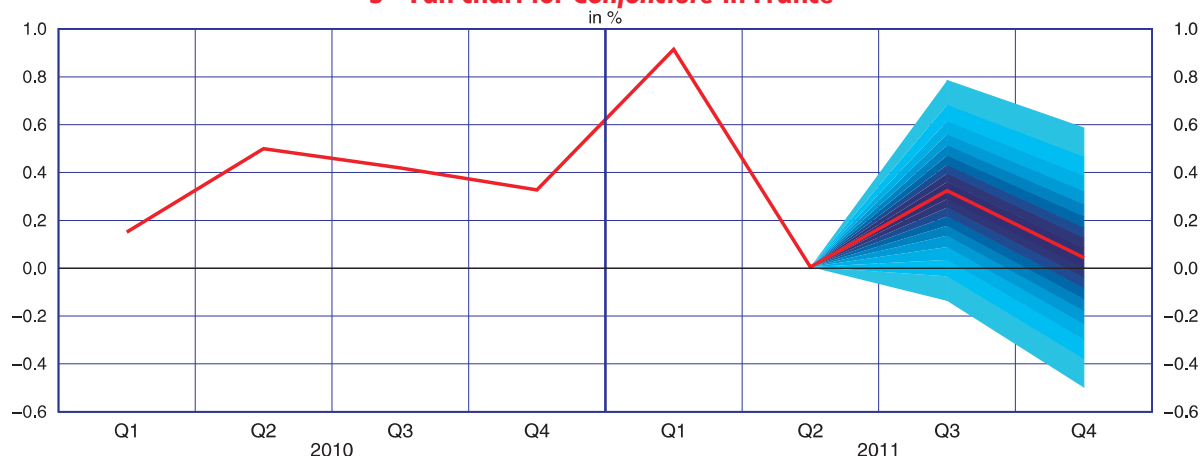
*Consequences of the financial turmoil*

The confidence shock in summer has resulted in greater financial turmoil and a downward revision of world growth prospects. And yet, according to the latest available data, the tensions on the interbank money markets have not yet led to a generalised tightening of financing conditions for private agents. But there is a risk of very tight restrictions on the distribution of credit, leading to a more marked slowdown in demand in the advanced economies than our scenario suggests. Conversely, the introduction in these countries of measures intended to reassure the markets of the soundness of the world financial system could have a positive effect on expectations.

*Easing of supply constraints on the oil market*

Despite weaker demand perspectives, the price of Brent has not fallen significantly over recent months, mainly because of supply constraints. Indeed, supply has been limited not only by the situation in Libya, but also due to prolonged maintenance operations among several producers (particularly Norway, the United Kingdom and Canada). Our scenario, which has oil prices stabilising, could underestimate the impact on oil prices of the end of these supply constraints. ■

**5 - Fan chart for Conjoncture in France**



Methodological note: see *Conjoncture in France*, INSEE, June 2008  
Source: INSEE