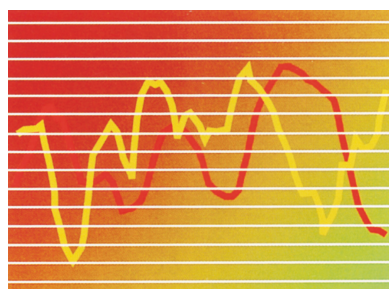


CONJONCTURE IN FRANCE



OCTOBER 2013

The recovery continues

In Q2 2013 activity accelerated once again in the advanced economies. The Eurozone in particular saw renewed growth, as expected, after six quarters of recession. Conversely, growth slowed in the emerging economies in Q2.

In the advanced economies, business climate as highlighted in the business tendency surveys continued to improve this summer, leading to expectations of a further recovery through to the end of the year. In particular, activity in the Eurozone should continue to grow in H2 (+0.1% in Q3 then +0.3% in Q4), stimulated by low inflation, a moderation of fiscal consolidation measures and a pick-up in investment after a very marked adjustment period. In the emerging economies the situation is more uneven, but growth in H2 2013 is likely to remain disappointing overall.

World demand for French products should remain buoyant and sustain exports, which are nonetheless likely to slow slightly under the effect of the appreciation of the euro since mid-2012.

In France the business climate, which started to pick up in industry in spring, is now improving across all sectors. Activity is however likely to be restricted in the energy and transport equipment sectors in Q3, most notably due to the after-effects of the previous quarter. GDP should thus stabilise in Q3 before growing once more in Q4 2013 (+0.4%). As an annual average, GDP should climb by 0.2% in 2013. Year-on-year, activity should show a far more positive trend at the end of 2013 than one year previously (+0.8% after -0.3%), driven by the rebound in manufacturing output, most notably.

Investment is set to stabilise after two years of decline. In particular, production in building should stabilise in the wake of the rebound in housing starts observed in H1 2013.

Due to the growth in activity and despite the pick-up in productivity gains, the drop in market-sector employment is likely to ease. With the sharp rise in the number of subsidised jobs in the non-market sector, total employment is set to rise in H2. Ultimately, the rate of unemployment should grow by 0.1 points in Q3, and stabilise in Q4.

The outlook for household purchasing power should be better in 2013 than in 2012 (+0.5% after -0.9%), under the combined effect of the drop in inflation - which so far has barely been passed on to wages - and a less sharp rise in the tax burden. Household consumption expenditure should therefore continue to rise in H2. As an annual average, this rebound is however likely to be offset by fluctuations in the savings ratio, which is set to pick up slightly (+0.2 points after -0.5 points).

Various uncertainties surround this scenario. First of all, the speed of recovery in the Eurozone is uncertain: once started, this recovery could, as is often the case, be surprisingly strong, but conversely it could also stall should the risks surrounding sovereign debt and banks make a reappearance. Additionally, through to the end of the year there will be uncertainty surrounding American economic policy, with questions marks about the rate at which the Fed will reduce its bond purchasing programme and the outcome of US Congress negotiations on the budget and the debt ceiling, which remains difficult to predict. Lastly, growth forecasts for the emerging economies are less robust than usual, as they are subject to the conflicting influences of the increase in financing costs and the ripple effect of the advanced economies. ■

Activity picked up once again in the advanced economies in Q2 2013

Activity buoyant in the advanced economies...

In Q2 2013, activity was surprisingly dynamic in the advanced economies (+0.6% after +0.3%), and growth was stronger than had been forecast in the June 2013 issue of *Conjoncture* in France (+0.4%). Most notably, activity accelerated in the United States (+0.6% after +0.3%) and the United Kingdom (+0.7% after +0.4%) and grew vigorously in Japan (+0.9% after +1.0%).

... with a marked rebound in Europe

After six consecutive quarters of declining activity, the Eurozone came out of recession (+0.3%). Activity grew particularly strongly in Germany (+0.7%) and France (+0.5%). All items of demand except for inventory contributed to this trend. In particular, investment showed slight progress, putting an end to eight quarters of decline.

... while growth in the emerging economies remained moderate

However, activity was only moderate in the emerging economies (+0.9%, as in Q1) compared with the pre-crisis rate (+1.8% on average from 2000 to 2008). Industrial output in particular saw its weakest quarterly growth rate since the start of 2009 (+0.5%).

In France, activity rebounded sharply in Q2

France rebound driven by manufacturing industry and energy production

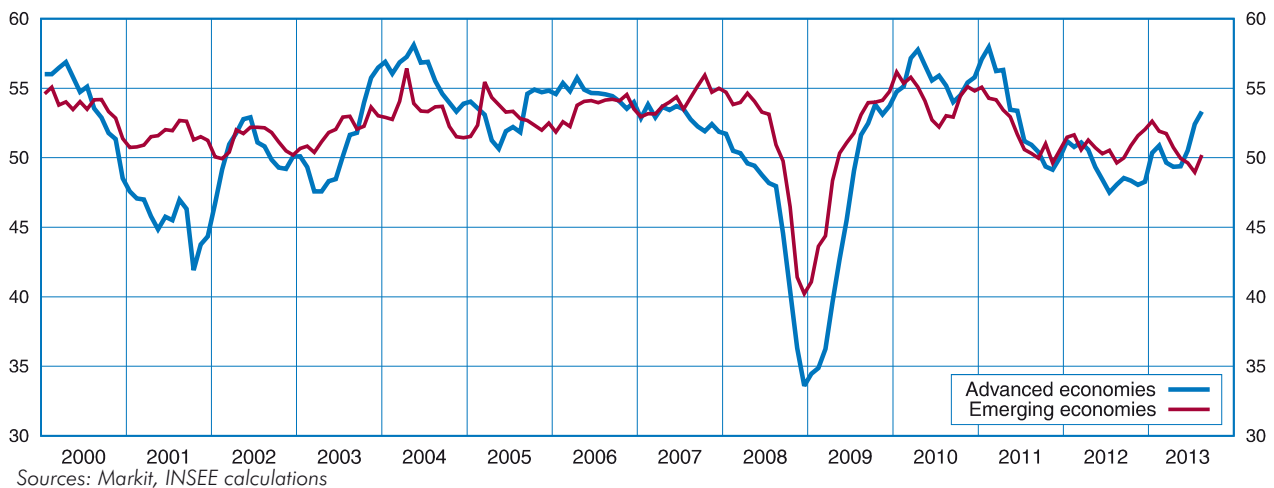
Activity rebounded strongly in France in Q2 2013 (+0.5% after -0.1%), picking up sharply in the manufacturing industry (+2.0% after +0.2%) thanks to the rebound in exports (+2.9% after -0.6%). Production of market services was also buoyant (+0.7% after 0.0%), mainly due to the ripple effect from the manufacturing sector. Furthermore, the unseasonably low temperatures in April and May maintained household heating expenditure at a high level, to the extent that energy production accelerated in Q2 (+2.0% after +0.7%). However, activity in construction continued to shrink (-0.7% after -0.8%), in terms of both housing maintenance and new builds.

World growth driven by the advanced economies through to the end of the year

The advanced economies building momentum

According to the business tendency surveys, the business climate has picked up sharply in the advanced economies since June. Activity is thus likely to remain buoyant over the forecasting period (+0.4% then +0.5%). Growth in the United States should remain strong, although the prospect of weaker monetary support from the Fed has already led to a rise in interest rates, slowing the recovery of the property market somewhat. The United Kingdom should see a marked upswing in activity: as in the United States, activity is likely to be boosted by the rise in asset prices and the recovery of lending. In the Eurozone, activity is set to grow further in H2 (+0.1% in Q3 then +0.3% in Q4), stimulated by low inflation, the moderation of fiscal consolidation and an upward trend in investment after a period of very marked adjustment. Activity in Japan is likely to slow slightly but should remain dynamic in the short term, thanks to highly expansionist fiscal and monetary policies.

1 - The business climate is showing an upward trend in the advanced economies



Conversely, several emerging economies set to slow sharply

Growth in the emerging economies should remain moderate overall, as witnessed by the sharp deterioration in the business tendency surveys (see Graph 1). But the dynamics are likely to be uneven. In China for example, activity should accelerate somewhat: the business climate is improving and the continued rise in the level of outstanding credit should boost the real estate sector in the short term, against a backdrop of vigorous increase in housing prices. Eastern Europe and, to a lesser extent, Turkey are likely to profit from improved demand from Europe. Conversely, in Brazil and all of emerging Asia, monetary tightening measures coupled with the sharp depreciation of currencies are likely to take their toll on agents with a high level of foreign currency debt, and activity is set to level off.

The economic upturn sustaining oil prices

In Q2 2013 tensions were low on the physical oil market, with a sharp decline in consumption in OECD countries, most notably. As a result, the price of North Sea crude (Brent) plummeted and then, in the wake of the Egyptian and Syrian crises, increased sharply, reaching \$ 115 at the start of September 2013. Through to the end of the year, the price of Brent is likely to hover around \$ 110: the upturn in the advanced economies should sustain prices but these upward pressures are likely to be counterbalanced by the still-high level of oil stocks in OECD countries and additional production capacities from OPEC.

Activity set to grow further in the Eurozone

Financial tensions still moderate

In Q3 2013, tensions are still moderate on the financial markets of the advanced economies. Sovereign and bank risks have, in the medium term, been partly reduced by the non-standard policy measures implemented by the main central banks in H2 2012 and Q1 2013. Furthermore, in order to ease the financing difficulties faced by households and businesses, the main central banks have kept their base rates at very low levels.

Cost of credit still high in certain Eurozone countries

The ECB's base interest rate is still very low, at 0.5% since May 2013. In July, for the first time in its history, the bank gave some clues to the future orientation of its monetary policy, indicating that its rates were likely to remain very low for an extended period of time. It also announced that its current policy of unlimited fixed-rate allotment would be maintained at least until July 2014. However, many banks are still dependent on the financing granted by the ECB, and the interest rates offered to companies remain high in certain Eurozone countries.

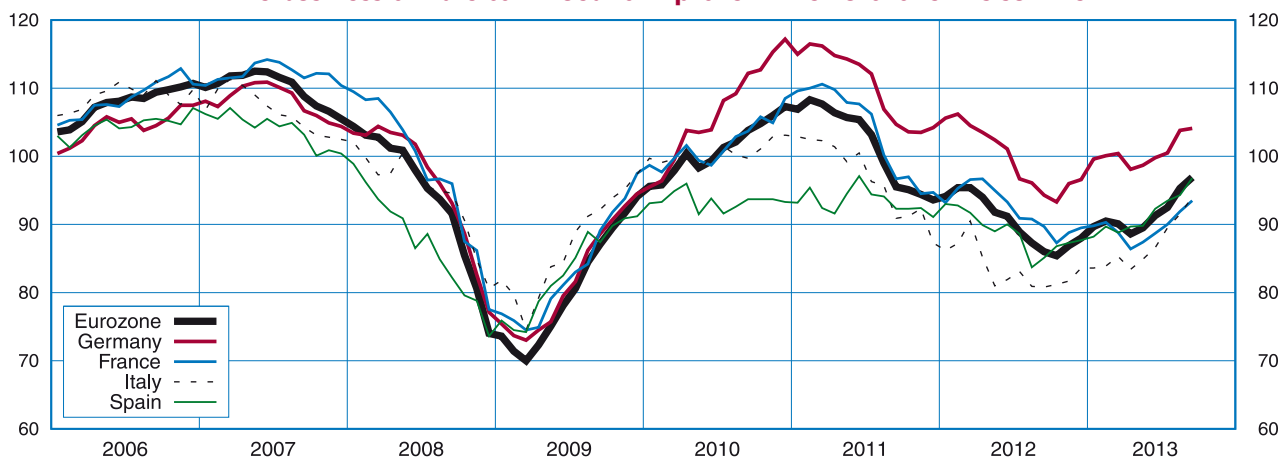
Business tendency surveys showing an upward trend once more

After slipping back briefly in spring, Eurozone business tendency surveys are showing an upward trend in all sectors (see Graph 2) except for construction. The improvement seen in Q2 is likely to continue, with activity in the Eurozone growing moderately in H2 (+0.1% then +0.3%).

Pick-up in investment

In the Eurozone, the decline in purchasing power should continue to ease under the effect of falling inflation, the slower decline in employment and a smaller increase in the tax burden. Consequently, household consumption should be

2 - The business climate continued to improve in the Eurozone this summer



How to read it: the business climate is calculated as a weighted average of the industry, services, construction, retail trade and household confidence composite indicators.

Source: DG ECFIN

stable in the Eurozone in H2 2013 (0.0% in Q3 then +0.1% in Q4). The gradual pick-up in activity and the need to renew production capacities after a marked adjustment phase should sustain the recovery of investment on equipment, although it will still be penalised by the high interest rates on loans to SMEs in Italy and Spain. In construction, the drop in investment should ease in H2, due to the increase in building permits.

Italy and Spain set to come out of recession by the end of the year

The contraction in activity eased in Q2 in Italy (-0.3% after -0.6%) and Spain (-0.1% after -0.4%). In both countries the smaller decline in household purchasing power and, above all, the recovery of investment on capital goods should allow a return to growth by the end of the year. Growth in Germany should be moderate in H2 (+0.3% then +0.5%), sustained by household consumption and exports but slowed by sluggish investment.

Moderate growth of French exports

Imports by the advanced economies sustaining foreign demand

With the upturn in the advanced economies, demand for French products should grow in line with world trade in H2 (+1.0% then +1.3% per quarter). However, exports are likely to be slowed somewhat by the effects of the euro appreciation since mid-2012, and progress should only be moderate (+0.6% then +0.9%).

In France, the upswing of Q2 to continue in H2

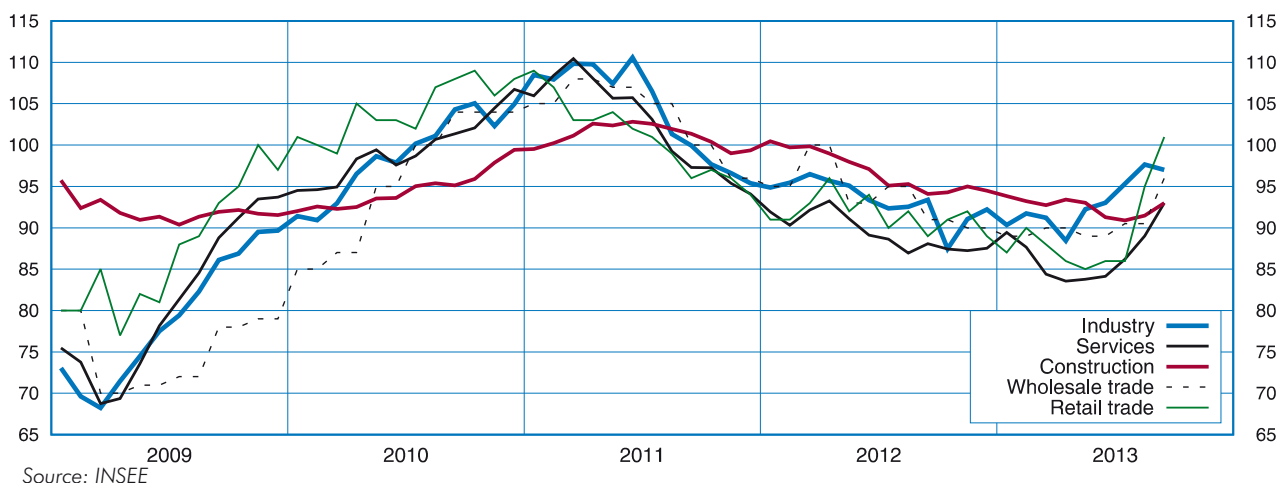
Since summer the business climate has improved significantly across all sectors

In line with the foreign environment, the business climate is improving in France in all sectors (see Graph 3), although it is still below average. This improvement got underway in April 2013 in industry (97 in September against 88 in April) and since the summer has extended to services (93 in September against 84 in June), construction (93 in September after 91 in July), wholesale trade (96 in September after 88 in July) and retail trade (101 in September against 86 in June). However, in industry, the assessment by industrialists of their past activity deteriorated in September, suggesting weaker activity in Q3 than in the previous quarter. This appraisal is consistent with the industrial production index which fell in July and shows a negative overhang for Q3 (-1.3% in manufacturing). Conversely, responses to questions on activity perspectives improved sharply in September, leading to expectations of a rebound in Q4 2013.

Activity likely to remain stable in Q3 and rebound in Q4

Manufacturing output should slip back slightly in Q3 (-0.4%), before rebounding in Q4 (+1.0%). Activity in market services should follow a similar profile, albeit less marked (+0.2% then +0.5%). Energy production in Q3 will no longer be sustained by exceptional climate factors and should thus decline in a backlash effect (-0.8% after +2.0%). Lastly, activity in construction should gradually pick up (-0.1% then +0.3%), in the wake of the recovery of housing starts in H1 2013. All in all, growth is likely to be sluggish in Q3 (0.0%) before rebounding in Q4 (+0.4%).

3 - The business climate is improving across all sectors in France



GDP set to grow by 0.2% in 2013, with a sharp acceleration over the year

Over 2013 as a whole, GDP should progress by 0.2%, after 0.0% in 2012. This small increase as an annual average masks a sharp acceleration during 2013. Year-on-year GDP growth should reach +0.8% at the end of 2013 (against -0.3% at end 2012), driven by the rebound in manufacturing production (+2.8% against -4.0%). In Q4 2013, GDP in volume should thus return to its pre-crisis level (Q1 2008).

Employment picking up and unemployment stabilising on average in Q4 2013

The decline in market-sector employment levelling off

Due to weak past activity, employment in the non-agricultural market sectors slipped back sharply once again in Q2 (-35,000). Under the effect of the return to growth, the fall in market-sector employment should gradually ease in H2 (-24,000 then -7,000).

Total employment up in H2 thanks to subsidised jobs

With the notable rise in "future jobs" work contracts (21,500 were signed in H1, for a target of 100,000 in 2013), the number of beneficiaries of subsidised jobs should increase sharply in the non-market sector in H2. All in all, after four quarters of decline, total employment should progress in Q3 and Q4, with 10,000 then 28,000 net job creations.

The unemployment rate set to stabilise at 11.0% in Q4

The rate of unemployment⁽¹⁾ stood at 10.9% of the active population on average in Q2 2013 (10.5% in Metropolitan France), a rise of 0.1 points against the previous quarter. As a quarterly average, unemployment is set to continue to rise in Q3, to 11.0%, before stabilising in Q4.

Inflation rising slightly through to December 2013, but still low

Energy inflation high

Though a high rate of unemployment and limited utilisation of production capacities restrict inflationary pressures, headline inflation should increase slightly through to the end of the year. It should stand at +1.1% in December, after +0.9% in August. Due to the rise in oil prices in late August and early September, year-on-year energy prices are likely to increase (+3.3% in December). Core inflation, which has fallen back sharply since July 2012, should grow slightly over the forecasting period (+0.7% in December, after +0.6% in August), due to a smaller contribution from telecommunications.

Purchasing power on the rise in 2013

Real wages showing clear progress

The average wage per head was dynamic in Q2 (+0.7% after +0.5%), mainly due to bonuses paid. In Q3, nominal wages should slip back in a backlash effect (+0.3%), before picking up slightly in Q4 (+0.5%). All in all, real wages should grow sharply in 2013 (+0.9% as an annual average), as the fall in inflation at the start of the year is only partially passed on to wages.

Purchasing power: a drop in H2 but an increase over the year

Household purchasing power is set to slip back slightly in H2 2013 (-0.1% then -0.2% in Q3 and Q4). This decline is largely ascribable to the rise in inflation and the high level of income tax and wealth tax. Indeed, the measures voted in for 2013 have led to a rise in the tax burden in the order of 1.1 points of household income over the year, and half of these measures - in particular those relating to income tax and wealth tax - are likely to affect household income in H2. Over 2013 as a whole, taxes should slow significantly and this, combined with the fall in inflation, should allow household purchasing power to grow once more (+0.5% after -0.9% in 2012).

Household consumption rising again

A drop in the savings ratio in H2

The drop in purchasing power in H2 should be more than offset by the fall in the savings ratio of households, which increased sharply in Q1. Household consumption should therefore progress in H2 (+0.1% then +0.3%). In Q3 it is likely to be affected by the decline in energy expenditure (-4.0%), while in Q4 it should be sustained somewhat by the unblocking of employee savings plans and early automobile purchases prior to the tightening of the ecological malus system.

(1) The unemployment rate here is adjusted for the estimated effect of the new Labor Force Survey questionnaire (see issue n° 203 of *Informations Rapides*). This effect is estimated at -0.3 points for Q2.

The slide in investment coming to a halt after two years of decline

Stabilisation in construction

After two years of decline, investment should stop falling by the end of the year. More specifically, production should stabilise in construction, in the wake of the rebound in housing starts observed in H1 2013. Additionally, corporate investment, which stabilised in Q2 (0.0%) after five consecutive quarters of decline, should very gradually recover in H2 (0.0% then +0.3%) thanks to improved activity perspectives against a backdrop of still-low interest rates and a pick-up of the margin rate.

Uncertainties

Speed of recovery in the Eurozone

The speed of recovery in the Eurozone is uncertain: once underway this recovery could, as is often the case, be surprisingly swift, but conversely it could also stall should the risks surrounding sovereign debt and banks re-emerge.

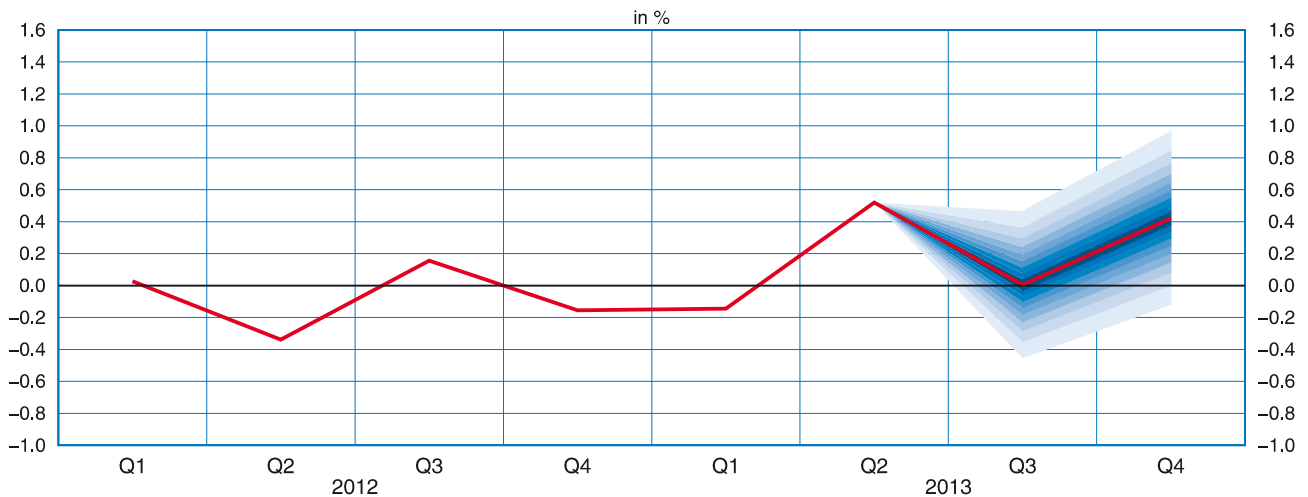
American monetary and fiscal policy

Through to the end of the year there will also be uncertainty surrounding American economic policy, with questions marks about the rate at which the Fed will reduce its bond purchasing programme and the outcome of US Congress negotiations on the budget and the debt ceiling, which remains difficult to predict.

Growth in the emerging economies

Lastly, the growth forecasts for the emerging economies are less robust than usual, as they are subject to the conflicting influences of the increase in financing costs and the ripple effect of the advanced economies. ■

4 - Fan chart for Conjoncture in France



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

Source: INSEE