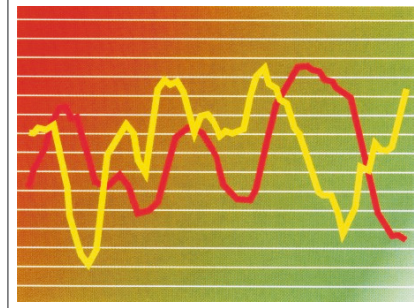


CONJONCTURE IN FRANCE



Clouds gathering in the west

In the advanced economies, domestic demand picked up in Q2 2010. This dynamic sustained growth in the United States and in Germany. It also led to a certain rebalancing of world trade: for the first time since mid-2009, the imports of the advanced economies grew faster than those of the emerging economies.

However, the global recovery is fragile and is currently showing signs of flagging. In both advanced and emerging economies, business leaders questioned in the business tendency surveys, are signalling a slowdown in their orders, most notably exports, and in their business prospects.

In the United States, the economic slowdown is marked. In the service sector, the business climate has deteriorated sharply and is now on the verge of stagnation. Over the coming months, household demand is likely to suffer from the expiry of the purchasing power stimulus measures. And the crisis has left lasting scars on the American economy, with persistent difficulties in the real-estate sector and a highly degraded situation on the labour market.

By the end of the year, the euro zone will likely be affected by the American slowdown, via export outlets. But without being spectacular, the domestic-demand dynamic should offset this effect somewhat. Indeed, household purchasing power should benefit from the effects of job creation and from moderate growth in real wages. Businesses should slowly but surely restore their production capacities.

This scenario is true of France, where activity is set to hold at a moderate pace: +0.4% per quarter until the end of the year. Domestic demand should sustain growth.

Purchasing power gains look likely to be consolidated in H2: job creations should continue to rise (+50,000 jobs in the market sectors), and wages are set to increase at a slightly faster rate than inflation. Consumption should progress by 0.4% in Q3, then 0.5% in Q4, i.e. at a slightly slower pace than prior to the crisis. Elsewhere, construction activity should stabilise by the end of the year. This sector had weighed heavily - and continuously - on growth since Q2 2008.

The weakness of the American economy is the biggest uncertainty in our predictions. In particular, if the trend of households getting out of debt were to continue at the same rhythm as it has since the start of the crisis, a new dip in activity in the United States is to be feared. Past observations show that the chances of a genuine "decoupling" between the USA and Europe are slight.

Conversely, domestic demand in the euro zone could be more vigorous than forecast, temporarily protecting the zone from the effects of the slowdown. Similarly, as inventory levels in Europe are judged to be lower than average, the coming months could see a movement towards restocking, which would be more favourable to growth. ■

In Q2 2010, domestic demand picked up in the advanced economies

In Q2, domestic demand was sustained in the United States and Germany

In Q2 2010, growth in all the advanced economies stood at 0.6%, as anticipated in INSEE's last issue of *Conjoncture in France*. In comparison to June's forecasts however, domestic demand has been surprisingly dynamic, notably consumption in Germany and in the United States. Investment expenditure by businesses has surged; in Germany, this rebound in investment has been bolstered by a catch-up effect in the construction industry, after a harsher than average winter. In France too, domestic demand made a significant contribution to activity in Q2 (0.4 point for GDP growth of 0.7%).

World trade flows are rebalancing...

Since mid-2009, world trade has mainly been sustained by demand from the emerging economies: their imports grew faster than those of the advanced economies (see *Graph 1*). In Q2 2010 on the other hand, imports from the advanced economies have picked up while they have slowed sharply in the emerging zones (see *Graph 1*). This suggests that the balance of world trade has been restored somewhat.

...while Germany has boosted euro zone growth

With a rebound of 8.2% in exports, Germany has been the main beneficiary of the brisk trade between the advanced economies; in this country, foreign trade has provided strong support for activity, with GDP registering record growth (2.2% in Q2). Conversely, in the United States the rise in demand has mainly been served by imports, and activity has slowed sharply. To varying degrees, the countries in the euro zone profited from the dynamism of German growth: for example, according to customs data, exports from France to Germany leapt by 8% in value in Q2, and those from Italy by 12%.

Activity in the advanced economies set to slow in H2

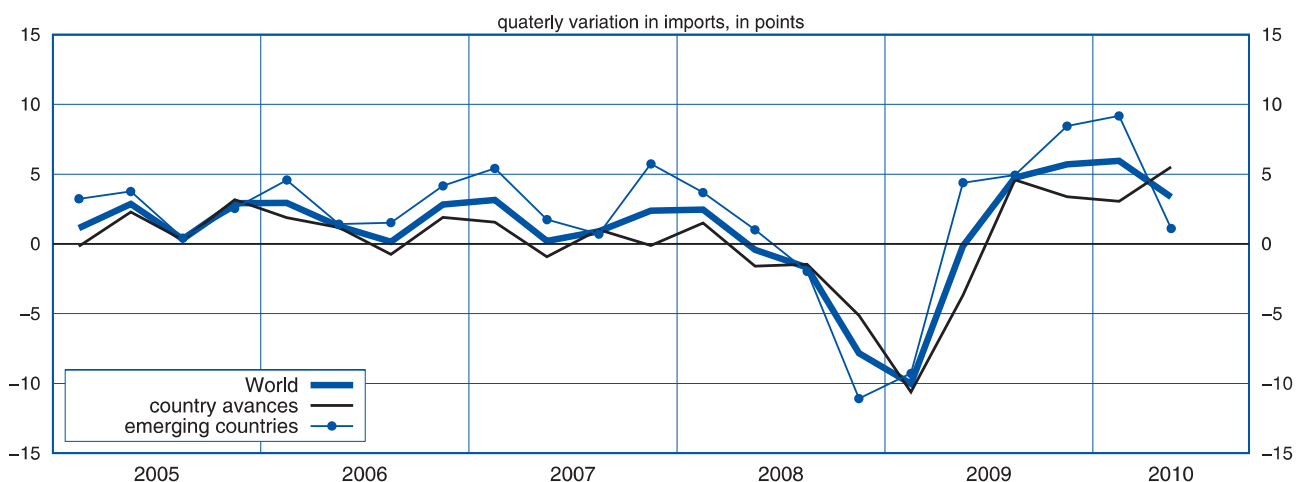
The advanced economies following in the wake of the USA

In H2, the vigour recorded in Q2 seems likely to slacken: growth in the advanced economies should slip from +0.6% in Q2 2010 to +0.4% in Q3, then +0.2% in Q4. In the business tendency surveys, purchasing managers have stated that their order books are filling up less rapidly - in particular on the export market - and their production prospects are deteriorating.

Deterioration of the business climate in the United States

In the United States most notably, the deterioration of the business climate has been making itself felt since May in the manufacturing industry, in line with the levelling-off of growth in Q2. The most recent surveys conducted among business

1 - In Q2, a rebalancing of world trade



Source: Centraal Planbureau

leaders report a sharp drop in the business climate in services, bordering on stagnation (see Graph 2). These indicators thus point to a new slowdown in the American economy by the end of the year.

Factors in the American slowdown: budgetary policy...

The scheduled end of the stimulus measures is likely to be the main factor in the American slowdown: it is set to cause an extensive shock to household purchasing power in H2 2010. However, as households have saved part of the extra revenue gained from the stimulus measures, they should be able to dip into these savings in order to soften the effects of the drop in their income. In our scenario, American households are therefore likely to cut back their spending moderately in the face of the drop in purchasing power, and their savings ratio should fall sharply.

... the property market and the labour market

The crisis has also had lasting effects on the American economy, making its recovery more fragile. For example, the property sector is still in difficulty and housing expenditure by households is set to fall in H2, following the expiry in April of the tax credit for house buyers. Despite the job creations underway since the start of 2010, the situation on the American labour market remains poor, with the unemployment rate still very high and a large number of long-term unemployed: the ability of households to sustain their consumption levels faced with a major budget shock is thus probably limited.

A slowdown in Asia too

Lastly, the impetus provided by the countries of emerging Asia looks likely to drop off. Their economic outlook indicators, which reached a turning-point in spring, are far less positive than they were at the start of the year, and activity in these countries should now grow more in line with its medium-term trend.

By the end of the year, the euro zone should still be sustained by its domestic demand

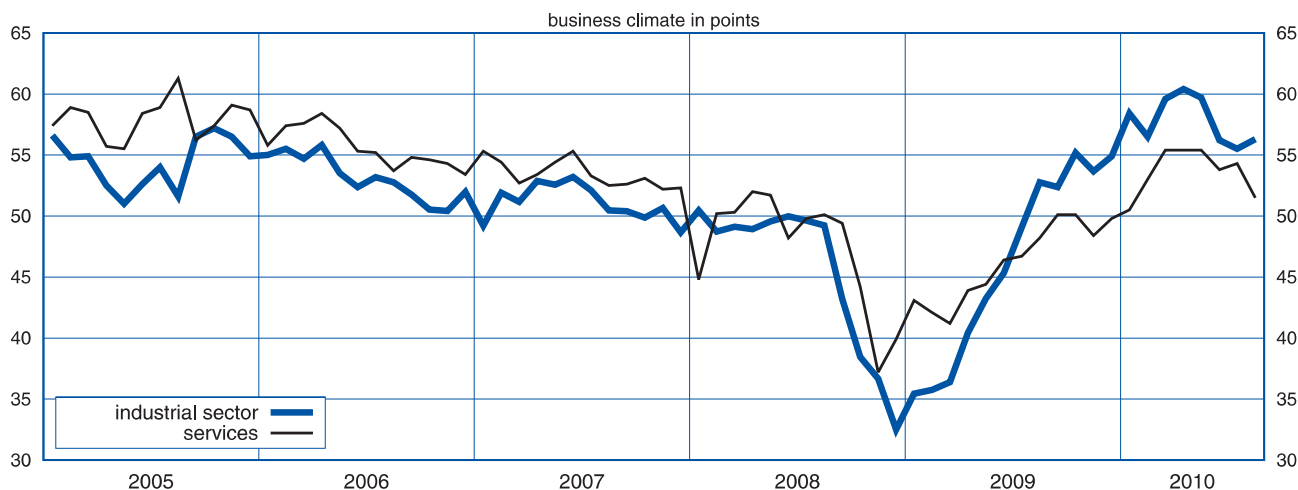
Without being spectacular, domestic demand is offsetting the effects of the slowdown in exports

In H2, the euro zone will probably suffer from the effects of the American slowdown, via export outlets. But without being spectacular, the dynamics of domestic demand should slightly offset this slowdown. Household purchasing power should benefit from job creations and from a slight rise in real wages. Businesses look set to continue to rebuild their production capacities at a moderate pace.

Germany comes back down to earth, Spain at a standstill

The slowdown in exports should be particularly marked in Germany. The latest industrial output indicators, customs data and business tendency surveys all point to a closing of the gap between Germany and its main partners in Q3. The Spanish economy, already less dynamic than that of the other main euro zone

2 – The business climate is deteriorating in the United States



Source: Institute for Supply Management

countries over the last year, looks set to grind to a halt in H2. It is still handicapped by a persistent surplus on its property market. Additionally, household consumption should drop sharply, following the increase in the main VAT rate in July.

Moderate growth in France for the rest of the year

Slowdown in exports, support from domestic demand

As a consequence of the decline in world growth, world demand for French products should grow more moderately in H2: +2% then +1.5% in Q3 and in Q4s, after +3.6% in Q2. As a result, exports will probably be less dynamic over the second half of the year, although they should still benefit from the recent depreciation of the euro. This slowdown in exports should be partially offset by strong domestic demand via household consumption and, for the first time since Q2 2008, a stabilisation of investment in construction (see Graph 3).

A moderate rise in activity in France

All in all, the French economy looks set to grow at a rate of around 0.4% per quarter for the rest of the year. The growth forecast has not changed since our June issue of *Conjoncture in France*. For all intents and purposes, the business climate indicators in services and the manufacturing industry have barely changed over the last few months and are at a level close to the long-term average. However, the business climate in construction, although still below normal, has recovered somewhat since the start of the year. Over 2010 as a whole, French growth should stand at 1.6%.

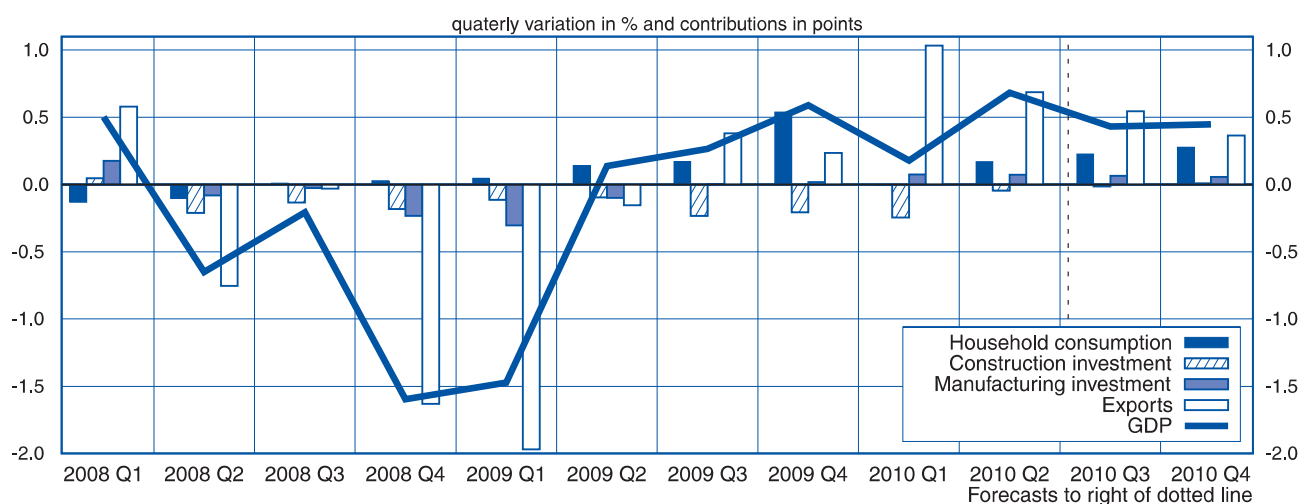
Corporate investment on the rise in H2

Stabilisation of the investment rate of enterprises

Corporate investment in non-energy industrial goods, which dropped by more than 11% in 2009, has gradually picked up since the start of the year. This recovery should continue moderately over the second half of the year. Among other factors, it should be sustained by the increase in outlets. Furthermore, the production capacity utilisation rate has picked up slightly, although it is still at a lower level than its long-term average. Last, financing conditions in France are tending to relax with the fall in interest rates, although credit award terms remain stricter than they were pre-crisis.⁽¹⁾ The corporate investment rate should stabilise after a sharp decline between mid-2008 and Q1 2009.

(1) According to the Banque de France survey on credit distribution.

3 – Slowdown in exports, support from domestic demand



Source: INSEE

Household income showing stronger growth in H2

A pick-up in household income

For households, income looks set to grow faster than it did in the first half of the year (see Graph 4). The effect of taxes on income should virtually disappear in H2. The suppression in 2009 of the last two thirds of income tax for modest households buoyed up household purchasing power in H2 2009, but then produced the counter-effect of weighing heavily on it at the start of this year.

A slight rise in market-sector employment in H2

Household income should still benefit from the rise in earned income. For example, employment should continue to progress at a moderate pace. Job creations should come to 50,000 in the non-agricultural market sector in H2 2010, after +60,000 in H1. The unemployment rate, which settled at 9.7% of the active population in Q2 (respectively 9.3% in metropolitan France), should be virtually stable, reaching 9.6% at the end of the year (respectively 9.2%).

Wages still fairly dynamic in H2

In H2 2010, the average wage per head should grow at a slightly faster rate than inflation. It nonetheless looks set to be slower than in H1: indeed, at the start of the year it benefited from a rise in bonuses with the return of growth. Other factors (increased recourse to overtime, reintegration of people in short-time work) also had an impact, although slight, and should hardly come into play at all in H2.

In line with rising purchasing power, household consumption should continue to sustain growth

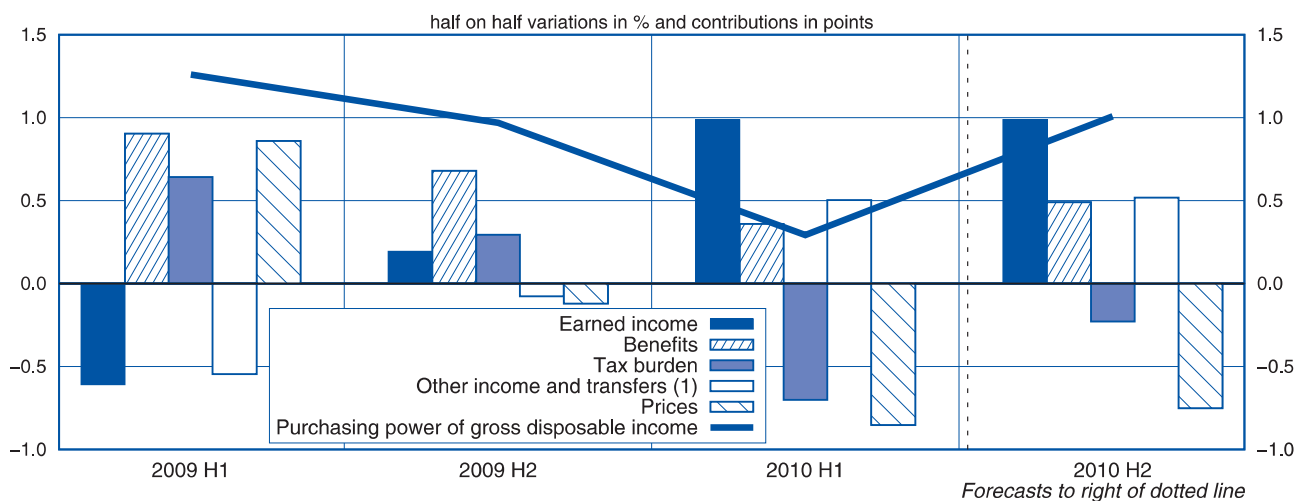
Relative stability of inflation, a rise in household purchasing power

Inflation should still be moderate until December: year-on-year price rises are likely to be minor for the rest of the year and should settle at 1.4% in December 2010. On the one hand, core inflation should rise slightly with the knock-on effect, via production costs, of previous rises in the prices of commodities and the depreciation of the euro. On the other hand, this slight rise should be counterbalanced by the slowdown in the prices of seasonal products. All in all, household purchasing power should grow at a rate of around 0.5% per quarter over H2 2010.

Progress for household consumption

With the rise in purchasing power, household consumption should continue to progress: +0.4% in Q3, +0.5% in Q4. It should nonetheless grow more slowly than the pre-crisis rate. In Q4, household consumption may benefit from a one-off increase in automobile consumption before the scrappage allowance comes to an end. The savings ratio of households should stabilise to the time horizon of the forecast.

4 – Pick-up of purchasing power in H2 2010



(1) EBITDA of pure households, property income and current transfers
Source: INSEE

Stabilisation of the construction sector

Housing investment by households starting to pick up

Households' investment in housing looks set to recover in H2 2010, in the wake of the new housing starts. As an annual average, household investment should however decline once again, by just over 2% in 2010, after a drop of almost 9% in 2009. In parallel, corporate investment in construction should continue to drop in H2, although less sharply. All in all, activity in the construction industry should stabilise by the end of the year. This point is worthy of note, as this industry has weighed heavily and continuously on activity since Q2 2008 (see Graph 3).

Uncertainties: risks of a relapse in the United States, a more sustained recovery of final demand and of inventory in the euro zone

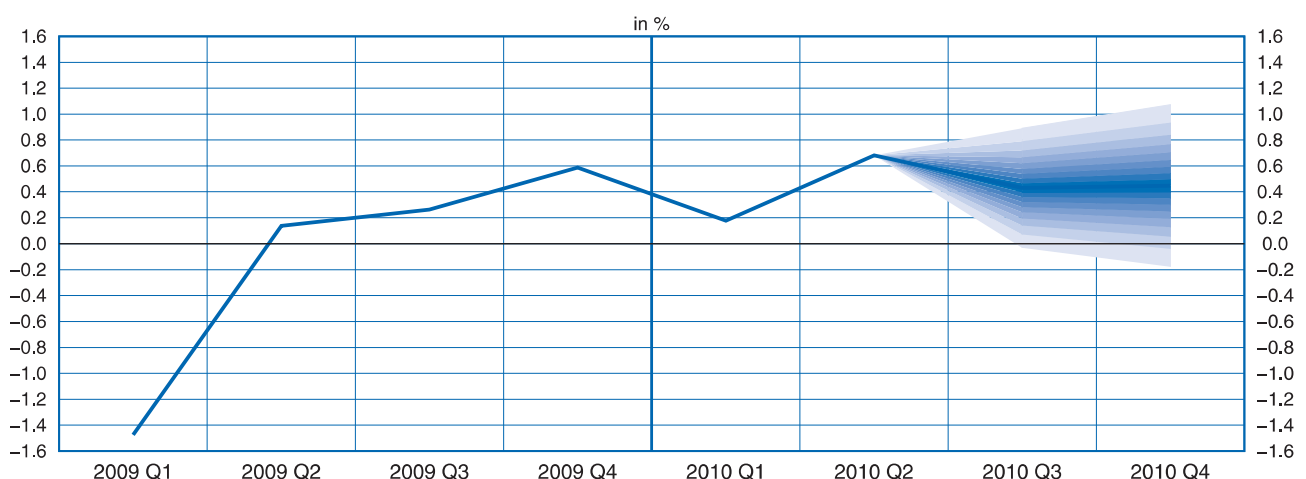
Weakness of the American economy

The weakness of the American economy is the biggest uncertainty in our scenario. In particular, if the trend of households getting out of debt were to continue at the same rhythm as it has since the start of the crisis, at the end of the year household consumption could fall much more sharply than expected in our scenario, in which case a new dip in business in the United States is to be feared. Past observations show that the chances of a genuine "decoupling" between the USA and Europe are slight.

Euro zone: dynamism of final demand and inventory

Conversely, in the euro zone the pick-up in domestic demand has been consolidated over the last few months. If this pace were to be sustained over the coming months, it could offset the American slowdown to a greater degree than in our scenario. Similarly, business leaders in the euro zone currently consider their inventory level to be lower than average. This may mean that they will run off stocks less extensively in the coming months, or even restock, which would improve growth. ■

5 - Fan chart for Conjoncture in France



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