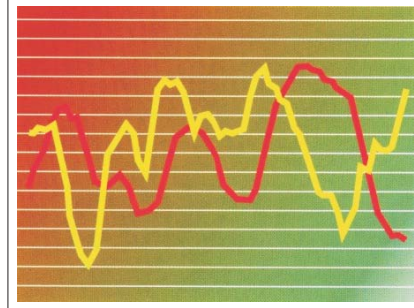


# CONJONCTURE IN FRANCE



## Convalescence

In Q2 2009, activity contracted much less sharply in the advanced economies than we had anticipated in June. These countries benefited from the strong upturn in demand from emerging countries, notably China. Additionally, the strength of private consumption surprised in Germany and Japan, buoyed by the stimulus plans and in particular measures to support the automobile sector.

In H2, world trade should be more dynamic. It should continue to be driven by the emerging countries, and also boosted up by an upturn in activity in the advanced economies. In the business surveys, for example, the outlook has returned to more usual levels, after the exceptional slump observed at the height of the crisis. Business surveys currently suggest an upturn in activity in all the advanced countries: after plunging at the same time, all these countries would appear set to rise again almost simultaneously. In France, for example, growth in GDP should be 0.5% in Q3 and 0.3% in Q4.

In France, as in the other advanced economies, corporate financing difficulties are gradually lessening, although they have not entirely disappeared: market financing terms have eased distinctly, but in the banking sector, lending conditions have merely stopped getting tighter.

The stimulus plans implemented in the course of 2009 are boosting all the advanced economies. The impact of these stimulus plans should drop off towards the end of the year, however, and their calendar is likely to have an effect on the expected growth profile in H2. This is because the direct support for household incomes was provided mainly at the start of 2009; vehicle scrappage

schemes came to an end in the summer in the US and Germany, and although the public investment projects are being progressively implemented, they traditionally take time to reach full speed.

In H2, household purchasing power should be down in most of the advanced economies, as employment continues to adjust to the marked decline in activity recorded this winter, and the boost to income provided by the stimulus plans fades out. Purchasing power would also be affected by the rise in inflation. Consequently, private consumption looks set to be sluggish over H2, even showing a downturn at the end of the year in Germany and the US with the end of the vehicle scrappage schemes. In France, purchasing power and consumption should continue to grow, although modestly.

After a sharp fall in H1, corporate investment should level out in H2, with improved sales prospects and the gradual easing of financing conditions. But the current underuse of production capacities does not suggest a rapid and strong recovery in investment.

All in all, H2 should bring confirmation that the French economy is emerging from recession at a moderate pace.

As is often the case in recovery phases, the scale and speed of the upturn could be under-estimated, especially as it is happening at the same time in all zones. For example, restocking could be stronger than expected. On the other hand, there are also risks that the sectoral measures behind the recovery in industry could run out of steam.

## Activity stable in Q2

*The advanced economies stabilised more quickly than expected*

In Q2 2009, activity was almost stable in the advanced economies (-0.1%), after the sharp decline in previous quarters. In France and Germany, it even recorded a rise of 0.3%.

*World trade begins its recovery*

The advanced economies benefited from the upturn in demand from emerging countries (see Graph 1), especially in South-East Asia. Chinese growth in particular was boosted by implementation of the stimulus plan and by easing of loan award terms. World trade, which had collapsed at the turn of the year 2009, almost returned to stability in Q2, driven by imports in emerging countries (+1.8%), and more particularly in Asia (+5.0%). It was also sustained by growing trade in automobile industry products, in the wake of the scrappage schemes introduced in many countries. This improvement in trade has been of benefit notably to those economies that are highly dependent on foreign trade, such as Germany and, even more so, Japan, where trade with the rest of Asia is particularly strong.

*Stimulus plans in support of growth*

Additionally, in the advanced countries the implementation of stimulus plans has boosted household demand. There has been a further marked decline in corporate investment, however, hit by very considerable overcapacity and by financing conditions that continue to be tight, and the labour market has continued to worsen in the wake of the sharp decline in activity at the turn of 2009.

## Easing of financial markets continues

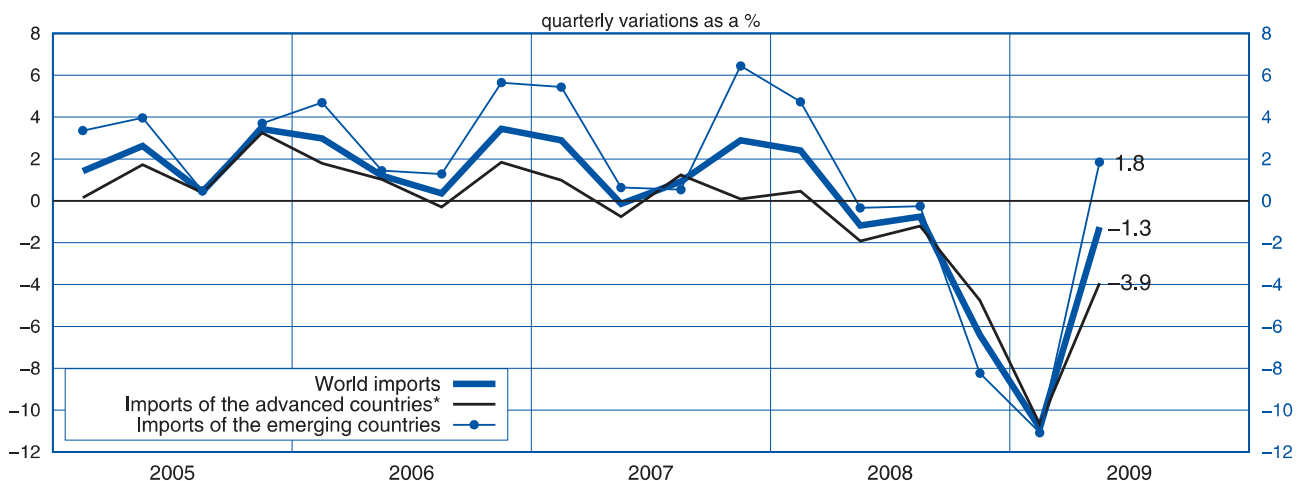
*Financial markets gradually returning to normal*

Interbank money markets have returned to normal under the effect of a marked easing of central bank monetary policies, via lower interest rates and then direct purchases of debt securities, and under the effect of large-scale State intervention to support financial institutions. This trend towards easing is now being felt on private bond markets (see Graph 2). However, corporate financing conditions, both via banks and on financial markets, remain more difficult than they were before the crisis. Likewise, household lending criteria remain strict, even though the banks have announced that they will not be tightening them any further.

*Relief on the property front*

While the property crisis continues to depress transaction volumes, there are also signs of a relief. In Spain, for example, the drop in property prices is becoming more moderate. In France, new housing sales increased in H1, notably thanks to the fall in interest rates, and stock levels fell back. In Ireland, housing starts would appear to have levelled out since the start of the year, although at very depressed

### 1 - World trade, imports in the emerging and advanced economies



\* OECD excluding Turkey, Korea, Mexico and the Central European countries.

Source: Centraal Planbureau

levels. Trends on the American and British property markets are looking distinctly brighter after a brutal correction: sales recorded an upturn on the American market and property prices seem to be levelling out in the US, while they are already on the rise in the UK. However, a further slide cannot be entirely ruled out at this stage, due to lending conditions that continue to be tight and deteriorating labour markets.

## The end of the recession likely to be confirmed in H2

*The recovery of the world economy and world trade set to be confirmed*

After levelling out in Q2, the latest business tendency surveys suggest that activity in the advanced economies should rise moderately in the last part of the year. Combined with the upturn in the emerging economies, this trend should consolidate the recovery in world trade. However, growth should weaken somewhat in Q4. In the emerging countries, China has introduced measures aimed at restraining investment and lending, while in the advanced economies, some measures to boost household demand, such as the German and US vehicle scrappage schemes, are coming to an end and the effects of the household purchasing power stimulus measures are likely to fade out gradually.

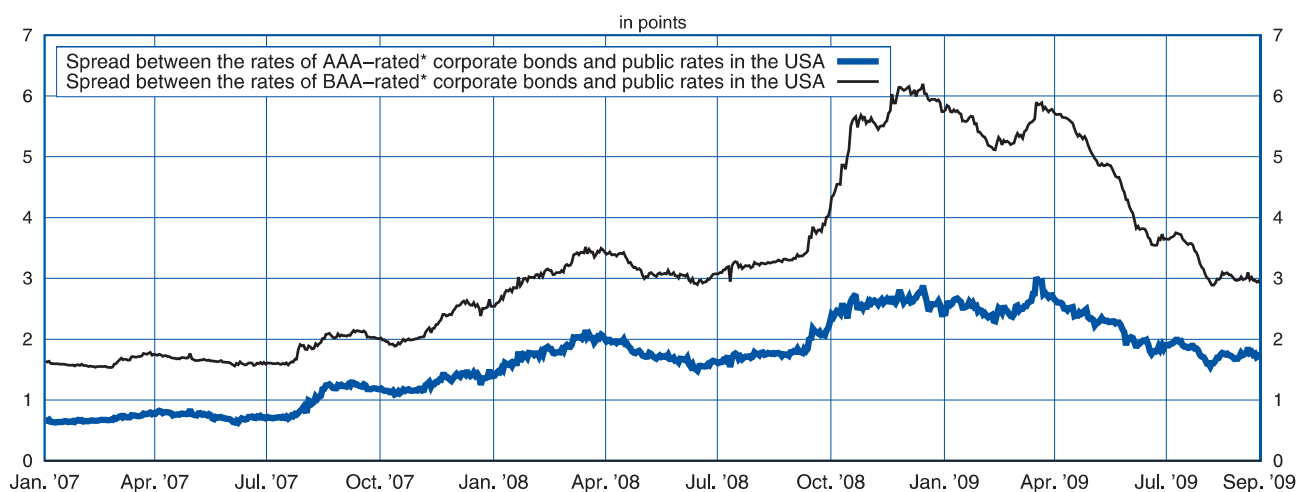
*French exports likely to continue rising*

Like world trade, foreign demand for French products is likely to recover in H2. Consequently, French exports should continue to rise. They should slow down in Q4, however, notably due to the end of the German vehicle scrappage scheme. French exports should therefore progress by 1.9% then 0.7% over the last two quarters of 2009. However, they should still be down 11.0% over 2009 as a whole.

*Moderate rise in activity in France*

After the recovery recorded in Q2, the French economy should continue to grow at a moderate pace over H2, as is suggested by the return into positive territory of the France turning point indicator built by INSEE from the main business tendency surveys conducted among business leaders. In particular, industrial production should continue to progress and public works activity should be buoyed up by implementation of the stimulus plan. However, growth should be slightly more moderate in Q4 than in Q3, in line with exports. Thus, after +0.3% in Q2 2009, GDP should progress by 0.5% then 0.3% over the next two quarters. All in all, activity should contract by 2.2% in 2009 after growing by 0.3% in 2008.

## 2 - Narrowing spread between private and public rates in the US



\* AAA-rated bonds have the lowest default risk. Those rated BAA are bonds of intermediate quality (ratings by Moody's).

Source: DataInsight

## Investment down sharply in 2009

### *Production capacities remain distinctly underused*

In 2009, corporate investment is likely to fall very sharply (-7.1%), as suggested by the results of the industrial investment survey announcing a sharp decline in projects. However, this drop in investments should be much less pronounced in H2 than at the turn of 2009. Although production capacities are still distinctly underused (see *Graph 3*), financing conditions should gradually ease and prospects for demand are improving.

## Inflation still moderate

### *A decrease in "core" inflation*

In the advanced economies, "core" inflation is on a downward trend but remains positive everywhere. The slide in inflation is due primarily to the rise in unemployment and the wage moderation. It is also due to weak demand forcing businesses throughout the production and distribution chain to keep their prices down to hold onto clients. Consequently, the slowdown in prices should continue. "Core" inflation should therefore remain very weak in the United States from now through to the end of the year. In the Euro Zone, it should continue to fall, from 1.3% in July to 1.1% in December. France is likely to follow the same trend.

### *Japan caught in deflation*

Japan never quite managed to get out of deflation which is now clearly back: "core" inflation and headline inflation are both clearly negative and wages are falling noticeably.

### *Headline inflation profile still driven by energy prices*

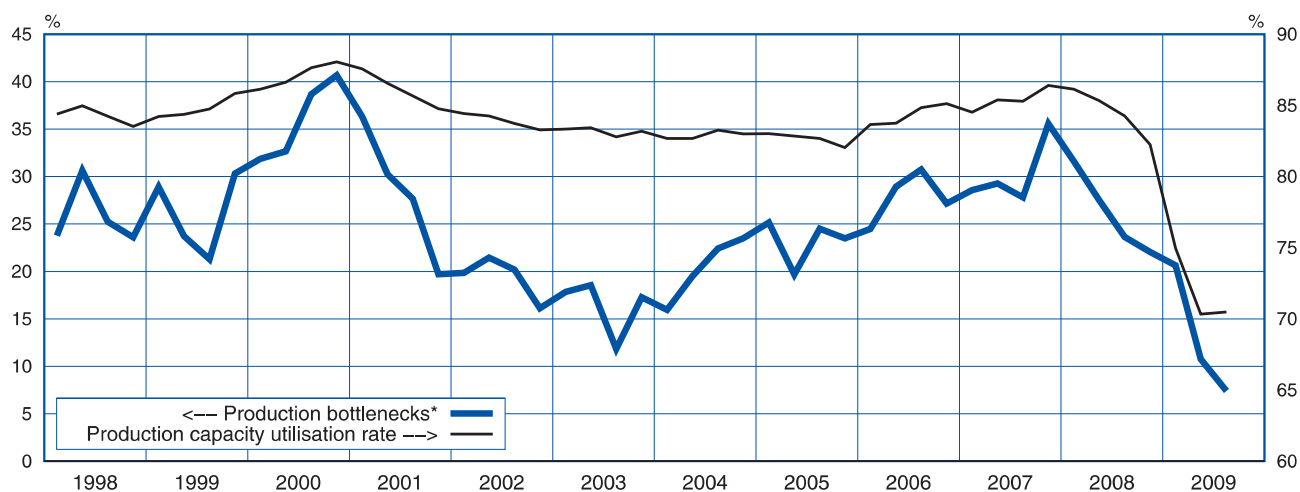
With a market close to equilibrium, oil prices have settled around the \$70-a-barrel mark after the upturn seen in H1, notably due to strong demand from China. They should therefore be much higher than the level reached at the end of 2008. Consequently, energy inflation should show a marked increase between now and the end of 2009, dragging the year-on-year change in consumer prices. French inflation should therefore rise to 1.0% at the end of the year, against -0.2% in August, while Euro Zone inflation should reach 1.1% against -0.2% in August.

## The labour market continues its adjustment

### *Employment down sharply again*

Further to the sharp contraction in activity recorded at the start of 2009, the labour market should again show considerable falls in employment in H2 2009, with the usual time lag. The decline should gradually become less severe with the return of growth. Employment should fall by a total of around 420,000 jobs in 2009, of which 140,000 in H2. The non-agricultural market sectors should lose

### 3 - Tensions on production capacity



\* Proportion of companies which, if they received more orders, could not produce more with their current means.  
Source: INSEE, quarterly survey on activity in industry

almost 500,000 jobs in 2009. Employment should fall distinctly in industry as well as in construction and the market service sector. The decline in employment should be slightly attenuated by the non-market sectors, notably thanks to the progression in subsidised employment.

#### *Unemployment continues to rise*

The unemployment rate saw a marked upturn from Q2 2008 onwards with the deterioration in the economic situation. It rose to 9.1% on average in Q2 in Metropolitan France, from a low point of 7.1% in early 2008 (see graph 4). Due to continuing heavy job losses, the unemployment rate is likely to climb distinctly in H2 2009. However, the rise should be smaller than that recorded in H1. At the end of 2009 the unemployment rate should therefore stand at 9.7% in Metropolitan France (10.1% including the overseas departments).

### Consumption should progress again moderately

#### *Purchasing power set to mark time*

Purchasing power for households as a whole is expected to stand still in H2 2009. Earned income should stagnate as job losses continue and the rise in unemployment weighs down on wages. Also, purchasing power should be boosted less by the stimulus plan than in H1. Finally, it is likely to be hit by the upturn in inflation. Over the year, however, it should grow more in 2009 (+2.1%) than in 2008 (+0.6 %), essentially due to inflation falling back.

#### *Consumption set to continue its moderate rise*

In line with the small gains in purchasing power in H2, household consumption is likely to grow at a very moderate pace (+0.2% per quarter). All in all in 2009, the rise in unemployment should incite households to be careful: their savings rate should increase to 16.5%, against 15.3 % in 2008.

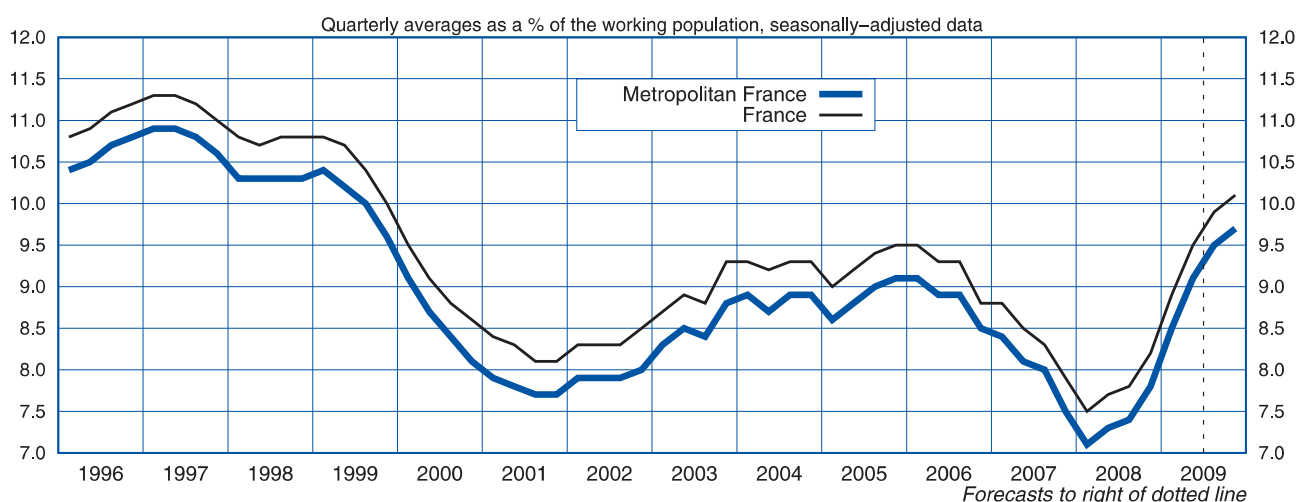
#### *Household investment still declining*

In the construction sector, the continued low levels of the business tendency surveys suggest that a rapid upturn in this sector is unlikely. New housing sales rose in Q2, driving stocks downwards, but due to construction lead times, these sales should only generate activity in the sector gradually. Household investments in housing are therefore likely to continue their decline in H2, but at an increasingly moderate pace.

#### *Imports likely to rise slightly*

In Q1 2009, imports of goods and services dropped considerably in line with the decline in domestic demand and in exports. Imports of non-energy industrial goods fell back particularly sharply, notably those of intermediate goods and automobiles. In H2 2009, they should progress a little, driven by the upturn in foreign trade, in particular in automobiles, and the still somewhat limited recovery in domestic demand.

### 4 - Unemployment rates



France = Metropolitan France + Overseas departments  
Covers the population of people living in households, aged 15 years or over  
Source: INSEE, Labour force survey

## Key unknowns: reductions in household debt and restocking

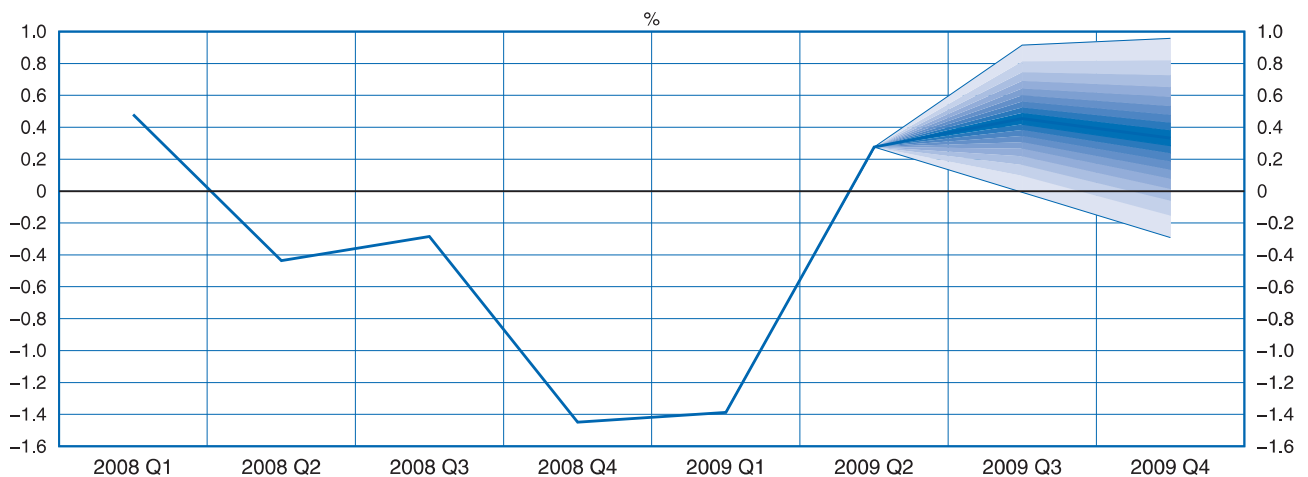
*The high level of household indebtedness could force them to reduce their debts more quickly*

Faced with rising unemployment and the uncertainties surrounding their future income, households could prove to be more cautious than expected in our scenario. This could be the case more particularly of households in Anglo-Saxon countries: they could seek to scale down their still very high debt levels more quickly. Such behaviour on the part of households would hold growth back distinctly.

*The recovery in activity could be more marked*

But the return of growth could be more marked than expected if a virtuous circle were to be established, with the first signs of recovery bringing renewed confidence, leading in turn agents to spend more. In particular, after the strong tendency to run down stocks over the last three quarters and with improved prospects for demand, businesses could decide to build up their stocks again more quickly than expected. ■

5 - Fan chart for Conjoncture in France



Source: INSEE