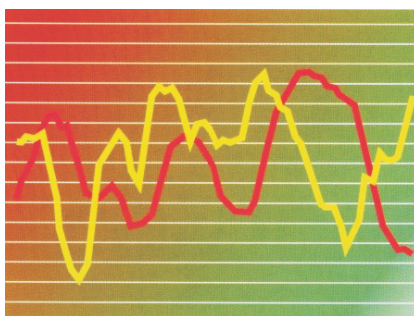


CONJONCTURE IN FRANCE



OCTOBER 2017

The Eurozone makes up lost ground

Global activity confirmed its good overall state of health in Q2 2017, accelerating in the advanced economies, particularly the USA and Japan, while the recovery underway in most of the emerging economies continued despite a slowdown in imports, most notably in China. Against this promising backdrop, Eurozone growth remained high (+0.6%, as in Q1). The French economy grew by 0.5% for the third consecutive quarter.

This summer's business cycle indicators point to continued expansion in H2, with oil prices stabilising at a low level. Although the Chinese economy is expected to slow somewhat due to the country's recent credit tightening measures, the recovery in Brazil, Russia and India is set to gather strength, thanks to declining inflation. In the advanced economies activity should also remain robust, driven by government expenditure in the USA and by improved consumption in Japan. The exception is likely to be the United Kingdom, which is hampered by sluggish consumption.

The Eurozone should continue to play catch-up, with expected growth of 0.5% to 0.6% per quarter through to the end of 2017. Private consumption in the zone is set to remain buoyant: while price rises are likely to erode the improved purchasing power induced by employment growth, households are expected to soften the impact of this rise by lowering their savings ratio. The European Central Bank is pursuing its accommodating monetary policy and investment should pick up across the zone as a whole, particularly construction

investment. Growth is expected to reach 2.2% in 2017 (after 1.7% in 2016) and the gaps between the main economies should narrow somewhat.

This summer the French business climate attained its highest level since 2011, and indeed its highest since 2007 in industry. French exports are set to pick up in 2017, thanks among other things to the return of tourists, although without fully capitalising on the renewed vigour of world demand. Domestic demand should remain buoyant, especially for capital goods. Activity should therefore continue to show solid growth through to the end of the year (+0.5% per quarter) with growth reaching +1.8% on average in 2017, after hovering around 1% for three years.

Labour force prospects remain positive in the business tendency surveys. Market-sector employment should slow only very slightly in H2, while non-market employment is expected to slip back with the reduction in the number of subsidised contracts. The unemployment rate should continue to fall, down to 9.4% of the labour force at year end.

There are a number of uncertainties surrounding this forecast, in which French exports are expected to partially make up lost ground by the end of the year. These exports may turn out to be either surprisingly robust or, conversely, disappointingly weak with slightly less favourable exchange rate conditions. Additionally, any slowdown in activity in the emerging countries could restrict growth in exports in the Eurozone. ■

In Q2 2017, global activity remained robust

The emerging economies are gradually recovering

In Q2 2017 the recovery continued in most of the main emerging economies. Chinese growth remained solid (+1.7%), driven by the pick-up in investment. Brazil and Russia have definitively come out of recession, although activity in these countries came to a standstill in Q2, in reaction to the sharp rise at the start of the year. All in all, after a spectacular recovery since the end of 2016, emerging economy imports virtually stagnated in Q2 (-0.2%), although the year-on-year increase has been strong (6.3%).

Activity rallied in the USA

Gross domestic product (GDP) grew by 0.7% in the advanced economies, in a distinct acceleration from Q1. Activity notably regained momentum in the USA (+0.8%), after two quarters that had disappointed given the high level of the business climate, as well as in Japan thanks to the pick-up in household consumption. In the United Kingdom however, growth remained modest (+0.3%) as households continued to curb their spending due to the loss of purchasing power induced by the depreciation of Sterling.

Eurozone GDP rose sharply once again

Eurozone growth remained strong (+0.6% as in Q1, slightly higher than anticipated in the June issue of *Conjoncture in France*), particularly in Germany (+0.6% after +0.7%) and Spain (+0.9% after +0.8%). It was slightly weaker in Italy (+0.4%).

French activity grew by 0.5%, for the third consecutive quarter

In France activity continued to rise steadily (+0.5% after +0.5%), as forecast in the June 2017 issue of *Conjoncture in France*. Manufacturing output increased in line with expectations (+0.7% after 0.0%) and consistent with the high level of the business climate in industry. On the demand side, household consumption picked up pace slightly (+0.3% after +0.1%) and household investment pursued its vigorous growth (+1.2% after +1.5%). Corporate investment held up better than expected when the one-off additional depreciation allowance scheme came to an end (+1.0% after +2.1% and compared to the anticipated -0.2%). Lastly, due to the sharp rebound in exports after a disappointing Q1 (+2.4% after -0.8%), and to the slowdown in imports (+0.3% after +1.2%), the contribution of foreign trade was broadly positive, as forecast (+0.6 points).

Oil stabilises and the Euro appreciates

Oil prices stabilise at a low level despite the drop in supply

In Q2, oil demand continued to outstrip supply, which was restricted by the sharp decrease in OPEC production implemented since January. Through to the end of the year the market should remain in deficit, but the extent to which oil was stockpiled during the surplus period is likely to continue to curb any upward pressure on prices. The price of Brent should therefore settle at around \$58 per barrel through to the end of the year.

The Euro appreciated over the summer

Monetary policies look likely to continue to diverge on either side of the Atlantic. In the USA, the Federal Reserve is expected to raise its base rates again, bolstered by a core inflation rate approaching 2%. Eurozone inflation remains well below 2% and the ECB is pursuing its accommodating monetary policy. However, the European upturn and the difficulties encountered by the USA in bringing concrete form to the expansionary fiscal policy announced during the presidential elections, led to a sharp appreciation of the Euro this summer. The exchange rate should stabilise at around \$1.17 to the Euro through to December, against \$1.06 at the start of the year.

World trade is expected to grow by 5.4% in 2017

China is set to experience a slight slowdown but the recovery in the other emerging countries should gather pace

The business climate rallied in the emerging economies in summer 2016 and has stabilised above the expansion threshold over the past year (*Graph 1*). In China, the recovery of investment has driven a sharp acceleration in industrial output since the end of 2016, but GDP is likely to slow slightly through to December with the country's recent attempts to rein in borrowing through monetary and fiscal policy measures. Conversely, the drop in inflation in Brazil, Russia and India should see consumption pick up gradually, and the recovery should gather strength in these countries. Imports in the emerging economies are expected to grow steadily once again through to the end of the year. All in all, they should rise by 7.6% in 2017 after two years of decline, driving the upswing in world trade (+5.4%).

Government expenditure is set to pick up in the USA

Activity in the advanced economies is expected to remain robust in H2 2017 (+0.5% per quarter). In the USA, the growth rate should reach 0.6% in Q3, then 0.5% in Q4: corporate investment is likely to slow after a marked recovery at the start of the year, but government spending should pick up again after five quarters of near-stagnation. Activity in Japan is set to slow down slightly, yet remain sustained thanks to the rise in foreign demand and the upturn in consumption. Activity is however expected to remain sluggish in the United Kingdom, where households are being adversely affected by the sharp rise in inflation caused by the past depreciation of Sterling.

Through to the end of the year, the Eurozone should continue to make up lost ground

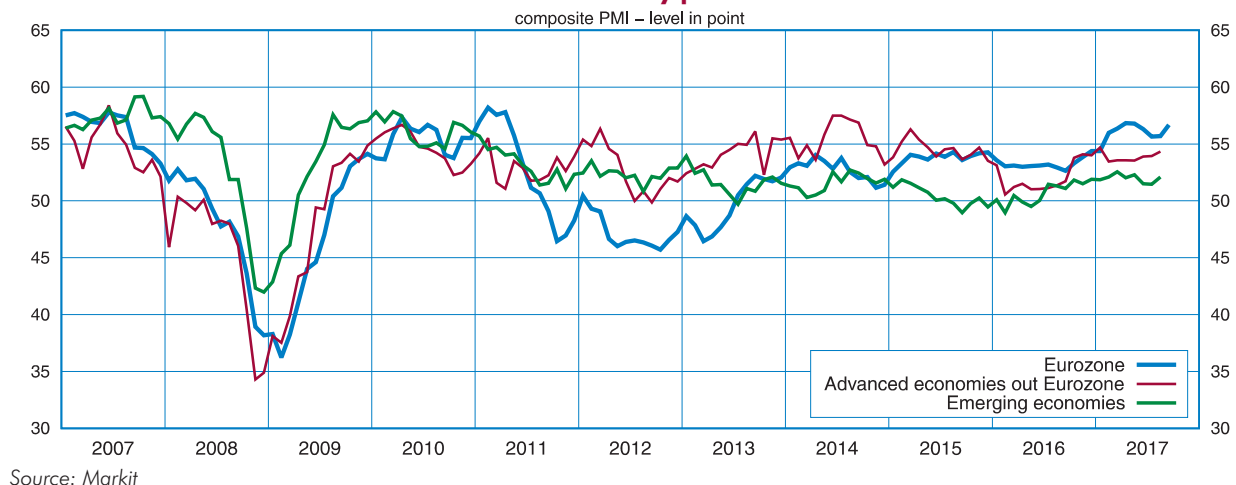
The decrease in the savings ratio is softening the impact of weaker purchasing power on consumption

The high level of household confidence suggests that private consumption in the Eurozone should remain vigorous through to the end of the year. Employment is expected to continue to progress robustly and the unemployment rate should fall to 8.7% at the end of 2017, one point down on last year. However, driven by a rebound in energy prices, year-on-year inflation rose to +1.5% in Q2 2017, against +0.7% at the end of 2016: it is likely to remain at 1.5% by the end of 2017, as core inflation has strengthened slightly in the four main Eurozone countries. This rise in prices is eating into purchasing power, but households are expected to save a little less in order to soften the impact on their consumption, especially in southern Europe.

Activity across the entire Eurozone is being sustained by investment, particularly in construction

After having declined almost continuously from 2009 to 2015, investment in construction started to recover last year. It should accelerate sharply in 2017 (+4.1% after +2.0%), sustaining activity in all the Eurozone countries. The accumulated delay since the financial crisis and the fall in interest rates, boosting household credit demand, are providing the stimulus for this recovery. Equipment investment should also remain vigorous in the current context, with a vastly improved financial situation for companies and growing tensions in production capacity.

1 – The business climate is very positive in the Eurozone



Growth gaps should narrow slightly in 2017

All in all, Eurozone activity should accelerate further in 2017 (+2.2% after +1.7%) and the zone is expected to make up some of the ground lost to the other main advanced economies. Growth is likely to remain more sustained in Spain (+3.1% after +3.2%) and Germany (+2.2% after +1.9%) than in Italy (+1.5% after +1.0%) and France (+1.8% after +1.1%), but the gaps between countries in the zone should narrow somewhat.

Foreign trade is likely to continue to hamper French growth in 2017, but less so than in 2016

French exports should pick up pace, yet without fully capitalising on the recovery of world trade

After falling in Q1 (−0.8%), exports bounced back sharply in spring (+2.4%); yet the half-year remains disappointing considering the significant increase in world demand for French products. Through to the end of the year, foreign sales should grow robustly (+0.9% then +1.7%), most notably in the aeronautical industry where deliveries at the end of the year should offset the weak performances observed earlier in the year. Looking beyond these quarterly ups and downs, French exports are expected to accelerate in 2017 (+3.3% after +1.9%), partially benefiting from the recovery of world trade but also the return of tourists to the country and the restarts of nuclear power plants.

French imports are set to remain vigorous, particularly those of capital goods

Imports are unlikely to weaken in 2017, as they are required to service still-vigorous domestic demand, particularly for capital goods. They are expected to grow by 3.9%, almost in line with 2016 (+4.2%). Thanks to the acceleration in exports, foreign trade should weigh far less heavily on growth in 2017 (−0.3 points) than in 2016 (−0.8 points). Nonetheless, the balance of trade in manufactured goods is expected to continue to widen, to its lowest since 2011.

The French growth rate should reach +1.8% in 2017

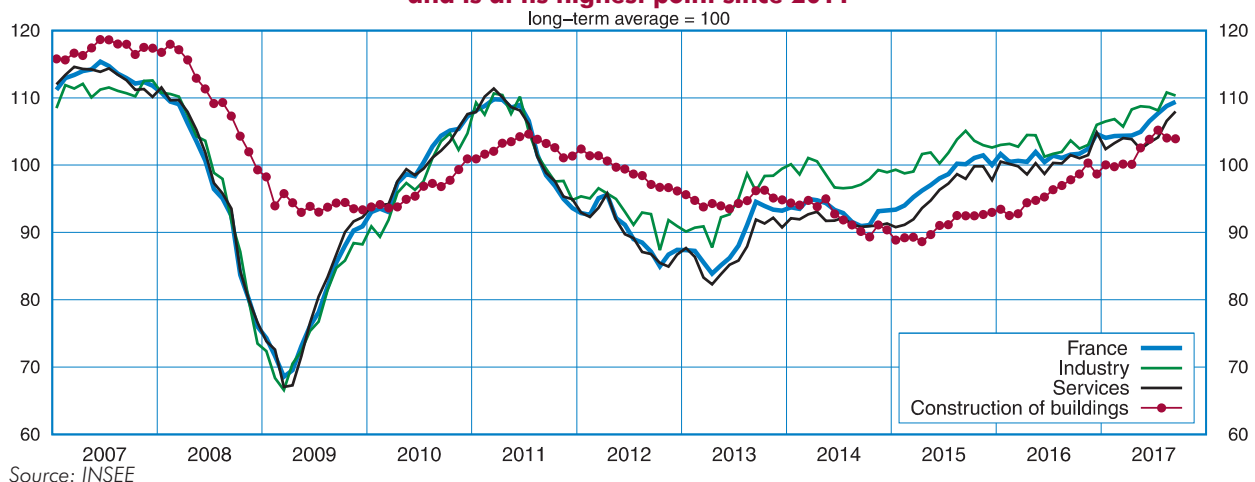
The business climate improved once again this summer

From October 2015 to November 2016, the business climate in France remained virtually stable, at slightly above its long-term average. Since December 2016 it has gradually risen and reached 109 in September 2017, its highest point since early 2011 (Graph 2). In industry, it has even climbed to a ten-year high.

Activity is expected to pick up sharply in 2017

Through to the end of the year, activity should continue to grow vigorously (+0.5% per quarter) across all sectors. Industry in particular is expected to capitalise on the high level of foreign demand, while construction should take advantage of the sharp rise in household demand for housing. Additionally, agricultural production is expected to recover in 2017, after last year's slump caused by exceptionally poor weather conditions. Lastly, in addition to buoyant domestic demand, the return of tourists should benefit production of services, especially accommodation and food services and transportation. All in all, GDP should climb to +1.8%, after three years of modest growth of around 1.0%.

2 – In France, the business climate continued to improve this summer and is at its highest point since 2011



Total employment is likely to slow in H2 due to fewer subsidised contracts, but the unemployment rate should continue to fall

Market-sector employment should slow slightly

Employment in the non-farm market sectors progressed further in Q2 (+69,000 jobs after +52,000 in Q1) and more sharply than anticipated in the June issue of *Conjoncture in France*. Labour force prospects remain positive in the business tendency surveys, although they slipped back this summer and market-sector salaried employment is expected to slow slightly in H2 (+86,000 jobs). The employment intensity of growth should be nil through to the end of the year, with the favourable effect of the tax credit for encouraging competitiveness and jobs and the Responsibility and Solidarity Pact being offset by the negative effect of the abolition of the hiring premium for SMEs on 30 June. All in all, the French economy is expected to generate 208,000 market-sector jobs in 2017, after 221,000 in 2016.

Non-market employment is set to decline sharply due to fewer workers on subsidised contracts

Employment in the non-market sectors should fall sharply in H2 (-46,000 after +29,000 in H1), due to the reduction in the number of workers on subsidised contracts. Total employment should therefore slow significantly in H2, with 41,000 net job creations after +154,000 in H1 (*Graph 3*).

The unemployment rate should continue to fall

In Q2 2017 the unemployment rate stood at 9.5%, 0.5 points down on the previous year. In H2, the expected rise in employment should be slightly greater than labour force growth, meaning that the unemployment rate is expected to fall once again, down to 9.4% at the end of the year (against 10.0% one year previously).

Purchasing power and consumption are set to slow in 2017

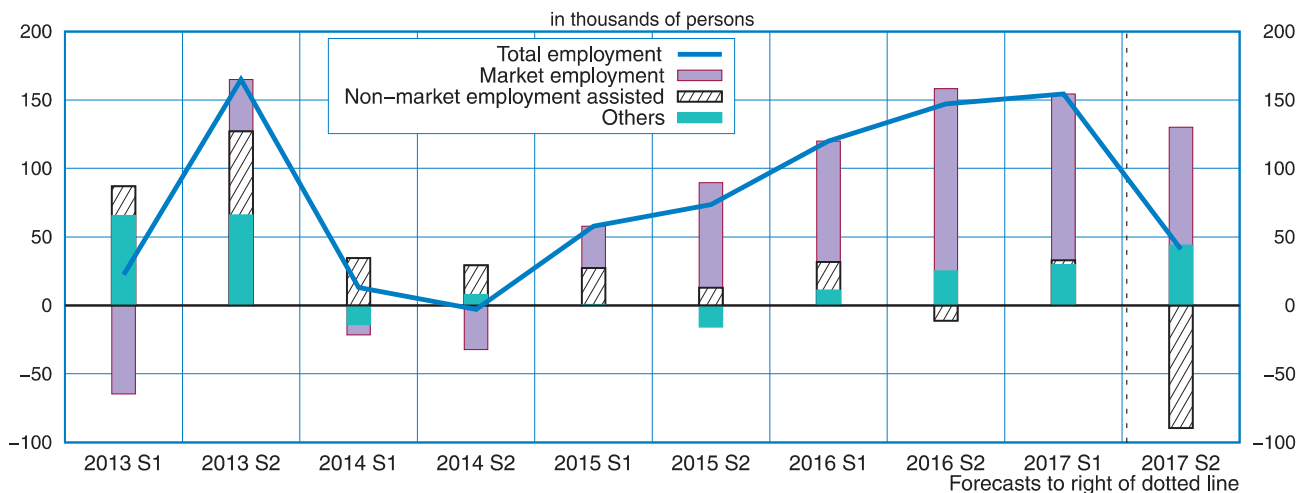
After rising at the start of the year, inflation should remain stable at around 1.0%

In September, year-on-year inflation stood at +1.0%, up sharply from September 2016 (+0.4%). This increase has come exclusively from energy, as core inflation has barely risen from one year ago. Through to the end of the year, inflation should remain stable at around +1.0% but its core component should rise slightly, to +0.8% in December, against 0.5% this summer.

Purchasing power is set to slow a little in 2017, down to +1.6% after +1.8%

In 2017 nominal wages per capita are set to accelerate in the market sector (+1.9% after +1.2%), thanks to the upturn in inflation and falling unemployment. They are expected to increase more sharply in the civil service because of rises in the index point and the statutory measures provided for in the Finance Law. All in all, earned income should pick up distinctly in 2017, partially offsetting the impact of higher inflation on purchasing power gains, which should remain solid (+1.6% after +1.8%).

3 – Employment is expected to slow sharply in H2 2017 due to lower numbers of subsidised jobs



Source: INSEE

In 2017, consumption is likely to slow more sharply than purchasing power

Driven by purchases of textiles and household durables other than cars, household consumption should pick up in Q3 (+0.5% after +0.3%), before slowing in Q4 (+0.3%). Over the year as a whole, consumption is expected to slow more sharply than purchasing power (+1.1% after +2.1%), in reaction to the one-off events that had boosted this consumption in 2016 (ticket sales for the European football championship, change in the TV broadcasting standard, effect of temperatures on energy expenditure).

Investment is expected to remain brisk

Household investment is rising fast

Household investment increased strongly in H1 (+1.5% in Q1 then +1.2% in Q2), as the past increase in new housing sales filtered through with a delay. These sales have stabilised since the start of the year, but because of the customary time lag between sales and construction, household investment should remain very brisk (+1.0% in Q3 then +0.9% in Q4). It should grow by 5.0% over the year, a rate not seen since 2006.

Tensions are reappearing in French production capacity, favouring corporate investment

In Q2, corporate investment slowed when the one-off additional depreciation allowance scheme came to an end on 15 April, but did not actually decline (+1.0% after +2.1%). In the business tendency surveys, business leaders still expect to increase their investment expenditure and a growing number of business managers in industry are indicating production bottlenecks. As both internal and external financing conditions remain favourable, corporate investment is unlikely to weaken over the rest of the year, and should grow by 3.9% in 2017 after +3.4% in 2016.

Uncertainties: fragility of the emerging economies and French exports

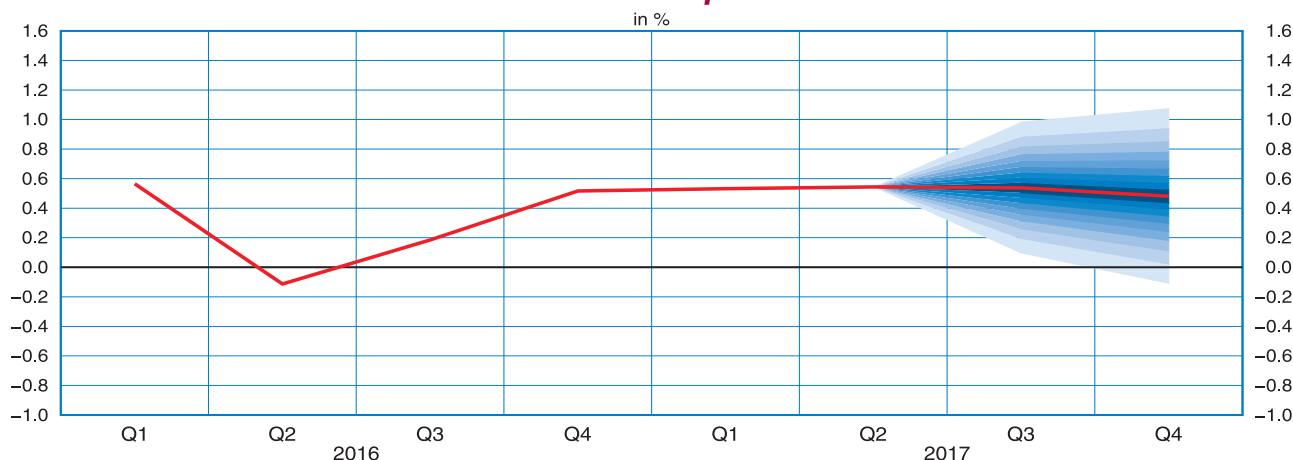
The recovery of the emerging economies seems fragile

After declining in 2015 and 2016, imports in the emerging countries rebounded suddenly at the end of 2016, intensifying the recovery movement that had got underway. But since summer the business climate has stopped climbing in these countries and has stabilised at a level well below that of the 2000s. This recovery therefore remains a fragile one. If activity were to slow, the trend in imports could be exacerbated, restricting growth in Eurozone sales to these countries.

Ability of French exports to bounce back

In H1, French exports grew only weakly considering the rise in world demand. The present forecast anticipates a partial catch-up through to the end of the year, but like in 2016, exports may be either surprisingly vigorous or disappointingly weak in H2, thereby raising questions about the French economy's ability to stem the deterioration of its trade balance. ■

4 – Fan chart associated with the Conjoncture in France of October



How to read it: the fan chart plots 90% of the likely scenarios around the baseline forecast (red line). The first and darkest band covers the likeliest scenarios around the baseline, which have a combined probability of 10%. The second band, which is a shade lighter, comprises two sub-bands just above and just below the central band. It contains the next most likely scenarios, raising the total probability of the first two bands to 20%. We can repeat the process, moving from the centre outwards and from the darkest band to the lightest, up to a 90% probability (see *INSEE Conjoncture in France* for June 2008, pages 15 to 18). It can therefore be estimated that the first estimate that will be published in the quarterly accounts for Q3 2017 has a 50% chance of being between 0.4% (lower limit of the fifth band from the bottom) and +0.8% (upper limit of the fifth band from the top) and 90% chance of being between +0.1% and +1.1%. In Q4 2017, the confidence interval at 90% is [-0.1% ; +1.1%].

Source: INSEE