The issues of Conjoncture in France along with a glossary of economic outlook terminology are available as soon as they are published on the INSEE web server, in the “INSEE conjoncture” section of the website www.insee.fr.

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Growth returns, but does not take off

While the improvement in the business climate at the end of 2013 announced a consolidation in the upturn in the advanced economies, 2014 got off to a rather disappointing start. With the notable exception of Germany, activity on the whole was less dynamic than expected in the advanced economies, while the announced slowdown in the emerging economies was confirmed. World trade contracted markedly, for the first time since 2009. Consequently, French exports slowed down sharply, notably those to our partners outside Europe. The weakness of activity in many countries was partly the result of one-off factors. For example, the US economy was handicapped by the harsh winter. Likewise, the emerging countries suffered from further withdrawals of foreign capital. In France, activity stagnated in Q1 due to some specific factors in addition to the contraction in world demand: in particular, the backlash after vehicle purchases were brought forward to before the end of 2013 and the drop in energy expenditure on account of a particularly mild winter.

In spring 2014, these one-off negative factors should fade, allowing a slight upturn. In France, as in the Eurozone, the upturn in activity is however likely to be modest (+0.3% in Q2) as certain lingering factors continue to limit its extent. Households’ purchasing power is indeed increasing too modestly to drive a significant acceleration in households’ consumption and to prevent a continuing slide in investment in new housing. Faced with demand that is still not taking off, and with margin rates that are improving but still low, companies are not inclined to invest. Finally, French exports are unlikely to profit fully from the expected acceleration in world trade, penalised as they are by the past rise in the Euro. Therefore, the business climate as indicated by the business tendency surveys, which hasn’t improve for nine months now, remains at a lower level than its long-term average.

In H2 2014, growth in France should be consolidated, but remain modest (+0.3% per quarter). On average over the year, GDP is likely to grow by 0.7% in 2014, after +0.4% in 2012 and 2013. Within the Eurozone, Italy is set to emerge slowly from the recession, while the upturn should be stronger in Spain. For these two countries, the construction sector is suffering from the poor business climate as it is in France. On the contrary, this sector is more dynamic in both Germany and the UK, thus contributing to a better global outlook in these two countries. The weakness of growth in France suggests that no significant improvement can be expected on the employment front; the slight rise expected in total employment is likely to be driven exclusively by the increase of assisted employment in general government. This is unlikely to be enough to offset the rise in the active population and the unemployment rate should increase slightly through to the end of the year, at 10.2% in France.

The main uncertainty is the trajectory of inflation. The scenario taken here assumes that the return of growth and resulting fall in unemployment in the Eurozone should stabilise inflation. It is possible, however, that the factors that explain the faster than expected fall in inflation in recent months might continue to push it downwards. Conversely, inflation could rise again, notably if the measures announced by the ECB at the beginning of June succeed in lowering the level of the Euro. The activity scenario will also depend on the response of businesses to the new economic policy measures announced by the government. Finally, there are also great uncertainties surrounding the behaviour of European households as regards savings. The assumption here is that the recent fall in their saving rate is not sustainable over the longer term and will therefore ease up gradually, although the improvement in the labour market that seems to be taking form could continue to favour a decrease in precautionary savings. Conversely, it is also possible that households may profit from the improvement in their income to begin building up their savings again and reducing their debt.
General outlook

Activity slowed down in most economies in Q1 2014
In Q1 2014, activity have maintained a moderate growth rate in the emerging economies: +1.1% after +1.2% in Q4 2013, against +1.7% on average between 2000 and 2010. Industrial production slowed down sharply (+0.5% after +1.4%, according to the CPB). While this sluggish activity was expected, foreign trade was much less dynamic than forecast: exports fell back (-2.5% after +3.2%), in particular in Asia, and imports levelled off (-0.1% after +2.1%).

Activity slowed down in the advanced economies
In Q1 2014, activity slowed down in the advanced economies (+0.3% after +0.5%), more sharply than forecast in Conjoncture in France in March 2014 (+0.5%). In the United States, it contracted under the effect of poor weather conditions and unexpectedly weak investment (-0.2% after +0.7%). In Japan, activity accelerated temporarily, boosted by pre-tax hike rush demand before the rise in VAT on 1st April.

The Eurozone maintained some impetus
In Q1 2014, the slow economic upturn was confirmed in the Eurozone (+0.2% after +0.3%). Activity accelerated in Germany, notably due to the mild winter (+0.8% after +0.4%), and in Spain (+0.4% after +0.2%). It remained sluggish in the rest of the Eurozone, however, notably in France (0.0%) and Italy (-0.1%).

In France, activity stagnated in Q1 2014
Activity stagnated in France in Q1 2014, when a slight progression (+0.1%) had been anticipated in Conjoncture in France in March. Foreign trade made a negative contribution to growth (-0.2 points), with the slowdown in exports (+0.3% after +1.6%). Domestic demand excluding inventory fell markedly (contribution of -0.4 points). Consumption fell (-0.5%), in particular in manufactured products (-0.7%) after growing strongly in Q4 2013 (+0.9%). In addition to this, total investment fell sharply (-0.9%), particularly in construction (-1.8%). It should be stressed, however, that the change in base has resulted in a revision of the quarterly profile of this type of investment which now shows a clear downturn at the end of 2013 (see Focus, “The quarterly accounts switch to the 2010 base”).

Oil prices remain high
Since the beginning of 2014, the price of Brent has stood at a high level of around $108 (€79.4) on average. This high level is no doubt partly due to geopolitical tensions which remain high, although those on the physical market are weak; demand is rising with the world upturn, but at a moderate rate, and oil supply is also increasing, driven by growth in production in North America. Through to the end of the year, tensions should remain low on the physical market: demand should progress slightly, held back by the relative weakness of the emerging economies, while supply should grow as US output increases and certain OPEC countries (Libya, Saudi Arabia) are set to increase their production levels. All in all, as the rises in supply and demand are relatively similar, the price per barrel of Brent is likely to be stable through to the end of the year, set by convention close to the latest observed price ($108).

The outlook should remain favourable in the advanced economies through to the end of 2014
After being shaken last spring, the currencies of the countries with high current deficits (Argentina, Brazil, Indonesia, Turkey), and also the Russian Ruble, fell again at the beginning of 2014, linked with the winding down of quantitative easing in the US. To deal with this, their central banks continued to tighten their monetary policies. The business tendency surveys, which had shown an
improvement in summer 2013, have been on a downward trend since November 2013 and were still at low levels in May 2014. Although past depreciations should continue to favour the price competitiveness of these economies, activity should remain at a slower level. Consequently, their imports are likely to progress at a distinctly weaker rate than prior to the crisis (about +1.6% per quarter, against +2.2% on average between 2000 and 2008).

In the advanced economies, the business tendency surveys showed a clear upturn in summer 2013 and remained at quite a high level in May 2014 (see Graph 1). Activity is likely to remain relatively dynamic through to the end of the year: +0.4% in Q2, then +0.5% per quarter in H2. The outlook is more singular in Japan where activity is set to contract in Q2, due to the rise in VAT. Conversely, in the United States, activity should rebound significantly in Q2 by a catch-up effect: purchases that were postponed on account of the bad weather conditions at the start of the year are likely to boost consumption and investment. In H2, activity should grow more moderately. In the UK, the upturn is set to continue at a strong rate, although domestic demand should slow down slightly in H2 as the real-estate market becomes more reasonable.

Through to the end of 2014, Eurozone activity should grow modestly

Against the backdrop of an improving economy, the question of monetary policy strategy is of acute importance on both sides of the Atlantic, although in different ways. In the US and in the UK, the central banks have pinned their credibility on maintaining an accommodating monetary policy with low rates over the “long” term, despite the return to growth picking up speed. For the moment, the Federal Reserve, faced with a robust upturn and sustained performance of the labour market, is pursuing its strategy of winding down its quantitative easing programme by reducing the amount of its monthly securities purchases. The Bank of England has maintained its interest rates and the size of its balance sheet until now. The ECB, meanwhile, is faced with weak inflation, a continuing contraction in lending to the private sector and the high level of the Euro which is weighing down on the competitiveness of the Monetary Union.

The ECB lowered its key interest rates in June and announced further unconventional policy measures: it proposes to supply liquidity to those banks that increase their lending to SMEs and households (excluding real-estate loans) and declares that it is ready to invest in securities backed by loans to businesses.

1 - The outlook remained favourable in most advanced economies

Sources: Institute for Supply Management, Shoko Chukin Bank, Commission Européenne
The weakness of this market is partly due to demand factors (non-financial private agents are still cutting back their debts), but also due to the poor transmission of the ECB’s accommodating monetary policy.

After showing an improvement in H2 2013, Eurozone business tendency surveys have levelled out at close to their long-term average, a sign that growth is likely to remain moderate (+0.3% per quarter) through to the end of 2014.

In the Eurozone, purchasing power is likely to increase weakly (+0.2% per quarter), due to the slower fall in employment and more moderate tax hikes, in particular in Italy. Through to the end of the year, prospects in terms of activity and employment should improve and households reduce their precautionary savings. Consumption is therefore likely to accelerate slightly (+0.3% per quarter) and the saving ratio fall a little more moderately than previously, from 13.0% in Q1 2014 to 12.8% at the end of 2014.

The growth in activity and the need to renew production capacities after a marked phase of adjustment should continue to support the upturn in investment in equipment, which is likely to progress by 6.4% on average in 2014. In construction, after a temporary backlash in the spring after the mild winter which had boosted the sector in Germany, activity should level out in H2 2014 after falling for five years. This improvement hides some widely varying trends within the Eurozone: construction is set to buoy up growth considerably in Germany, while it is likely to hold it back in France, Spain and Italy.

World trade likely to grow again, but the upturn to be moderate through to end 2014

In Q1 2014, world trade contracted unexpectedly (-0.8% after +1.5%), under the effect of the cold spell on the Chinese and US economies. World trade should progress by 1.3% in Q2 2014, with the upturn in trade in the emerging countries, notably in Asia. It should then slow down slightly in H2 to +1.2% per quarter, as the improvement in trade in the Eurozone is likely to be timid.

The progression in French exports is likely to be limited, however

In Q1 2014, French exports slowed down sharply (+0.3% after +1.6%). The dynamism of the imports of France’s trading partners was less than expected and the demand for French products progressed weakly, especially that from non-European countries. Through to the end of the year, foreign demand for French products is likely to be buoyed up by the upturn in the advanced economies and increase in line with world trade (+1.2% then +1.0% per quarter). The growth in French exports should be more modest, however (+0.6% on average per quarter), being held back by the downward trend in market share and the past rise in the value of the Euro.
The French economy set to progress at a moderate rate through to the end of the year

The business climate has not progressed for nine months now in France

After a marked rebound in all sectors in summer 2013, the business climate in France has been almost stable for nine months (at 94 in May against 95 last September) and is still below its long-term average (see Graph 3). In industry and commerce, the business climate remains close to its long-term level. Conversely, the composite indicator remains at a level well below its average in building (at 94 in May) and it is even falling in services where it stands at a low level (90 in May 2014 against 95 in November 2013).

Manufacturing production to increase in Q2 2014, then slow down

In manufacturing industry, production grew slightly in April (+0.3%). In INSEE’s May business tendency survey, the responses of entrepreneurs remained relatively optimistic as regards their past activity. The balance on production prospects, however, showed a marked fall. Manufacturing production should therefore progress in Q2 2014 (+0.4%), and then slow down again in H2 (+0.1% per quarter), in line with the weak growth in demand and an increasing penetration rate.

More positive factors for energy production

With the mild winter, energy production fell back significantly in Q1 (-1.4%). It should rebound by a backlash effect in Q2 (+2.1%) and remain dynamic in Q3 (+2.1%), notably if there is a return to normal in heating expenditure. After a sharp fall in Q1 (-1.5%), activity in construction should continue to fall in the spring (-0.7%) and summer (-0.6%) and then tend to level out at the end of the year. The fall in the number of housing starts, at their lowest level in 15 years, does seem to be easing and the number of building permits seems to have stopped falling. In addition to this, the public works sector is progressing again, after stalling in Q1 2014 on account of the municipal election cycle. All in all, the French economy is likely to grow at a moderate rate through to the end of the year (+0.3% per quarter).

Growth should come to +0.7% in 2014, after +0.4% in 2012 and 2013

As an annual average in 2014, GDP should progress by 0.7%, representing a slight acceleration after two years of very modest growth: +0.4% in 2012 and 2013 (corrected for the number of business days1). The acceleration in activity should be driven in particular by manufacturing industry (+1.2%, after -0.6% in 2013 and -2.1% in 2012). In contrast, construction is likely to fall for the third consecutive year (-2.6%, after -1.2% in 2013 and -1.7% in 2012).

(1) In raw data (as published in the annual accounts), GDP progressed by 0.3% in 2012 and in 2013. In 2014, the effect of working days should be neutral on growth in GDP.

3 - The business climate is stable in France for nine months, below its long-term average

Last point: May 2014

Source: INSEE
**General outlook**

**Total employment and unemployment set to increase slightly through to the end of the year**

Employment in the non-agricultural market sectors fell in Q1 2014 (-22,000 jobs), hit by the drop in temporary employment. Through to the end of the year, the expected rise in activity is likely to be too modest for employment to show an improvement; it is likely to level out, however, buoyed by the increase in the growth in jobs that the tax credit for competitiveness and employment (CICE) should give rise to.

In 2014, non-market sector employment is likely to rise in both H1 (+22,000) and H2 (+38,000). The number of beneficiaries of assisted contracts should progress by 16,000 in H1, essentially driven by the ramp-up of the "emplois d’avenir". It should increase slightly more in H2: in addition to the "emplois d’avenir" that continue to be created, there will also be those of the new single "CUI" contracts. Due to this dynamism of assisted employment, total employment should progress by 54,000 jobs in 2014, after growing by 55,000 in 2013.

**Unemployment to rise slightly through to the end of 2014**

In Q1 2014, the unemployment rate levelled out at 10.1% of the active population in France on average (9.7% in Metropolitan France). In Q2, the unemployment rate should increase again slightly, to 10.2% (9.8% in Metropolitan France) and then, with the slight rise expected in total employment, it should level out at this level in H2.

**Inflation likely to remain below 1% through to the end of 2014**

In May 2014, consumer prices were up 0.7% year-on-year. Inflation has remained contained at below +1.0% since last summer and is likely to remain at this very moderate rate through to the end of the year. At the end of 2014, year-on-year consumer prices should stand at +0.7%. Looking beyond the ups and downs from one month to the next, core inflation should fall to +0.2% in December 2014, notably due to the slowdown in telecommunication prices. This moderation is all the more notable given the rise in VAT rates on 1st January 2014; the effect of that rise seems to have been partly absorbed by corporate margins which have been increased by the effect of the tax credit for competitiveness and employment (CICE). Headline inflation, on the other hand, should be up slightly, due to the acceleration in food and energy prices. On the assumption of a Brent oil price stable at €79.4 ($108), the year on year change in energy prices should increase to +1.4% in December 2014 (after +1.1% in May), notably due to the rise in electricity prices.

**Purchasing power should return to growth in 2014**

After a marked fall in 2012 (-0.9%) linked with the increase in the tax burden, household purchasing power stabilised in 2013, mainly due to the fall in inflation (+0.6% after +1.4% in 2012). In 2014, the purchasing power of household
Gross disposable income should accelerate again (+0.7%), notably thanks to less dynamic taxes and contributions (+2.5% after +4.2% in 2013, see Graph 4).

Social benefits should slow down (+2.4% after +2.8%), under the effect of the postponement of the increase in general pensions (from 1st April to 1st October) and then the pensions freeze. This should be more than offset by the slight acceleration in earned income (+1.4% after +1.0%). The quarterly profile of disposable income is likely to be marked by that in tax, with ups and downs as new measures come into force: while earned income should progress at a globally stabilised rate throughout the year, taxes, after the rises at the end of 2013, should fall back symmetrically in Q1, before rebounding in H2.

Household consumption set to increase in line with their purchasing power

In Q1 2014, household consumption decreased (-0.5%). More particularly, spending on automobiles fell, after being boosted at the end of 2013 as people brought their purchases forward before the tighter terms of the “malus” (carbon emission tax) came into force on 1st January 2014. Also, the fall in energy expenditure was sharper than in Q4 2013, due to temperatures that were well above the seasonal norms. In Q2, consumption of manufactured products should increase (+0.6%), notably of automobiles. With the mild spring, energy consumption should rebound slightly in Q2 (+1.2%) and then accelerate in Q3 (+1.9%). In H2 2014, household consumption should increase by 0.4% then 0.3%, in line with the average progression in their purchasing power, making an increase of +0.3% on average in 2014, as in 2013.

Despite the quarterly ups and downs, the savings ratio is forecast to be stable

In Q1 2014, thanks to an upturn in purchasing power, the savings ratio would appear to have rebounded by 1.4 points to 16.1%, the highest level since spring 2011. Given the expected profile of the purchasing power of income, the savings ratio should fall progressively over the rest of 2014, to stand at 14.7% in Q4, the same level as one year earlier (see Graph 5). On an annual average, it should progress by 0.3 points to 15.4%.

Public consumption set to slow down slightly in 2014

Public consumption should progress by 0.3% per quarter through to the end of 2014; the rise on average over the year should be 1.6%, slower than in 2013 (+1.9%). Public investment fell back in Q1, after the peak in public works at the end of 2013 linked to the electoral cycle. It should stabilise through to the end of 2014.

4 - In 2014, the purchasing power of gross household disposable income should progress again

![Graph showing annual means and contributions](source: INSEE)
Household investment likely to fall back, while corporate investment should rebound moderately

The fall in household investment is likely to be accentuated

In Q1 2014, household investment, especially in new housing, continued to fall for the ninth consecutive quarter (-2.6% after -2.2%). This fall should ease moderately in the course of the year and level out at the end of 2014. Given the overhang in Q1 2014, the fall in household investment should be accentuated in 2014 (-6.7% after -3.1% in 2013), the sharpest fall since 2009.

Corporate investment set to progress slightly

Corporate investment contracted again in Q1 2014 (-0.5% after +0.8%). Expenditures in services held up, but that in construction fell back (-1.1%). Investment in manufactured products also fell (-0.9%), by a backlash effect after companies brought forward their purchases of heavy goods vehicles before the entry into force of new anti-pollution standards on 1st January 2014. Through to the end of 2014, corporate investment should progress at a moderate rate (+0.2% on average per quarter), against a backdrop of weak demand and despite the favourable effects of the CICE and the improvement in financing conditions. Over the whole of 2014, corporate investment expenditure should rebound moderately (+0.7% after -0.6% in 2013), in the wake of activity.

France set to grow at the average rate for the Eurozone through to the end of the year

France and the Eurozone to grow at the same rate

Through to the end of 2014, quarterly growth should be the same in France as the average for the Eurozone (+0.3% per quarter). The drivers are likely to differ, however, with more consumption in France and more dynamic investment in the rest of the Eurozone.

Uncertainties: effects of economic policies and savings behaviour

Effect of economic policies in the Eurozone and France

The main uncertainty in this scenario is the trajectory of inflation. In the scenario taken here, the return of growth, improving labour market and monetary policy measures and announcements should allow the Euro and inflation in the Eurozone to stabilise. It is possible, however, that the factors that explain the faster-than-expected fall in recent months might continue to weigh on inflation. Conversely, inflation could grow again, notably if the measures announced by the ECB succeed in bringing the Euro down.

5 - Despite quarterly ups and downs, the savings ratio appears to be stable year on year

Source: INSEE
In addition, the scenario for activity in France will depend on the response of businesses to the set of economic policy measures taken and announced by the government. Depending on their perception of them, their behaviour in terms of investment and inventory might be more or less dynamic.

There are also greater uncertainties than usual around the trade-off between household consumption and savings. In the scenario taken for this Conjoncture in France, the fall observed recently in the household savings ratios of France’s main trading partners continues but at a lesser rate. However, European households might choose to profit more in the future from the improvement in their income to build up their savings again, and thus reduce their debt. Conversely, the fall in the savings ratio might not ease, especially in the short term, thereby having a positive impact on demand for French products. The savings behaviour of French households is also a subject of uncertainty and could vary in either direction.

**General outlook**

6 - Fan chart for Conjoncture in France

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 result published by the quarterly accounts for Q2 2014 has a 50% chance of being between +0.1% (lower limit of the fifth band from the bottom) and +0.5% (upper limit of the fifth band from the top). Likewise, it has a 90% chance of being between -0.2% and +0.8%. In Q3 2014, the 90% confidence intervals is [-0.3% ; +0.8%].

Source: INSEE
General outlook

The quarterly accounts have switched to the 2010 base

On 15th May 2014 the national accounts changed calculation base, coinciding with the publication of the initial results for Q1 2014. The accounts have now switched to the “2010 base”. Every year the annual growth estimates for the macroeconomic aggregates are updated for the past three years, to reflect new information which has become available since the previous publication. However, on 15th May 2014, all aggregate figures since 1949 were updated. Changing base means reviewing the methods, classifications and statistical sources used to compile the national accounts, in order to better reflect the economic reality.

The transition to the 2010 base thus provided an opportunity to make a certain number of conceptual changes, mostly related to the 2010 change in European accounting methods (transition from “ESA95” to “ESA2010”), along with certain methodological adjustments, as is always the case when changing calculation base. These changes are outlined in the detailed explanation published in L’Économie Française, and available on the website insee.fr (the “2010 base” web file).

The overall methodology used to compile the quarterly accounts has not changed: the principles remain the same as those which underpinned the previous calculation base, with the exception of a few conceptual modifications.

A comparative analysis of the two bases reveals that the resulting revisions to GDP statistics and the principal aggregate indicators of demand (consumption, investment, foreign trade etc.) are relatively small when set against the variability of data series and the changes seen in previous base transitions. Broadly speaking, in terms of growth rates, the differences involved are on the same scale as the variation generally encountered in the usual annual updates. Therefore, the general picture of economic developments since the war, and particularly since the onset of the economic crisis in 2008, remains largely unchanged. This consistency between the estimates generated by the two bases is not a foregone conclusion and, although welcome, is not immediate. Changing base is a complex statistical operation, and the results at the aggregated level are difficult to predict and control, as the changes are made at a very precise level of detail.

GDP level increased by 62 billion €

GDP now stands at 1,998 billion Euros € for 2010, an upward revision of 3.2% compared to the figures given by the 2005 base. The reclassification of research and development spending (R&D) as investment, which increases GDP by 41.5 billion €, accounts for two-thirds of this change (+61.8 billion €).

A comparison of the fluctuations in GDP growth and the various demand factors reveals that the revisions required to the 2005 base figures are relatively minor (see Graph 1).

For the recent past, the overall narrative remains unchanged: after five successive quarters of shrinking GDP (from Q2 2008 to Q2 2009), activity grew strongly for seven quarters (up until Q1 2011) then slowed sharply, growing by only 1.2% for the last three years (up until Q1 2014).

While the outline of these phases of recession and recovery remain unchanged, the revised overall development since 2008 paints a slightly less negative picture of the dynamism of economic activity since the onset of the crisis (see Graph 2). In the 2010 base, GDP had returned to its pre-crisis level by Q1 2011. In Q4 2013 GDP stood at 1.1 points above its Q1 2008 peak, while the 2005 base gave it as 0.1 points below this pre-crisis highpoint at the same date. These revisions result both from the usual revisions which take place at this time of year - involving the integration into the annual accounts of the detailed information from the structural business statistics, which only become available three years after the end of the year which they cover - and the conceptual changes which can be attributed to the evolution of the ESA framework.

(1) At European level, consistency across the various national accounting systems is ensured by the European System of Accounts (ESA), adopted by the member states of the European Union. ESA 2010 will be in application in all EU nations by September 2014.
**A strong increase in investment expenditure**

The total value of investment has been substantially revised. The 2010 base counts as investment by companies and general government certain forms of expenditure which were previously considered as intermediate consumption: R&D spending or databases and capital goods with purely military applications (this latter form of investment concerns only the government).

Total investment has thus been revised upwards, by just over 63 billion € per annum for 2010. The rate of investment by non-financial companies (NFCs) thus increases from 21.1% in Q4 using the 2005 base to 24.3% in the 2010 base. The most significant modifications concern the last few years: investment by NFCs in the 2010 base thus falls slightly in 2012 and 2013 (-0.7% between the end of 2011 and the end of 2013), while the 2005 base had this figure dropping off sharply over the same period (-4.3%); on the one hand this demonstrates the impact of R&D investment, which was more dynamic than other forms of investment during this period; on the other hand it reflects the effects of the integration of data from the definitive, semi-definitive and provisional accounts, which always takes place at this time of year. The result is that at the end of 2013 NFC investment was down 6.2 points from its pre-crisis level, while the 2005 base gave this decline at 11.5 points.

**The scope of "investment by households" is modified by the introduction of a new indicator**

Furthermore, the change of base provided an opportunity to incorporate new indicators of spending on housing (by households and NFCs). These indicators are estimated directly by the Observation and Statistics Department (SOeS) at the Ministry for Sustainable Development, based on statistics for housing starts and using "delivery schedules" for their completion which depend on the region and the type of housing in question, and vary in response to the current climate in the construction sector. Previously, projections for all new construction projects were made using the same aggregated, fixed delivery schedules. The new indicators are thus more consistent with the method used to calculate the annual housing figures. But they do engender a noticeable change in the contours of this sector’s development over the past few years.

As such, in comparison to the previous estimates, investment by households (more than 80% of which is investment in construction) enjoyed a more robust rebound in early 2010 but fell back again from Q1 2011 onwards; in 2013 it fell very sharply in H2 [see Graph 3], reflecting the earlier fall in the housing start.

**Several modifications affect the import and export figures**

The data series for imports and exports have also been revised, with noticeable changes in quantity but only minor changes in terms of the contours of their trend. The first major revision is the integration of two significant conceptual changes. International trading (buying and reselling goods on the international market without changing them in any way) is now included in the category 'goods exports', whereas it was previously classified as a commercial service. This has caused service exports to fall by 10 billion Euros for 2010, in favour of goods exports. The second modification concerns commissioned work (when a company subcontracts operations to a foreign company, providing all the intermediate resources required for the process), which in the 2005 base generated both exports and imports of goods. In the 2010 base this flow of goods is no longer recorded, with the whole operation now counted as an import of services to the country from which the order originates. This change brings a fall in the total volume of imports and exports equivalent to just below 10 billion Euros for 2010. Furthermore, revisions to the estimates of the balance of payments have led to a marked increase in the volume of exports (+34 billion € in 2010) and imports (+27 billion €) of services.

All in all, while the levels of exports and imports have changed significantly, the overarching narrative of recent years is not significantly altered. As with GDP, exports and imports bounced back more strongly after the crisis than the 2005 base figures suggested: +5.4% between Q1 2008 and Q4 2013 for exports (compared to just +2.2% in 2005 base) and +5.3% over the same period for imports (compared to +3.0% in 2005 base). Once again, these changes are a result of both conceptual changes and the customary revisions made at this time of year.
General outlook

The margin rate is increased

The revisions to GDP, and by extension to value added, resulting from the redefinition of R&D are largely to be found in the increased operating surplus of companies. As a result, the margin rate of French businesses is increased. The margin rate of NFCs is also increased, from 28.0% in Q4 2013 in the 2005 base to 29.5% in the 2010 base figures (see Graph 4). Once again, the effect on the proportional variation from one quarter to the next is however very limited. Finally, the self-financing ratio of NFCs shows little variation between the two bases: the greatest discrepancies result from the integration of information on the balance of property income in recent years.

3 - Household investment since 1995

Source: INSEE

4 - Comparison of the margin rate of non-financial corporations between 2005 and 2010 bases

Source: INSEE
The breakdown of GDP using the demand approach is very similar in both bases

Finally, GDP can be broken down using one of several approaches (income, demand, production). For each of these approaches we can compare the 2005 and 2010 bases with regard to the relative contribution of their primary components, i.e. average level of GDP, average growth and average variance. Our analysis using the demand approach reveals very few discrepancies between the two bases (see Tables). Most notably, the proportion attributable to business demand, via the contribution of inventory and investment expenditure, accounts for 64% of the volatility of GDP in both the 2005 and 2010 bases. Breaking down GDP using the production approach also reveals a great consistency between the results returned by both bases.

### Breakdown of GDP using the demand approach, and contributions to its average level, development and fluctuations

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Source: INSEE
### Key figures: France and its international environment
seasonally adjusted / working-day adjusted data (except for prices), quarterly or annual averages, as a %

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Forecast

(*) Inventory changes include acquisitions net of sales of valuable

(**) For annual data, unemployment rate is that of the last quarter of the year

(*** ) Year-on-year on the last month of the quarter and annual averages

How to read it: the volumes are calculated at the previous year's chain-linked prices, seasonally and working-day adjusted, quarterly and annual averages, as a %.

Source: INSEE
Credit conditions do not seem to amplify the economic cycle in France

Since the beginning of the Great Recession, corporate credit in Europe has seen a sharp contraction. This decline is certainly due in part to a fall in the demand for credit from companies. Faced with a collapse in demand and what was initially a pronounced increase in uncertainties as to future economic growth, companies have cut their investment spending sharply and scaled down their inventory, resulting in a fall in their demand for financing.

But the decline in credit may also be partly due to the credit supply behaviour of the banks. In addition to tighter prudential requirements, the deterioration in the creditworthiness of borrowers may have led banks to restrict their supply of credit. The latter phenomenon refers us to the concept of the financial accelerator in the economic literature: in phases when the short-term economic situation is poor, the value of the assets held by companies and the profitability of their use tend to fall, thereby increasing the risk for a bank of not getting its funds back when it grants a loan. For projects of identical quality, phases when the short-term economic outlook is poor and phases when prudential requirements are being tightened are therefore less conducive to the distribution of credit by banks. This theoretical prediction involves testing for the existence of two economic regimes, one «standard» and the other of a credit squeeze.

The nonlinear nature of the financial accelerator lends itself well, on the macroeconomic level, to the estimation of a threshold model. In the case of France, over the period 2003 to 2013, this model detects two major periods during which there was a credit squeeze. However, this squeeze had a very limited impact on economic activity and does not provide evidence of a significant financial accelerator effect, even during the 2008-2009 financial crisis and the sovereign debt crisis of 2011-2012. The main cause of the fall in credit therefore lies in the decline in demand from companies.
Credit conditions do not seem to amplify the economic cycle in France

Over the past six years, the weak credit environment must be linked with a difficult economic situation

In the Eurozone, the fall in bank credit continues, despite the upturn in activity...

Despite the emergence of the Eurozone from recession in Q2 2013, the credit market continued to contract at the beginning of this year: outstanding credit to non-financial enterprises was down 3.0% year-on-year in April. This contraction, which has been almost uninterrupted for close to 5 years, is directly linked with the two spells of recession in the Eurozone in 2008-2009 and then 2011-2013. Among other things, the latter led to a fall in the investment spending of companies, and therefore in the drying up of demand for credit from the banks. However, this is not necessarily sufficient to explain the extent of the adjustment in credit volumes or, most importantly, the big contrasts between the countries of the monetary union. For example, in April, credit fell by 9.7% in Spain, while it grew very slightly in France, by 0.6%. The survey conducted by the European Central Bank (ECB) among small and medium-sized companies (SAFE) confirmed this heterogeneous access to bank financing. While 45% of Spanish companies surveyed at the end of 2013 considered access to financing a major problem, 38% were in the same situation in France and only 28% in Germany.

This fall in credit contrasts with the pre-crisis period. During the first half of the 2000s and through to 2007, the credit market went through a phase of sometimes massive expansion in the major Eurozone countries. Beyond the relationship between credit and activity, this expansion phase was also driven by a poor perception of credit risk by European banks (see report in Conjoncture in France, March 2009, The Subprime Crisis: from Financial Crisis to Economic Crisis). The causes were many: the scarcity of violent crises in the course of the period of "the great moderation" from the mid-1980s through to 2007, the practice of securitisation in the United States and the perception - disproven by the crisis - that all the Eurozone countries offered investors the same level of risk exposure, created an illusion of the dilution of systemic risk. This resulted in risky behaviour on the part of the banks and investors, reinforced by deregulation of the banking system in certain States (in Germany, for example, but above all in Spain, see Illueca et al. (2013)). In the wake of the subprime crisis that started in 2007 in the United States, the risk carried by banks that had granted loans to insolvent borrowers began to materialise with the growing level of borrower defaults, causing a sudden turnaround in expectations. The European credit market then stalled suddenly, before contracting in a process that continues today (see Graph 1).

The growing awareness of the weaknesses of the banking systems in the wake of the Lehman Brothers bankruptcy in September 2008 led to a sharp rise in risk aversion among financial players. Consequently, the interbank financing that is necessary to provide banks with good liquidity conditions partly dried up, endangering the banks’ ability to serve demand for credit from the private sector. Since then, the liquidity conditions of the European banks have remained a matter of concern and several unconventional monetary policy operations conducted by the ECB (for example the 3-year refinancing operations at the end of 2011 and beginning of 2012) have contributed to reducing the banks’ liquidity risk. This risk is still there, however, notably on account of the still sub-normal working of the interbank market in the Eurozone. The introduction of the prudential ratios of Basel III decided on by the G20 in 2010 may also take its toll on the credit distribution behaviour of banks (see Annexe).

(1) This proportion corresponds to enterprises that gave a score of between 7 and 10 on a scale of 1 to 10 to describe their financing difficulties.
...and the interventions of the Central Bank...

The ECB reacted to the shock of the crisis by bringing down its main policy rate to a level which was soon close to zero. In the first half of 2009, it came down to 1% and stands at 0.15% today. This has led to a reduction of the room for manoeuvre of the central bank which then introduced a series of unconventional monetary policy measures.

But this accommodative monetary policy is passed on in different ways in the countries of the Eurozone. The very fragile state of the banking system of certain peripheral countries, such as Spain, where the banks were highly exposed to real-estate risk, prevented the transmission of the ECBs’ low-rate policy: it was passed on more clearly to corporate lending rates in countries perceived as being sounder, such as France and Germany. Systemic risk was also reinforced by the correlation between sovereign risk and banking risk highlighted by the sovereign debt crisis from 2010 onwards. On the one hand, some States had been forced to recapitalise their banking system when it was insolvent, thereby increasing their debt and placing their own solvency in peril. Such was the case in Spain, for example, where about €60 billion in aid was ploughed into the partial recapitalisation of the banking system (of which €40 billion lent by Eurozone partners via the European Financial Stability Fund). On the other hand, like in Italy, the banks of the Eurozone held large amounts of Treasury bills of the countries in which they are based and were therefore exposed to the losses caused by the fall in value of sovereign securities.

This situation whereby each nation carries a specific risk premium has led to the fragmentation of the credit market. For example, the borrowing costs faced by non-financial enterprises continue to be much higher in those countries perceived as being more fragile than in those seen as being sounder (see Graph 2).

...due mainly to weak demand from companies

The decline in credit is not necessarily the result of restrictions on supply, meaning a situation in which a loan is refused to a company despite the fact that the project for which it is applying for credit is considered profitable. The credit may be refused simply because the bank judges the project not profitable enough. It should be noted that restrictions can take two forms: either by volume, refusing all or part of the amount requested by companies, or by price, proposing higher or lower interest rates depending on the borrower.

The credit market situation in the Eurozone is therefore particularly heterogeneous.

The weakness of credit is caused by the poor economic situation...

Credit conditions do not seem to amplify the economic cycle in France

1- Annual growth rate of outstanding credit to non-financial companies

Last point: April 2014

year-on-year changes in %

Source: ECB
Several studies have been conducted at microeconomic level in the Eurozone in recent times. They tend to conclude that there was no credit rationing through to 2010. In France, according to Kremp and Sevestre (2013), there is no robust evidence of small companies having been the subject of rationing between 2008 and 2010: although the banks reduced their credit supply idiosyncratically, the decline in lending to small companies was mainly due to a fall in demand in the wake of the shock in activity. Likewise, Cabannes et al. (2013) conclude that limited markets predominated over any restrictions there might have been in credit for French companies. In the case of Italy, according to Del Giovane, Eramo and Nobili (2011), based on the data of the Bank Lending Survey (BLS), while restrictions on supply did have a certain impact, pure supply effects (meaning those unrelated to the financial situation of the borrowers) were of minor importance over the period 2007-2009. In Germany, Rottman and Wallmerhäuser (2012) also conclude that there was no real credit rationing in 2008-2009.

Bentolila et al. (2013), meanwhile, developed a different approach based notably on detailed data on relations between companies and their banks. According to them, there is credit rationing in Spain, and it is significantly more severe when the intermediated financing was taken out from a bank that was hit hard by the crisis.

The current difficulties of the financial system can therefore explain some of those encountered by the European economies over and above the level justified by the weakness of demand. In addition, the banks surveyed by the ECB for the BLS survey indicated that they had tightened their lending terms in 2008-2009, then again in 2011-2012, and had not eased them since. 14% of European SMEs, meanwhile, declared that they were having difficulties gaining access to external financing between October 2013 and March 2014 in the SAFE survey (see Graphs 3 and 4). These difficulties were even leading some of them to restrict themselves and not even apply for bank credit.

![Graph 2 - Average rate of bank loans to enterprises in the Eurozone](source)

*Source: ECB*
Consequently, the structure of corporate financing has been changed substantially

The difficulties of the banking systems of the different European countries have had an impact in return on the structure of corporate financing in the Eurozone, although to varying degrees.

The vast majority of European companies gain access to external financing through bank financing, unlike American companies, for example, whose financing is less intermediated and based more directly on financial markets, and in particular bond issues. In France, for example, bank lending is thought to have represented about 73% of the total debt of companies prior to the crisis. Since 2008, this share has fallen regularly and bank credit currently represents 63% of companies’ external financing. This process shows a substitution in external financing sources between bank financing and market financing. The origin of this substitution lies in the financing difficulties of the banking system and the fall in the rates on bond issues, generating opportunistic behaviour. It is hitting companies in varying ways, however. For large companies that enjoy easier

3 - Bank credit difficulties for SMEs - (SAFE survey)

4 - Net percentage of opinions of European banks on credit supply and demand

Last point: March 2014

Source: ECB
access to financial markets, the fall in bank credit supply has been offset by a substantial rise in debt security issues (see Graph 5). In France, for example, market debt progressed by 15% in 2009, after a 1% fall in 2008. At the same time, bank financing fell from a growth rate of 13% in 2008 to 3% in 2009. The same substitution phenomenon can be observed between the end of 2011 and 2012. The liquidity crunch which, in the wake of the sovereign debt crisis, was threatening at the time to hit the European banks, partly explains this.

This reallocation of external financing by companies weighed differently both between countries and according to the type of companies concerned. While the lowest-risk companies (generally large companies) achieved this substitution at low cost, the same does not apply to companies perceived by the markets as bearing higher risk (usually smaller companies), whose bond rates incorporated a high risk premium that still exists today.

The financial accelerator and flight to quality phenomena may have amplified the deterioration in activity

The weakened economic situation experienced by the Eurozone over the last six years may have amplified the difficulties encountered by the banks and, in return, hit activity harder. One part of economy theory addresses this question and can provide insights into the mechanisms involved. This is the financial accelerator theory and the phenomenon referred to as the ‘flight to quality’. These mechanisms are based on microeconomic foundations and can result in the appearance of differentiated economic regimes from a macroeconomic point of view.

The financial accelerator, a mechanism that amplifies the shock in the real economy, is the macroeconomic translation of market imperfections

Bank financing involves lenders and borrowers in a principal-agent relation as described by contract theory: lenders and borrowers do not have the same information concerning the degree of risk attached to the investment projects, the behaviour of the borrower, or the final returns of the projects to be financed. This

(2) These data are from the ECB. Market-based debt refers to total issues of bond debt of French non-financial companies, and bank debt refers to total outstanding debt granted by banks, also to non-financial companies.
(3) See the ‘stat info’ publication ‘Financement des PME en France’ by the Banque de France for a presentation of the structure of bond yields by risk class.
asymmetry of information is an imperfection (within the meaning of the economic theory) of the bank credit market. The banks therefore implement an audit and information collection procedure that is costly and which cost is therefore passed on by the banks to their clients in their credit access terms. These costs resulting from asymmetry of information give rise to an external financing premium and to frictions on the credit market.

To reduce these information asymmetries to the minimum, along with the counterparty risk that goes with them, lenders can base their decisions on the value of the assets held by the borrowers, and accordingly apply an inversely-proportional external financing premium. These assets may be in the form of the financial balance sheet of the company or its collateral. However, as the value of such assets is generally correlated with economic activity, the banks introduce a de facto procyclical mechanism in their loan granting. Bernanke and Gertler (1989) described the role of the balance sheet position of agents in economic dynamics. This information provides an insight into the solvency of borrowers and can reduce agency costs for the banks.

The external financing premium applied is inversely correlated with the financial situation of borrowers: companies with higher net wealth will be considered more solvent and will benefit from a lower financing premium. In economic slowdown periods, the deterioration of the balance-sheet position of agents results in a variation in this premium and, more generally, a deterioration of lending conditions. Given this increase in the cost of access to financial resources, companies are then forced to limit their inventory and their investment expenditure, and hence their level of production: the initial shock spreads and grows (see Graph 6).

Kiyotaki and Moore (1997) perform a general equilibrium analysis of these microeconomic frictions and develop the idea that production factors (real-estate assets, plant, etc.) may also serve as collateral for loans. The potential amount of credit corresponds to an exogenous fraction of the value of collateral. When the price of assets falls, the increased difficulty in obtaining financing leads to a drop in investments. The initial shock is then amplified. In other words, an idiosyncratic shock on the price of assets may generate a variation in the value of the collateral and hence trigger the mechanism described above. In a loop system, this idiosyncratic shock may then be passed on to the economy as a whole (see Graph 6).
This mechanism is known as a financial accelerator, or "broad credit channel", and explains the interdependence between the real and financial sectors. It presents two types of asymmetries that may widen. On the one hand, banks adopt different behaviours according to the size of companies; the resulting phenomenon is known as the 'flight to quality' (Bernanke 1993). On the other hand, the influence of the financial accelerator mechanism differs according to the phase in the economic cycle.

**Bank behaviour towards large and small enterprises is asymmetric...**

Banks usually reduce the proportion of funds allocated to uncertain projects requiring close monitoring and tend to prefer safer projects. The information asymmetry is potentially smaller for large enterprises, mainly due to the greater diversification of their risks. Next, they are also less sensitive to economic fluctuations than small enterprises as they have better control over their inventory. Last, they generally have officials (accountants, auditors) who afford banks easier access to information, leading to economies of scale in the information collection process and thus, by definition, a relatively lower agency cost borne by the bank.

The second asymmetry stems more broadly from the economic cycle. The financial accelerator has a stronger effect in the low phase of the cycle than in its high phase. During an expansionary phase the global net worth of borrowers, at aggregated level, is high and hence the agency costs are lower. Consequently, variations in the value of companies have little effect on the lending decision and the financial accelerator is weakened. In recessionary periods however, when global wealth is low, fluctuations in current profits have significant effects on investment and production. The amplifying effects are therefore stronger in unfavourable economic periods. This difference may foster and amplify the flight to quality, mainly because large enterprises have smoother activity. Gertler and Gilchrist (1994) develop the idea that small enterprises are more sensitive to credit rationing during adverse phases than in expansionary phases.

The financial accelerator is thus asymmetric in character and potentially displays nonlinearities in the response of real activity to economic and financial shocks. The methodology developed hereafter and the variables used attempt to identify these differentiated regimes.

**In order to find out whether the financial accelerator phenomenon exists in France...**

Real-financial spheres linkage model attempts to test for the existence of this accelerator effect, and to quantify it

**A real-financial spheres linkage model attempts to test for the existence of this accelerator effect, and to quantify it**

Is there a financial spheres accelerator mechanism in France? Can flights to quality be observed? What about in the current period? To answer these questions, a model inspired by Balke (2000) is adapted to France.

**A representation of the French economy by a vector model allowing a change of regime and integrating a lending-conditions variable**

Real-financial spheres interactions are accounted for via a vector autoregression model, or VAR (see Box 1), which, with monthly data, takes into account the dependencies between economic activity, inflation, the interest rate and a credit market status indicator.

As in any VAR model, it is necessary to associate causality relations with the instantaneous correlation that exists between the variables, based on assumptions from economic theory. In the case at hand, from an economic viewpoint it seems reasonable to assume that the activity and inflation variables react with a time lag to the financial variables, while the two financial variables (interest rate and credit terms) depend contemporaneously on the macroeconomic environment. We also assume that activity does not react to a price shock within the same month, and that interest rates do not react to a lending-conditions shock within the same month (see Box 1).
Box 1 - Modelling the nonlinear transmission of credit shocks

The modelling of the nonlinearities described by the economic theory and resulting from differentiated credit conditions is inspired by Balke (2000), who uses a threshold vector autoregressive model (TVAR) to capture the differentiated responses from the economy. This multivariate model approximates the continuous phenomena of credit constraints into a binary phenomenon by introducing a threshold that distinguishes two separate regimes.

The monthly TVAR equation is written as follows:

\[ Y_t = C_1 + A_1 Y_t + B_1(L) Y_{t-1} + (C_2 + A_2 Y_t + B_2(L) Y_{t-1}) I_{t-d} \geq \gamma \]

where:

- \( Y_t \) containing the following four variables: growth rate of the industrial production index (IPI), growth rate of the producer price index, 3-month Euribor rate, and a measure of the bank credit squeeze.
- \( B_1(L) \) and \( B_2(L) \) are matrix lag polynomials that represent the autoregressive structure of the model, i.e. its dependence on its past.
- \( I_{t-d} \) corresponds to the regime indicator and is used to introduce the nonlinearity. This indicator is equal to 1 provided that \( c_{ud} \), which measures credit conditions, remains above the estimated threshold \( \gamma \).
- \( d \) is introduced in order to take account of the transmission time, which is the time economic agents need to take account of the past conditions of the banking market.

Matrices \( A_1 \), \( B_1 \), and \( C_1 \) are the coefficients of a linear VAR model estimated only on the part of the sample that corresponds to the standard regime (the indicator then has a value of 0). However, on the portion of the sample corresponding to the credit squeeze regime, the estimated matrices are \( C_2 + A_2 Y_t + B_2(L) Y_{t-1} \). The differentiated response from the variables in the different regimes (i.e. the accelerator effect) stems from this estimation. Matrices \( A_1 \) and \( A_2 \) represent the contemporary relations between the different variables of \( Y_t \). To estimate the model it is necessary to make a causal assumption in accordance with the following schema used in Balke (2000) and Cecchetti (1995):

\[ \text{IPI} \rightarrow \text{Producer price} \rightarrow \text{Euribor} \rightarrow \text{Bank credit squeeze} \]

This causal relation means that here economic activity does not depend contemporaneously on any variable and hence only reacts with a time lag to the evolution of the other variables. Conversely, the measure of credit conditions reacts contemporaneously to the IPI, to inflation and to the interest rate (as well as to the past of all the variables). As a result, matrices \( A_1 \) and \( A_2 \) are lower triangular with zeroes along the diagonal. This assumption is equivalent to the particular choice of a Cholesky decomposition.

The particularity of this sort of model is the requirement to estimate \( \gamma \) and \( d \). If these parameters were known, the model would be estimated directly by Ordinary Least Squares as in a classical VAR model. In the case at hand, a grid search method is used.

First, a set of acceptable values for unknown parameters \( \gamma \) and \( d \) is selected. A maximal \( d \) is chosen arbitrary and \( \gamma \) is chosen according to the empirical distribution of \( c_{ud} \). For each of these pairs of values, the model is estimated by ordinary least squares. Next, the so-called optimal pair (\( \gamma \), \( d \)) is chosen to minimise the log-determinant of the variance-covariance matrix of the estimated residuals. On the assumption of Gaussian residuals, this methodology actually corresponds to a discrete evaluation of the estimator by maximum likelihood.

Prior to this estimation, it should be noted that the choice of the number of lags in the model is carried out separately by parsimony analysis on the Schwartz and Akaike information criterion.

Once the optimal model has been estimated, the presence of two regimes, i.e. nonlinearities, is tested in our model. The aim is to find out whether the threshold model provides more information than a linear model built on the same data. Formally, the assumption tested is:

\[ C_2 = A_2 = B_2 = 0. \]

As previously, the threshold structure of our model does not allow direct recourse to the usual tests. In particular, \( \gamma \) is not estimated in a linear model, and this modifies the asymptotic behaviours of the test statistics. Hansen (1996) and Andrews and Ploberger (1994) derive analogous tests in the form of an average or a maximum of the likelihood ratio and Wald statistics on all the values of the search grid. These four tests are respectively denoted avg-LR, sup-LR, avg-Wald and sup-Wald. The critical values of the tests are calculated by bootstrapping to simulate the distributions.

Lastly, the refinement introduced by the threshold modelling also does not allow direct recourse to the classical definition of response functions. Indeed, due to the nonlinear structure of the model, the amplitude and the sign (positive or negative) of the shock under study, but also the initial conditions, are determining factors of the response from the model's four variables. Koop, Pesaran and Potter (1996) avoid this stumbling block by developing so-called generalised response functions taking these particularities into account. These response functions are calculated by bootstrapping and allow the switch between regimes in response to the simulated shocks.
...and authorising nonlinearity

The model also allows for a switch from a normal economic regime, when the credit squeeze indicator is below a given threshold, to an unfavourable regime when the indicator is above this threshold. However, the switch does not occur immediately after the threshold is crossed. This time lag corresponds to the speed of reaction of economic agents to the change in financial conditions, for example the time required to renegotiate loan contracts, or the time companies need to set up a market financing operation.

The model variables are the IPI, the industrial producer price index, the 3-month Euribor rate, and a credit market indicator...

Economic activity is measured here by the growth rate of the industrial production index. This monthly index gives the closest reflection of growth in the activity of French enterprises. While the scope of this index is restricted, the correlation with quarterly GDP remains strong. Accordingly, inflation is measured by the growth rate of the French industrial producer price index for the French market. It both provides a measure of prices on a monthly basis and serves as a support for individual companies in their production decision-making processes. The interest rate corresponds to the refinancing cost of banks. It is measured by the Euribor 3-month rate, the average lending rate on the interbank market. Lastly, the model contains a variable intended to represent the credit market situation and more specifically the phenomena of flight to quality and the credit squeeze.

Flight to quality and credit squeeze are unobservable values which several indicators attempt to approximate

In this framework, a constrained economic regime may be linked either to a flight-to-quality effect or to a bank credit squeeze phase, and to different lending behaviours depending on the case. These two phenomena are identified by measurements of bank behaviour that differs either according to company size or to a deteriorating financial environment. The responses to the BLS survey have not been used as indicators since they come from banks and differ from the responses by companies to the SAFE survey. The analysis that follows uses four variables, presented below (see Graphs 7).

Two variables serve to record the flight-to-quality phenomenon. A first variable uses the difference between the loan interest rate billed to small enterprises and that billed to large enterprises (Indicator 1). The theory, based on differences in agency costs and on the uncertainties surrounding the projects of large and small enterprises, does indeed suggest that banks apply an external financing premium that differs according to company size. As the refinancing rate of the bank is the same whether it lends to a small or a large enterprise, this difference in premium captures the difference in bank behaviour faced with the risks of the project. In a general climate of uncertainty, banks are likely to increase the lending cost to small enterprises in order to guard against the risk of default and attempt to capture the investment demand of large enterprises, which are considered more reliable. The rate spread therefore tends to widen during periods where bank credit is tightening.

[4] An alternative would be to retain a monthly GDP by means of the IPI, using the Chow-Lin method for example. As the estimate results (available on request) are very similar, this approach is not presented here.

[5] A structure effect could however reduce this difference if a proportion of small companies did not take out these loans which have become more costly. The riskiest loans would be granted relatively less often, bringing down the average rate overall and probably more for small enterprises.
...or in quantity of credit granted to small and large enterprises

As banks can also modulate the quantities of loans granted according to company size, the flight to quality may also lead to an increase in the flows of new loans granted to large companies (whose projects are deemed safer) and a decrease in the flows granted to small companies. Hence the growth differential between new bank debt contracted by large companies and that contracted by small companies is an identifier of changes in economic regime (Indicator 2).

However, due to a lack of monthly data filtered by company size, it is necessary to use an approximation in order to build the indicators. Therefore, the loan amount is used as a proxy for size. The rates and flows of new loans agreements for less than €1 million are considered as being granted mainly to small enterprises, while the rates and flows of new agreements for loans of more than €1 million are considered as being granted mainly to large enterprises. This breakdown by company size, which is regularly used in the empirical literature, is an approximation of the partition between “more secure borrowers”, i.e. large companies, and “riskier borrowers”, i.e. small companies.

7 - The four credit market status variables used

![Indicator 1: Bank rate spread](image1)

![Indicator 2: Bank debt volume spread](image2)

![Indicator 3: European stock market volatility index](image3)

![Indicator 4: Bank margin](image4)

Source: ECB

Source: Data Insight

Source: ECB
Credit conditions do not seem to amplify the economic cycle in France

As well as their a priori ability to capture flight-to-quality periods, these two measurements present the advantage of being relatively independent of the economic cycle and of monetary policy decisions. Indeed, in a "standard" economic regime the behaviour of banks towards borrowers should evolve in an undifferentiated way between the various types of company. For example, in an economic recovery period, banks will increase their flows of new loan agreements at the same speed across all companies. Similarly, when the ECB’s base interest rates are cut, banks will pass this reduction on identically to small and large enterprises. According to Lown and Morgan (2002), the lending conditions of American banks do not depend on monetary policy. On the contrary, by capturing the differentiated ex-post behaviour of banks towards different company sizes, these indicators mainly identify the credit supply side of credit squeezes. However, like any indicator, they can also take account of a differentiated behaviour by the companies themselves, and, in this particular case, a differentiated behaviour among large companies, who would attempt to replace bank financing by market financing.

The credit squeeze situation

Two other variables complete this identification of flight-to-quality phenomena by identifying bank credit squeeze phases, that is, a deterioration of the financial environment which may have an impact on the credit behaviour of banks. First of all, the Vstoxx 50 index (Indicator 3) of stock-market volatility in the options market on the Euro Stoxx 50, which more generally measures conditions on the financial markets and is tied to the uncertainty surrounding the balance-sheet valuation of companies. Although it measures the stock-market volatility of the European market, the strong integration of financial markets in the Eurozone allows an approximation of a similar behaviour in national markets, and here the French market.

...or a bank margin indicator

Next, bank margins on loans (Indicator 4), measured by the spread between the average yield on loans to non-financial enterprises and the 3-month Euribor rate. This latter rate measures the short-term refinancing cost on the interbank market. In bank credit squeeze periods, at a constant interbank refinancing cost, a rise in the financing premium for companies translates a risk-averse behaviour among banks and a price constraint on lending. As previously, this indicator has the particularity of being independent of the monetary cycle, and probably represents the banks’ own margin decisions. It is also an element in the trade-off by companies, and more specifically large companies, between bank and market financing, and may also capture the more structural effects of financial liberalisation. In particular, the stronger competition between banks, or their ability to diversify risk, may structurally lead to a drop in the bank margin. Lastly, this indicator may also be sensitive to changes in banking regulations, which can alter the way the risk linked to corporate credit is weighted.

34 Conjoncture in France

In France, three of the indicators presented point to the presence of two regimes...

In France the credit market accelerator effect has not been in evidence over the last fifteen years

The four indicators presented were used to estimate four models encompassing two credit regimes depending on whether the indicator was higher or lower than a threshold, which itself was determined endogenously during the estimation (see Box 2 for the details of the results of the estimates).

Three of the four models identify two different regimes depending on the value taken by the credit indicator included in the model. In other words, the introduction of a change of regime according to lending conditions generally provides significant information about the behaviour of the French economy, but the changes in behaviour do not indicate a financial accelerator phenomenon.

(6) Only the second one, which uses the growth differential in bank debt contracted by large enterprises and small enterprises, rejects the existence of this effect.
Due to the short time horizon, the VAR models are built with only one lag and with transmission times ranging from $d = 1$ to 3 months, suggesting that the economy takes the credit environment into account relatively quickly.

**Three of the four models indicate the presence of a financial accelerator effect in France**

For the four models estimated, the existence of an accelerator effect is given by the test statistic and its associated p-value [see data in parentheses in the Table]. Statistics 1 and 2 (resp. 3 and 4) correspond to the average and the maximum of the likelihood ratio (resp. Wald) statistics on the search grid. Models 1, 3 and 4 reject the null hypothesis of the absence of financial accelerator, while model 2 accepts it: this finding actually shows that the indicator used is not discriminating enough. For each model the moving average of the credit squeeze variable and, when it is significant, the threshold used to determine the values of the credit regime indicator, are represented (see Graph).

**A negative shock in the bank credit squeeze indicator implies a 10% to 30% rise in the likelihood of an unfavourable regime for two quarters**

The temporal evolution of the likelihood of being in the “credit squeeze” regime following a shock (on condition that the starting point is in the “standard” regime) depends on the model and is a function of the nature of the shock. For example, for Model 1 we observe 55% more likelihood in $t=2$ of being in a credit squeeze regime than in the absence of a shock and the natural evolution of the model.

A positive shock of two standard deviations of the credit squeeze indicator, that is, a deterioration in the credit environment, leads to increases of 35% to 55% in the likelihood of being in an unfavourable regime. This greater likelihood of being in an unfavourable regime persists for 6 to 8 months in models 1 and 4, while it lasts longer in model 3 with a likelihood that is still 10% after two years. This similarity between model 1, with a credit spread between small and large enterprises, and model 4, with bank margin on credits, may come from the fact that these indicators are directly linked to the credit decision of banks, while model 3, based on Vstoxx, is a more “diffuse” indicator of constraints relating to the financial sector.

Additionally, it emerges that all shocks, in particular those concerning the Euribor and credit squeeze indicators, have a retroactive effect on lending conditions and thus play an important role in the switch between regimes. In the financial accelerator theory all shocks are important, not only “credit” shocks. These findings are in line with those of Balke (2000) on American data.

In theory, the switch between the two regimes brings with it an asymmetry - if it exists - in the response from the economy to a shock. For example, an adverse shock on credit conditions is likely to have a stronger impact if it occurs in the credit squeeze regime than if it takes place in the standard regime. However, the empirical estimates only show very little asymmetry in the responses from the variables to the shocks.

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**Results and models estimated for each indicator**

<table>
<thead>
<tr>
<th>Model</th>
<th>Bank credit squeeze indicator</th>
<th>Model specification</th>
<th>Estimated threshold</th>
<th>Stat 1 avg-LR</th>
<th>Stat 2 sup-LR</th>
<th>Stat 3 avg-Wald</th>
<th>Stat 4 sup-Wald</th>
<th>% of observations in the standard regime between 2004 and 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Borrowing spread between SMEs and large enterprises</td>
<td>2003M2-2013M12 $d=1, P=1, m=4$</td>
<td>0.015</td>
<td>45.10 (0.05)**</td>
<td>71.57 (0.05)**</td>
<td>42.97 (0.00)**</td>
<td>71.11 (0.02)**</td>
<td>67.5 %</td>
</tr>
<tr>
<td>2</td>
<td>Difference in growth in credit flows between SMEs and large enterprises</td>
<td>2004M1-2013M12 $d=2, P=1, m=6$</td>
<td>0.0075</td>
<td>29.72 (0.36)</td>
<td>65.08 (0.07)*</td>
<td>27.68 (0.35)</td>
<td>63.24 (0.09)*</td>
<td>A single regime</td>
</tr>
<tr>
<td>3</td>
<td>Stock market volatility</td>
<td>1999M2 - 2014M1 $d=3, P=1, m=6$</td>
<td>24.0792</td>
<td>44.65 (0.03)**</td>
<td>87.75 (0.00)**</td>
<td>43.20 (0.00)**</td>
<td>88.46 (0.00)**</td>
<td>56.7 %</td>
</tr>
<tr>
<td>4</td>
<td>Bank margins on loans</td>
<td>2003M2-2013M12 $d=1, P=1, m=6$</td>
<td>-0.0035</td>
<td>48.16 (0.02)**</td>
<td>101.4 (0.00)**</td>
<td>45.98 (0.00)**</td>
<td>102.19 (0.00)**</td>
<td>65 %</td>
</tr>
</tbody>
</table>

How to read it:
- **, *, and *** - correspond to a significance at the threshold of 10%, 5% and 1% respectively
- $d$ indicates the time for transmission of changes in condition to the banking market
- $P$ indicates the number of lags used in the model
- $m$ indicates the order of the moving average applied to the credit squeeze indicators in the regime-change indicator
Credit conditions do not seem to amplify the economic cycle in France

Over the last ten years, between three and four years are qualified as credit squeeze periods

Model 1

Model 2

Model 3

Model 4

Source: INSEE
In France, two major credit tightening periods are pinpointed in the last ten years...

The behaviour of the different indicators towards their critical estimated thresholds highlights two bank credit squeeze periods in the course of the last ten years: from mid-2008 to early 2011 and from end 2011 to early 2013. These two episodes correspond respectively to the financial crisis and the sovereign debt crisis in the Eurozone. One other episode identified in the model using the Vstoxx 50 stock-market volatility index as an indicator of the triggering of a credit regime, in early 2004, is more difficult to interpret.

It is also worth comparing these credit-squeeze periods with spells of recession in the French economy. The conventional definition of recession as a period of at least two successive quarters of zero or negative growth allows the identification of two episodes since 2003: 2008Q2-2009Q2 in the recession, and 2012Q4-2013Q1 further to the sovereign debt crisis. These two periods do indeed correspond to credit-squeeze periods as identified by all the indicators: this result is reassuring as to the relevance of the indicators used, although strictly speaking it does not provide conclusive evidence of a causal relation between credit squeeze and recession.

In all, the French economy has experienced between 39 and 52 months of tighter lending conditions over the last ten years. The actual length depends as much on the choice of indicator as on the choice of binary modelling of the switch between the two regimes, which qualifies as a "credit squeeze" values which can be both slightly higher than the threshold and much higher, like those observed at the end of 2008. The period is similar to the time in recession, which is 48 months according to the CEPR European cycle dating, a period that is nonetheless longer than the 21 months of recession in France with the criterion used previously.

...but the credit squeeze periods do not seem to aggravate the reaction of activity to lending conditions

Irrespective of regime, an adverse credit-market shock results in a drop in the industrial production index. For the most empirically satisfactory model, which uses stock-market volatility, the growth rate of the IPI falls by 0.1 to 0.2 percentage points for an adverse lending-conditions shock of one standard deviation (see Graph 8).

But this reaction is not amplified in the credit squeeze regime compared with the other regime. It seems difficult to reconcile this observation with the theory of the financial accelerator. However, the difference is much greater as regards both the reaction of prices and that of rates. The existence of the two regimes as detected by the estimate could thus indicate the presence of common shocks bringing about changes in both the dynamic of prices and in the behaviour of the financial sector.

But ultimately the impact of the credit market environment on activity is not discernable

(7) The CEPR dating committee draws up an official list of recession periods in the Eurozone. For further information:
http://www.cepr.org/content/euro-area-business-cycle-dating-committee
Conclusion: the credit market does not appear to constitute an obstacle to growth in the French economy

With the ongoing recovery, the credit market should brighten. The beginnings of this brighter picture are already visible: in France, outstanding credit in the private sector is showing a slight upward trend (+0.6% year-on-year in April). Furthermore, according to the latest BLS survey in April 2014, lending conditions for companies stabilised in Q1 2014 and, for the first time since mid-2007, banks are indicating that their perception of the macroeconomic environment and corporate perspectives has had a positive impact on lending. This survey also signals a sharp improvement in corporate demand for credit, which is on the rise for the first time since mid-2011.

The switch in early 2013 to a non-constrained credit regime seems to have been confirmed and the credit market should therefore not constitute an obstacle to the recovery of the French economy if the behaviours observed between 2003 and 2013 are an indication of future behaviours.

8 - Response to a unit shock in the credit indicator (model 3)...

... of the growth rate of the industrial production index

... of growth of output prices

... of Euribor

... of bank credit squeeze indicator

Source: INSEE
A bank’s balance sheet (and off-balance sheet)

A bank is first and foremost a financial intermediary: it is the contact point between savings (households and businesses) and cash requirements (borrowers). This is a far from simple operation, because:

(i) the demand for loans may differ from the amount of deposits;
(ii) households may withdraw their deposits more quickly than the bank can retrieve the sums loaned;
(iii) borrowers may default, while the bank has to guarantee all depositors the ability to retrieve their deposits if needs be.

Two other elements therefore complete banks’ balance sheets (on top of deposits and loans):

- capital exchanged on the financial markets in order to finance the bank or invest surplus cash (short term, with day-to-day financing for example, or medium-term with bond issues, for example),
- the bank’s own capital, held in reserve to guard against unexpected losses.

A bank’s balance sheet can thus be represented as follows:

"Basel III" Accord

Bearing in mind the lessons learned from the crisis, the Basel Committee made three key decisions in the Basel III Accords (see Basel Committee on Banking Supervision 2010):

(i) an increase in capital requirements,
(ii) the creation of two liquidity ratios: the Liquidity Coverage Ratio (LCR) to ensure that banks have the necessary assets to ride out a ‘severe but not extreme’ liquidity crisis for a period of one month, and the Net Stable Funding Ratio (NSFR) for the medium-term (1 year) financing capacity of banks, forcing greater harmonisation between the maturities of liabilities and assets,
(iii) the introduction of a 3% limit on authorised leverage.

These decisions are likely to have an impact on the credit market:

In theory, the "Basel III" Accords could impact the credit market:

- the rise in capital requirements could increase the cost of credit, all the more so for risky loans, by increasing the cost of holding assets proportionally to the degree of risk of the asset. Several microeconometric studies seem to indicate an adverse effect of capital requirements (identified either by financial crises causing capital shocks or by various regulatory modifications) on the bank credit supply. For example, the financial crisis in Japan in the late 1980s led to a constraint on Japanese banks to meet regulatory capital requirements and resulted in fewer loans on the American market (Peek Rosengren 1997). Similarly, certain German banks were exposed to the American subprime market and had to cope with liquidity constraints; a comparison of their credit supply with other banks indicates an adverse effect (Puri, Rocholl, Steffen 2011). Various assessments of changes to macroprudential policies also show a negative short-term effect on credit supply (Jiménez et al. 2013 on Spain, Aiyar et al. 2014 on the United Kingdom, Brun, Fraisse, Thesmar, 2013). Conversely, certain studies find no impact of the increase in capital requirements on lending activity (Buch and Prieto 2012 in Germany) or on rates (Martin-Oliver et al. 2012 in Spain);
- the introduction of liquidity requirements could work slightly in favour of households and small enterprises, as banks are constrained in lending at the short term, but may be able to refinance at the medium-term, with liabilities like bonds at longer maturities or with central banks.

(1) However, this balance sheet does not present all the financial commitments of a bank. Part of the bank’s activities is recorded as ‘off-balance sheet’: these are operations that may become, but are not yet, financial transactions (purchase or sale commitments, guarantees, commitments linked to term funding instruments, etc.).
Credit conditions do not seem to amplify the economic cycle in France

...
Credit conditions do not seem to amplify the economic cycle in France

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Slowdown in China: what risks for the world economy?

Analysts are suggesting more and more frequently that there is a risk that imbalances in the Chinese economy will result in a crisis. The Chinese economy, as measured in the national accounts, has unquestionably slowed considerably since the beginning of 2012. Growth settled at around 7.7% in 2012 and 2013, against 10% per year on average between 1999 and 2011. Although this slowdown may have been magnified by short-term economic factors (backlash from stimulus plans, monetary tightening, crisis in the Eurozone), it is mainly structural. Demographic changes, natural and ecological constraints, especially regarding hydrocarbon resources, and above all the loss of momentum in the recovery process all lend weight to the idea that growth in the longer term will be less than 10%. On the one hand, cost competitiveness seems to be eroded and investment in capital goods is slowing markedly. On the other hand, China is approaching the level of GDP per capita at which countries in catch-up mode generally start to slow. The experiences of other Asian countries (especially Singapore and South Korea) which have gone through an intense catch-up period show similarities, especially in the turning-point of the construction sector, which always happens just at the moment when the economy slows.

As is only logical, Chinese imports, and hence the country’s contribution to world trade overall, have slowed substantially. The effect of the slowdown in imports was accentuated by the drop in the rate of trade openness resulting from the reduction in the proportion of processing trade in the economy. However, the upward trend of imports for domestic demand does not seem to have been affected. The consequences for France remain limited: the slowdown by around 3 points per year in domestic demand from China converts to a loss of 0.1 points of annual growth in French GDP. In fact, the restabilising of the Chinese economy has resulted in a significant improvement in the balance of trade with China since 2008, especially in services.

In the medium term, two factors increase the risk that the Chinese slowdown will be magnified: first the construction sector, which had boosted the country’s activity since 2009, clearly seems to be suffering a reversal; second, outstanding credit has increased considerably since 2009 with rapid growth in non-bank loans. However, there is very little risk that these factors will pull China down into a real economic crisis, especially since with the scale of currency reserves the country has accumulated, it has the means to keep its financial system afloat. However, if credit dries up this could amplify the slowdown in current activity which, even without financial contamination by the rest of the world, could have a marked effect on world trade.
Slowdown in China: what risks for the world economy?

Marked slowdown in activity in China for the last 2 years

After a decade of growth at an average annual rate of over 10% from 1999 to 2011, activity, although still very dynamic, did slow markedly from 2012 onwards: Chinese GDP grew 7.7% in 2012 and 2013, which is the lowest growth recorded for the last 15 years, apart from 2009, the year of the great world recession (see Graph 1). Although the slowdown concerns all sectors of the economy, it is particularly pronounced in industry. Nominal value added in industry increased 5% in 2012 and 2013, a similar increase to that observed in 2009 (world recession) and in 1998 during the Asian financial crisis. The reason for this slowdown can be found in short-term factors (less demand from the Eurozone, monetary tightening, backlash from stimulus plans) but it does also have some structural qualities.

Some short-term economic factors may account for this slowdown. At the end of 2008, the massive stimulus plan adopted by the authorities (4,000 billion yuan, or approx. 13% of GDP in 2008) triggered a rapid upswing in activity, especially in construction. Expenditure was planned two years ahead until the end of 2010. Activity then suffered in turn when funds linked with this stimulus plan ran out.

From mid-2011, recovery in the European Union, China’s primary trading partner (20% of its exports) ground to a halt. The sovereign debt crisis and the fiscal consolidation measures adopted by the countries of southern Europe resulted in a levelling off of European imports, especially from China. Chinese exports to the EU (in current dollars) fell by 6.2% in 2012 and increased by barely 1.3% in 2013 compared with an average annual increase of 22.5% between 2000 and 2011.

In addition, from mid-2012, diplomatic tensions with Japan over the Senkaku islands (Diaoyu in Chinese) caused a slump in trade between the two countries. Chinese exports to Japan increased by only 2.2% in 2012 and dropped 0.9% in 2013. At present, this dispute seems to have resulted in a longstanding drop of about 10% in bilateral trade between the two countries.

1 - Marked slowdown in activity in China for the last 2 years

Source: National Bureau of Statistics, INSEE calculations
... and monetary tightening from the beginning of 2011

Faced with a vigorous recovery and in particular with soaring commodities prices and assets from 2010, the Chinese monetary authorities gradually tightened their monetary policy, like most central banks in the emerging countries. From the beginning of 2010 until mid-2011, the Chinese central bank increased its base interest rate from 5.3% to 6.6% and the minimum reserve requirement ratio imposed on major banks from 15.5% to 21.5%. This policy contributed to slowing activity, especially in the property market.

In addition to short-term uncertainties, the Chinese economy is undergoing a structural slowdown

As well as these short-term economic aspects, which certainly had an effect in 2012 and 2013, Chinese activity in the future will probably not return to the rate of progress it enjoyed from 1999 to 2011. The reason for such strong growth in the 2000s was above all a technological and capitalist catch-up phenomenon. Although this has not halted, several indices show that it is slowing: for example, capital seems to be moving into property, which in turn is leading to a slowdown in productivity gains; cost competitiveness has also declined as a result of the appreciation of the yuan and wage rises. In addition, the Chinese economy is ageing rapidly with the working age population even set to fall from 2017. Lastly, the Chinese economy is struggling with the physical impossibility of increasing its consumption of raw materials when its pollution emissions will then increase at the same rate.

The aging population is the major shock of the 2010 decade

China’s one-child policy, which came into effect in 1979, resulted in a demographic «golden age» from 1980 to 2009 as in this period the dependency ratio was halved (see Graph 2). However, as the population ages, this ratio has once again started to increase since 2011. The 20 to 60-year-old age bracket which increased by an average of 1.5% per year in the 2000s, increased by only 0.4% in 2012 and is likely to stabilise by 2015 before dropping between 2015 and 2020, according to projections by the World Bank. The working age population is no longer increasing, which accounts for half of the slowdown in activity observed in 2012 and 2013.

2 - Chinese demography

Source: World Bank
In view of past experiences of convergence, the recovery appears to be running out of steam.

The decade from 2000 was marked by a very dynamic recovery in the Chinese economy, a recovery that was both technological, with sustained productivity gains, and capitalist, with a very high investment rate, especially in capital goods. In 15 years, GDP per capita in China increased four-fold (from about $2,500* in 1998 to more than $10,000* in 2013). This convergence phase was both longer and more intense than similar phases observed in other Asian countries (Japan in the 1970s, Korea in the 1980s, see Box 1).

Based on observations of growth in 128 countries since 1950, Eichengreen, Park and Shin (2011) estimate that the slowdown in economies in a catch-up phase (which they put at about 3.5 annual growth points on average) occurs when GDP per capita reaches about $17,000*, a level that China will probably not reach until 2018. However, Melkin and Spiegel (2012) apply the same methodology to a scope limited only to countries in Asia and conclude that the threshold at which the regime changes is lower in this region of the world, at around $10,000*, a level that China exceeded in 2013. And more particularly, by using regional data they show that the slowdown has already taken hold in the richest regions (Beijing and Shanghai) and thus forecast a fairly gradual slowdown in global growth.

As well as what has been learned from previous experiences in neighbouring countries, several indices seem to suggest that the dynamics of China’s recovery are running down: first, capital has been skewed for the last 3 years in favour of property assets while investment in capital goods is merely marking time; second, cost competitiveness is being eroded with the increase in wages.

* 2005 dollars in purchasing power parity

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**Box 1 - The catch-up cycle in China compared with that of its neighbours**

**Strong growth for the last 30 years**

Chinese GDP grew by 10% per year on average between 1980 and 2010. This strong economic growth over a long period (30 years) is indeed exceptional both in its scale and duration (Aizenman and Spiegel (2010) maintain that rapid catch-up phases do not generally last longer than 10 years), and it can be compared with that observed in other Asian countries such as Korea between 1963 and 1992 (8.4%), Singapore between 1966 and 1995 (9.1%), Thailand between 1966 and 1995 (7.7%), and even Japan between 1956 and 1995 (6.7%). As described by Eichengreen, Park and Shin (2011), once this recovery period was over, growth in these countries slowed by about 3.5 percentage points per year.

**1 - Investment rate from take-off point in several Asian countries**

How to read this chart: for each country, the year in brackets corresponds to the first point on the graph. Sources: National Statistical Institutes.
**Investment rate is slightly higher in China**

An important feature of the Chinese recovery is its very high investment rate, of around 46% of GDP. This «imbalance» in domestic demand in China, which is to the detriment of consumption, and reflects the overabundance of savings by households which, when combined with restrictions on the movement of capital, facilitates the funding of investment projects that are relatively weak in production. Nevertheless, the existence of overinvestment has been debated: while Bai, Hsieh and Qian (2006) believe that the return on capital is comparable with that in other countries from business data, Ding, Guariglia and Knight (2010) conclude that there is overinvestment. Similarly, by comparing China’s trajectory with that of other Asian countries, Lee, Syed and Xueyan (2012) consider that overinvestment is around 10 GDP points.

The proportion of investment in China has reached a considerably higher level than that recorded in Japan during the catch-up phase, and which is comparable to levels achieved before the turning point in Thailand, Korea or Singapore (see Graph 1). In each of these examples, the investment rate held this level for less than 5 years before falling back, fairly sharply, and settling 5 to 10 points lower. During the period when the investment rate was declining, activity was significantly affected, falling back in 1974 in Japan, in Thailand and Korea in 1998 and in Singapore in 1985.

**Skew towards construction foreshadowed the change in regime in South Korea and Singapore**

At the beginning of the 1980s in Singapore and at the beginning of the 1990s in Korea, investment in construction was out of control while investment in capital goods stagnated against a backdrop of accelerated activity (see Graphs 2a and 2b). In both cases, this rapid rise in the investment rate in construction preceded the beginning of the slowdown identified in both countries by Eichengreen et al. (2011). The sharp rise recorded in construction investment in China since 2009 may therefore represent a prelude to a phase of pronounced slowdown and continued productivity.
Slowdown in China: what risks for the world economy?

3 - Investment in China

in % of GDP

Investment in fixed assets – Building and structures ←
Investment in fixed assets – Equipment goods ←
Value added in construction →

Source: National Bureau of Statistics

4 - Imports of machine tools

value – $ Currents – year on year moving average over 3 months

Source: Douanes chinoises

5 - Annual average growth rate of wage per capita in China

in %

Whole economy
Manufacturing industry

Source: National Bureau of Statistics
Capital skewed towards property assets

Yet even when demographic factors are taken into account, fewer productivity gains have been observed since 2007. This slowdown is attributable in part to the distortion of the structure of capital in favour of property assets, which are less productive than capital goods. While acquisitions of property assets and capital goods evolved at similar rates in 1981 and 2007, the acquisition of property has increased much more quickly since then (see Graph 3). According to customs data, this relatively sluggish investment in capital goods is confirmed, particularly for machine tools (see Graph 4). Overall, the share of industry in value added, which increased at a regular rate until 2006, fell back between 2007 and 2013, from 42% to 37%. Conversely, the share of construction increased over the period.

Cost competitiveness is deteriorating

This slowdown in productivity in a context of sustained wage rises (see Graph 5), especially in the manufacturing industry, has damaged cost competitiveness. These wage rises are surprising as they were implemented even though the processes of job reallocation between sectors, especially from agriculture to industry, did not appear to be complete: the proportion of the rural population continued to decline rapidly in 2013 and according to Das and N'Diaye (2013), the «Lewis turning point», i.e. the moment when the supply of labour from the agricultural sector runs out, would not be reached until 2020 or 2025. Be that as it may, since 2008, the real effective exchange rate of the Chinese yuan has appreciated by almost 30%. At present, the export performance of the Chinese economy has been only slightly affected by this phenomenon: market shares have certainly experienced a slowdown, especially in the United States and Europe, but they continue to gain ground at world level. Indeed, export prices remain stable as wage rises have been passed on in their entirety through the drop in profit margins: while the share of the payroll in value added in industry was stable at around 38% between 2000 and 2008, it climbed to 48% in 2012.

The rate of increase in energy consumption is not sustainable

Growth in China has resulted in an almost equivalent rise in the consumption of commodities. On average, oil consumption has increased by 7% per year for the last 14 years and that of coal by 6% per year. China’s share in world consumption has therefore doubled over this period to reach 12% for oil and 50% for coal. Forecasts for world production indicate that a rise on this scale is not sustainable in the future given China’s position in global consumption. Pollution too has increased tremendously over this period, with China the largest source of greenhouse gas emissions (27% of total worldwide) in 2012. Air quality too has seriously deteriorated in Chinese cities: according to the United States Embassy, more than 21% of the hourly readings taken in 2013 in Beijing exceeded the threshold of 150 µg/m3 of fine particles (PM 2.5).

(1) The WHO recommends that levels should not exceed 10 µg/m3 on average over the year and 25 µg/m3 on average over 24 hours.
The consequences for the global economy of the slowdown in China are mainly coming through trade channels

**Chinese imports have slowed**

The slowdown in activity in China has resulted in a curbing of final demand and imports have slowed significantly. The increase in imports of goods in dollars was 4.3% in 2012 and 7.3% in 2013 against an average increase of 23% per year between 1998 and 2008. Of China’s main economic partners, imports from the European Union and Japan have suffered most as a result of this slowdown. The territorial dispute over the Senkaku/Diaoyu islands resulted in a very large drop in imports from Japan (-6.9% in 2012 and -9.4% in 2013). Imports from the European Union were up only very slightly (+2.2% in 2012 and +3.4% in 2013), due to the reduction in imports of machinery (see Graph 4).

Imports from France slowed first to +9.4% in 2012 and in 2013 they even dropped by 5.4% against an average annual increase of 16% between 1998 and 2011. However, the direct effect was limited, as exports to China account for only 3.2% of French exports overall. When the knock-on effects of the various Asian stimulus plans in 2009 are taken into account, i.e. the indirect effects of the shock on domestic demand in the Asian countries excluding Japan, Lalanne and Mauro (2010), using elasticities from “Mesange” Model, conclude that a 10% rise in domestic demand in Asia, excluding Japan, caused a 0.7-point increase in French GDP (0.3 points as a direct effect). By estimating that China represents about half of domestic demand in Asia excluding Japan, these results suggest that the slowdown in growth in China of around 3 points “costs” about 0.1 points of annual growth in France. The impact is broadly comparable for Germany, the United States and Canada. In contrast, Australia and Japan are about three times more affected than France by a Chinese slowdown.

(2) French customs estimate that exports to China shrank by -0.4% in 2012 and increased by 5.3% in 2013. The average increase from 1998 to 2011 is exactly the same.

**6 - Share of imports in the Chinese GDP**

Sources: National Bureau of Statistics, INSEE calculations
Slowdown in China: what risks for the world economy?

Deceptive drop in the degree of openness of the economy

The effect of the present slowdown on imports has been magnified because the process of opening up the Chinese economy has halted. When expressed in value terms, imports of goods and services represented only 24% of Chinese GDP in 2013 against almost 32% in 2005 (see Graph 6). This drop is much more marked for imports of manufactured products (goods excluding raw materials and food) of which the share has fallen back from 23% to 13%, a similar level to that of 1999, before the country became a member of the WTO. The scale of this drop can be explained to a large extent by the appreciation of the yuan since 2005 (25% against the dollar from 2005 to 2013), but, even in volume, the degree of openness, calculated as the ratio of imports to GDP, has stagnated since 2010 to reach a level that is barely higher than the pre-crisis level, whereas it had increased steadily between 1998 and 2008.

The decline in the degree of Chinese openness does not necessarily mean that the import content of domestic demand is decreasing. The «bazaar economy» model, to use the expression coined by the director-general of the German institute for economic research, IFO (Sinn, 2006), reached its peak in the middle of the 2000s in China. The import content of exports increased on a regular basis from 1997 culminating at around 45% in 2005 (see Koopman, Wang and Wei (2008)) while that of investment reached 22% and household consumption 12%. Indeed, customs duties are reduced for the processing trade, i.e. for imported components which are assembled in China, then re-exported. From 2005, the share of processing trade imports and exports in total trade nevertheless started to decline (see Graph 7). In 2013, only 22.5% of imports were of the processing type compared with 37.4% in 2004. The decline in the degree of openness can therefore be interpreted in part as a drop in the import content of exports, whereas the import content of domestic demand is increasing slowly. This was the result obtained by Roucher and Sicsic (2013), from the latest Chinese input-output tables available at that time (2007): between 2005 and 2007, the import content of consumption and investment remained stable while the import content of exports had already plummeted by 6 points.

7 - Share of processing trade in the Chinese trade

Source : National Bureau of Statistics

(3) There are no national accounts by volume for China. The calculation of imports and exports by volume is from Roucher and Sicsic (2013) and should be interpreted with caution. Nevertheless, these values are consistent with estimates given by the IMF and the OECD.

(4) In February 2014, the National Bureau of Statistics of China published new tables for 2010.
Modelling confirms that there has been no interruption in the trend towards openness underlying the Chinese economy.

On the basis of this observation, an import model was constructed using an error-correction equation as a function of domestic demand by volume (calculated according to the balance between changes in GDP on the one hand and changes in imports and exports on the other) and processing trade exports. A trend towards openness of the economy was added. The model was estimated from Q1 1997 to Q4 2007 in one stage, using the procedure suggested by Ericsson and MacKinnon (2002) for small samples. The results were as follows:

\[
\Delta M = -0.13 - 0.50(M_{t-1} - 0.63X_{t-1}^{\text{proc}} - 0.37DI_{t-1} - 0.8\text{Trend}_{t-1}) + 0.51X_t
\]

\[-(-3.8) (3.2)\]

* Ericsson MacKinnon value test at 5%: 3.7

where, expressed in logarithms:

\(M\) = total imports

\(X\) = total exports

\(X^{\text{proc}}\) = processing trade exports

\(DI\) = domestic demand

Trend is a linear trend

The sum of the coefficients of processing trade exports and domestic demand in the long term equation is limited to 1. Exports excluding processing trade were taken out of the equation because the estimated coefficient would have been too close to zero.

The estimated openness trend is in the order of 0.8 points per quarter, which is scarcely more than the values obtained by Borey and Quille (2013) for European economies. The weakness of this trend may be surprising, but it nevertheless proves that the rise in the degree of openness recorded for the estimate period is almost entirely attributable to processing trade exports. Thus since 2007, imports simulated using this equation are not based on observed imports (see Graph 8) and they take account of the slowdown in Chinese imports not by a break in the trend towards openness in domestic demand (which does exist but which remains weak) but by the gradual decrease in assembly activity in the Chinese economy.

(5) Quarterly volume series are constructed using the method put forward by Roucher and Sicic (2013).

(6) There are no processing trade series by volume. The share of processing trade exports in the total by value is used to estimate processing trade exports by volume.

(7) This is a dynamic simulation: at each period, the equation is brought into play by allocating imports simulated by the equation to the preceding quarters and not to observed imports.

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**8 - Real and simulated import**

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Sources: National Bureau of Statistics, INSEE calculations.
The estimated long-term elasticity of imports to domestic demand is low (in the order of 0.4 points), with the result that, if we assume that the weakening trend in processing trade continues, China’s contribution to any variation in world trade in the years to come would be substantially less than the average in the 2000s.

**At the same time, the deterioration in cost competitiveness is due to services and the contraction in processing trade**

The slowdown in imports has not produced an improvement in China’s external balance. After reaching a peak at around $300 billion in 2008, trade surpluses in goods and services have hovered around $120 billion per year since 2010 (see Graph 9).

An item by item analysis identifies trends in how competitiveness has changed in China. The trade balance, excluding processing trade, was balanced overall until 2009, but deteriorated dramatically when stimulus plans were put in place and has remained very much in deficit since then. The improvement observed in 2012 and 2013 was linked mainly with the boom in exports to Hong Kong but which did not appear to be a real trade flow (see Box 2). After correcting for this effect, the deficit is around $200 billion. The trade balance for processing trade improved constantly until mid-2011 (apart from the few quarters of the crisis). Since then it has fallen back, providing confirmation of the idea put forward by Masson, Tianhe and Urban (2013) of a very gradual shifting of low value-added industries (toys, textiles) into other Asian countries (Indonesia, Vietnam, etc.).

Finally, the balance of trade in services has deteriorated substantially over the last two years, mainly due to activities related to transport and tourism. Across 2013, the deficit settled at $125 billion compared with $30 billion in 2009. France recorded a surplus of $3.9 billion in trade in services with China in 2013 compared with $0.8 billion in 2009.

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**The trade surplus fell...**

**... affected by stimulus plans and the change in the economic model...**

**... and also because of a deterioration in the balance of services.**

---

**9 - Foreign trade balance**

平衡货物和服务贸易平衡

平衡加工贸易

货物和服务贸易余额

服务贸易余额

Source: National Bureau of Statistics
Data are reliable overall...
The reliability of data produced by the Chinese statistics system is regularly called into question. Studies generally conclude that on the whole trends are shown correctly (see Holz (2005, 2013), Chow (2006), Klein and Özmucur (2002)) although the decentralised data collection system and the lack of separation between data collection and the local authorities accounts for a certain number of inconsistencies (see Koch-Weser (2013), Koech and Wang (2012)). Of all the data produced, the external trade in goods data appear to be most robust as they were collected directly by the customs authorities that levy the duties. In addition, it is easy to verify their quality as these data can be compared with the «mirror» trade flows recorded by the customs authorities of trading partners. For most of China’s major economic partner zones (Australia, Japan, Korea, Taiwan, European Union), variations and levels are similar, proof that these data are robust. The correlation is less marked in bilateral trade with the United States and it is very much less so concerning trade with Hong Kong, especially for the recent period.

... except in bilateral trade with Hong Kong
Trade with Hong Kong appears very differently according to Hong Kong customs and Chinese customs, for whom it is much more dynamic. In particular, exports to Hong Kong soared from mid-2012, as Chinese exporters tried to bypass the restrictions on movement of capital by overcharging their Hong Kong affiliates in order to repatriate funds into China. The Chinese authorities have apparently strengthened their inspections in order to restrict this practice and sales to Hong Kong plummeted 11.5% in the first quarter of 2014. At the beginning of 2013, Hong Kong became China’s top client, ahead of the European Union and the United States, accounting for more than 20% of the total for about $106 billion of exports in one quarter, whereas the Hong Kong customs recorded only $56 billion of imports from China. Hong Kong seems to be the only country for which there is such a discrepancy. Using data from the IMF (Direction of Trade Statistics), we compared Chinese exports in the world total with imports from China in the world total (see Graph). As well as some differences in levels, the graphs are not perfectly parallel, especially for the recent period when market shares increased rapidly according to Chinese customs, whereas the «mirror» flows show a clear slowdown. The only explanation for this difference seems to be in bilateral trade with Hong Kong. By correcting Chinese exports from trade with Hong Kong alone (using the «mirror» values rather than the Chinese statistics), China’s share in global exports seems to be perfectly consistent with the share of imports from China. ■
The fragile nature of the financial system could accentuate the slowdown in the medium term

The beginning of 2014 was marked by some very high-profile cases of credit default in trust companies (issued by investment funds, trust companies) which in some respects were a reminder of the triggering of the subprime crisis in the United States. Indeed, the recent expansion of shadow banking raised fears of a possible subprime financial crisis in China, which in the medium term would harm growth prospects. Although there is probably only a very small risk that this rise in shadow banking will degenerate into a financial crisis, nevertheless the general weakening of Chinese banks since 2009 and of their ability to fund the economy could heighten the risk of an increase in the medium term of the slowdown that we see today.

There is no major risk to the Chinese economy from the substantial growth in shadow banking and especially not to global activity

According to the European Commission’s definition (2012), shadow banking is «a system of credit intermediation that involves entities and activities outside the regular banking system». In China, it can be divided into two parts: first are the unregulated or poorly regulated family or local credit businesses, and second are new regulated bodies that can provide credit but which are not banks.

Two categories of «shadow banking»

The first category of shadow banking, through informal tontine investment or small local credit companies, has grown in parallel and fulfils an important role in funding the private sector since small and medium-sized businesses have very little access to credit from banks. Interest rates (these are very high, at around 20% per year on average), and analysis and risk control are very different from those in the banking system. Outstanding loans in this category are estimated at between 6% and 13% of GDP according to different sources (see IMF (2012), Artus and Xu (2013)). As there is little interaction between this sector and the banking system, this means that it is relatively autonomous. As a result, the systemic risk to China’s banking system is very small, even virtually non-existent.

Parallel financing is an ancient and stable phenomenon...

The second category of shadow banking, on the other hand, has expanded only recently. One reason for this is recent monetary tightening and another is that stricter and stricter banking standards are being put in place. This category consists mainly of investment trusts and the number of loans has increased significantly from 2012 (see Graph 10). The banks work very closely with these trusts, transferring credit into them from their balance sheet, to achieve higher interest rates. In contrast to credits, these funds provide wealth management products (WMP) which are sold by the banks to investors, who may be households attracted by the high yields.

... whereas growth in «off-balance-sheet» has been spectacular

As a result of this transformation, there is a liquidity risk due to the maturity mismatch between the WMP terms, which are very short (most mature after 6 months or less), and those of assets to offset the WMPs, i.e. loans that have been made. The default risk with these loans can be high since these are borrowers who have been refused by the banks themselves. According to the China Trustee Association, investment trusts invest mainly in infrastructure projects (25%), which rarely show immediate profit, and industrial and commercial firms (28%), which may have to face production overcapacity and/or project procyclicality. As a result, credit risk may affect capital repayment and interest on the WMPs that investors have taken out. The close interlinking between the banks and the investment trusts is a clear indication of the existence of systemic risk. In addition, measuring the dilution of risk via this securitisation of loans provided by the investment trusts is probably fragile.
This arrangement is often compared to the American subprimes since the structuring of the credit is somewhat questionable. However, there are two differences between the two:

- in China, structured products are not allowed, whereas in the United States products could be structured several times, hence the loss of traceability of credit risk;
- the main agents involved in marketing these WMPs are commercial banks, which are public (see Table); if there were a severe risk to the Chinese banking system, it is difficult to believe that the Chinese state would not intervene;
- Chinese banks have a very limited impact at global level as their activities tend to be domestic and capital flows between China and the rest of the world are still relatively small because of capital controls (thus the bankruptcy of an important Chinese player would not at the present time have the same effect on the global financial system as did that of Lehman Brothers in September 2008);
- lastly, the amount of credit provided by the trust funds is still relatively small, despite their rapid growth; at the end of 2013, outstanding credit from these funds represented only 9.4% of Chinese GDP, and the nominal value of WMPs was 17.4%, whereas bank credit has reached 130% of GDP; even in the event of systemic risk, the strong presence of the State and its financing capacity (currency reserves stood at $3,821 billion at the end of 2013 or 41% of GDP) should be able to maintain the stability of the financial system (see Box 3).
Steep rise in bank debt since 2009...

The post-Lehman period has been marked by major monetary expansion in China through the country’s economic stimulus plan. Growth has thus become even more dependent on investment and debt. The credit-to-GDP ratio has increased from 110% before the crisis to 130% today (see Graph 11). The monetary environment, which is highly favourable both in terms of liquidities and interest rates, has made it possible to allocate massive amounts of credit to sectors benefitting from the stimulus plan, such as some heavy industries in production overcapacity, the commodities sector or even property. With the economic slowdown, credit risk increases, as in some cases credit has been given to projects where profit potential is doubtful.

11 - Total bank loans

in % of GDP

Source: People’s Bank of China

Slowdown in China: what risks for the world economy?

Box 3 - How were credit default cases settled at the beginning of 2014?

The first case involved the ICBC bank and the China Credit Trust Co. This was a WMP (Credit Equals Gold No. 1) of which the main component was a loan to a coal company, Shanxi Zhenfu Energy Group, in 2010 even though this company was already very much in debt and the owner had been arrested in 2012 for corruption. The ICBC bank sold the WMP and the China Credit Trust Co issued the loan. As the creditor had defaulted, the WMP - with a principal of 3 billion yuan ($495 million) - also ran the risk of defaulting before term in January 2014. A third body, whose identity remains unknown, bought out these assets and thus default was avoided at the very last moment.

The second case in the year (Shanxi Liansheng Resources Co.) concerned a network of fairly complex links in a shadow banking system financing over-indebted sectors: Liansheng is a coal company with very sizeable debts (28 billion yuan, of which 4.5 billion was generated by 6 trust companies). After payment difficulties with one of these fiduciary loans (Jilin Province Trust) this led to problems with a WMP (Songhua River No. 77 with 289 million yuan outstanding) sold by the China Construction Bank (one of the four largest Chinese banks). As one of the other major creditors, the China Development Bank alone owns 4.5 billion yuan. This is one of China’s policy banks and had apparently restructured Liansheng debts, as the largest creditor.

The third case is a default that has not been the subject of a rescue package. This is a default on the interest of a bond issued by Shanghai Chaori Solar Energy. This first default on the bond market of continental China was for a small amount, and did not in itself present any systemic risk, but it seems to have been used as a warning to investors, to limit any future moral hazard phenomena.

(1) The policy banks, created in 1994, are responsible for financing the economy in accordance with the aims of the State.
Nonperforming loans have been increasing at a rate of 20% per year since 2013 and unrecoverable loans have risen sharply since Q2 2013 (see Graph 12). There is therefore an undeniable deterioration in bank credit quality, with the rise of the proportion of nonperforming loans since 2012.

Chinese banks are caught in a vice-grip between increased credit risk and their «duty» to continue to fund economic growth. On the one hand the transition of China’s growth model suggests a slowdown in the construction sector and associated industries, especially steel and cement which are already in production overcapacity. The increased credit risk in these indebted sectors is structural and costly for the banks. On the other hand, maintaining economic growth and developing new sectors favourable to the transition from the growth model requires financial resources. Given the need to regulate shadow banking and the absence of any mature financial markets, bank loans remain one of the preferred methods of funding, in the eyes of the Chinese authorities.

Meanwhile, liberalising current interest rates has the effect of reducing the interest rate margins which, thanks to the implementation of regulations concerning a ceiling on deposit rates and a lending rate floor, was a major source of banking income.

Paradoxically, the Chinese private sector is having difficulties finding funding: this situation is due to the eviction effect associated with priority being given to public or semi-public projects and inadequate levels of skills in the banks in terms of assessing credit risk (see Ding, Guariglia and Knight (2010)). Despite changes underway, bank loans still predominantly finance the public and semi-public sector. In the short term, there should not be any significant change and private enterprises (which are often smaller in size) will continue to experience difficulties in obtaining bank funding even though the aims behind rebalancing the growth model require the private sector to be more developed.

In addition, the sharp fall in recent property transactions, and the first indications of a drop in property prices (see Emerging Economies note) could exacerbate the situation for the banks. As properties are currently used as collateral for loans, a decrease in property prices would increase the risk of credit losses and would result in Chinese banks becoming even more fragile.
In addition, weak signals are increasing in real estate (see “Emerging Economies” note), which may worsen the situation of banks. Existing dwellings sales decreased sharply and prices start to adjust. New dwellings sales and housing starts have collapsed since the beginning of the year (respectively -24.5% and -8.6% yoy from January to April, see Graph 13) while stocks of houses for sale increased sharply (+23.9%). As properties are commonly used as collateral for a loan, decreasing real estate valuations increases the risk of losses on loans and weakens a little more Chinese banks.

Conclusion

The Chinese economy has slowed substantially since the beginning of 2012 and this long-term slowdown, by about 3 percentage points of annual growth, results from the loss of momentum in the dynamics of the recovery process. The effect on imports, and hence on China’s contribution to the slowdown in world trade, has been amplified by the fall in the country’s degree of openness as a result of the reduction in processing trade activity in the economy. On the other hand, the upward trend in the import content in domestic demand does not seem to have been harmed.

In the medium term, two factors could be accentuating the Chinese slowdown: first, the construction sector, which has boosted activity since 2009, clearly seems to be experiencing a reversal. Second, there has been a rapid development in shadow banking and the Chinese banking system shows signs of real fragility. The scale of the accumulated currency reserves means that China could contain any sizeable financial crisis, but if credit dries up this could amplify the slowdown in current activity which, even without financially contaminating the rest of the world, could have a marked effect on world trade. In the years to come, even if market share has risen for 10 years, China’s contribution to world demand for French products, could be substantially less than its average levels between 2000 and 2010. However, the ongoing rebalancing of imports from processing trade to consumer goods and services could lead a stabilisation of France’s market share in China.
Slowdown in China: what risks for the world economy?

Bibliography


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In Q1 2014, activity stagnated whereas we had expected a slight progression (+0.1%) in the Conjoncture in France of March 2014. Foreign trade contributed negatively to growth (-0.2 points) whereas we had forecast a zero contribution. Exports slowed down more than expected (+0.3% against +0.9% forecast, after +1.6%). Furthermore, domestic demand excluding inventory fell back more than expected (a contribution of -0.4 points against -0.2 points forecast) but restocking was more substantial than expected (a contribution of +0.6 points against +0.3 points forecast).

Paid employment in the non-agricultural market sector fell back (-22,000 jobs), whereas we had expected a slight rise (+6,000 forecast). Headline inflation at the end of Q1 2014 stood at +0.6%, against +0.7% forecast.

For Q2 2014, our growth forecast remains unchanged (+0.3%). Paid employment in the non-agricultural market sector should be stable (against +6,000 forecast in March), and inflation in mid-2014 should be lower (+0.5% against +0.9%).

Activity stagnated in Q1 2014, whereas we had predicted a slight rise

In Q1 2014, GDP stagnated, after progressing by 0.2% in the previous quarter, whereas we had expected a slight increase (+0.1%). This small error is found in total production (+0.2% against +0.3% forecast), particularly of market services (+0.3% against +0.4% forecast). In addition, production in the construction industry fell much more sharply than we had expected (-1.5% against -0.7% forecast). Investment in construction fell back by 1.8% in Q1 2014 whereas we had predicted -0.9%.

Production was as dynamic as expected in the manufacturing industry (+1.0% against +0.9% forecast) and more dynamic than expected in non-market services (+0.5% against +0.2% forecast). Furthermore, activity in the ‘energy-water-waste’ branch declined sharply, as expected (-1.4% against -1.5% forecast) and production of trade services progressed by 0.1%, as we expected.

Final domestic demand excluding inventory slipped back more than forecast

Final domestic demand excluding inventory fell, as expected. But this decline was more marked than forecast. On the one hand, consumption fell back more than forecast (-0.5% against -0.3% expected), particularly that of manufactured products (-0.7% against -0.5%) after strong growth in Q4 2013 (+0.9%). On the other hand, total investment declined somewhat more sharply than we expected (-0.9% against -0.5%) across all institutional sectors. Investment in construction explains significant share of this differential. All the same, it should be emphasised that a change in the base led...
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to a revision of the quarterly profile of this type of investment over the recent period (see Focus, “Quarterly accounts switch to the 2010 base”).

**Slowdown in exports more marked than expected**

In Q1 2014, exports slowed down markedly (+0.3% after +1.6%). Manufacturing exports progressed by only 0.4% whereas we had expected an increase of 1.1%, after +1.8% in Q4 2013. Moreover, exports of agricultural products fell back sharply (-2.8%) whereas we had expected a rise (+2.0%). Our March forecast had banked on a perceptible progression in demand for French products in Q1 (+1.2%), but this did not occur (0.0%). In particular, exports to countries outside the European Union shrank. The error in the imports forecast was, however, much smaller (+1.0% against +0.8% expected). All in all, the accounting contribution of foreign trade to GDP variation was therefore negative (-0.2 points), whereas we had expected it to be neutral. Lastly, the contribution of inventory change was considerably bigger than forecast, at +0.6 points against +0.3 points expected.

**Surprising fall in temporary work**

Paid employment fell back slightly, contrary to what we expected in March (net loss of 22,000 jobs in the non-agricultural market sector, against +6,000 jobs forecast). This discrepancy is mainly due to the fact that temporary work fell back by 26,000 jobs, cancelling out the progression of the previous quarter, whereas we had predicted a slight rise. Lastly, headline inflation at the end of Q1 2014 was lower by 0.1 points than our forecast (+0.6% against +0.7% expected). Core inflation settled at +0.4%, against +0.5% expected. This difference is attributable in particular to the prices of catering and accommodation services, which rose less than forecast in March. In Q1, the unemployment rate stabilised as expected. It stands at 9.7% in Metropolitan France.

**Our growth forecast for Q2 is unchanged**

Our GDP growth forecast for Q2 2014 is unchanged (+0.3%). According to the business tendency surveys and available activity data, manufacturing production should be slightly more dynamic than forecast in March (+0.4% against +0.3% previously). For domestic demand the forecast changes only slightly. Household consumption should progress by 0.5% (against +0.6% forecast in March) and investment slip back by 0.1% (against -0.3% forecast in March). However, contrary to what we predicted in March, the sharpness of the fall in household investment should start decreasing already in Q2 (-1.5% after -2.6%). The contribution of foreign trade should be slightly positive, whereas we had expected a zero contribution in March. Indeed, imports should be less dynamic (+0.2% against +0.8% previously) while our exports forecast is unchanged (+0.8%). Paid employment should be stable in Q2 in the non-agricultural market sector, against an increase of 6,000 in our March prediction. Lastly, inflation at the end of Q2 2014 should be lower than forecast in March (+0.5% against +0.9% expected), as should core inflation (+0.2% against +0.6%).
In Q1 2014, production of goods and services increased slightly once again (+0.2%, as in Q4 2013) and GDP stabilised (after +0.2%). Activity in the manufacturing industry rebounded (+1.0% after 0.0%). Production in market services progressed again (+0.3% after +0.3%). But activity in construction fell back sharply (-1.5% after -0.3%).

In May, the business climate is stable in France for the ninth consecutive month and remains below its long-term level. From this point, activity should progress moderately in the spring and then in H2: overall production of goods and services should progress by 0.4% in Q2 and then by 0.3% per quarter in H2, which would drive annual growth to +1.0% in 2014, after +0.5% in 2013.

Production of goods and services should continue to increase moderately between now and the end of the year

In Q1 2014, production of goods and services continued its slow progression (+0.2%, as in Q4 2013). The French business climate indicator, derived from business tendency surveys carried out on business leaders, shows no signs of improvement: in May, for the ninth consecutive month, it fluctuated between 94 and 95 points and remained below its long-term average. To varying degrees, this is also the case of the business climate indicator in each sector (see Graph 1). These surveys do not suggest any short-term acceleration: production of goods and services should continue its moderate progression, from +0.4% in Q2 and then +0.3% per quarter (see Graph 2). On average for the year, production of goods and services should accelerate slightly, increasing by 1.0% in 2014 after +0.5% in 2013.

Manufacturing production set to slow down in H2

Manufacturing production picked up in Q1 2014 (+1.0%), taking advantage of an upswing in activity in the coking and refining branch (+8.5%) after two quarters of sharp decline (-9.0% in Q3 and then -8.2% in Q4) due to the temporary closure of refineries for maintenance and then industrial action. Activity accelerated slightly in the agri-food industries (+0.4% after +0.2%), in the transport equipment sector (+0.3% after +0.1%) and in “other industries” (+0.9% after +0.8%). Conversely, production of capital goods fell back sharply (-1.6% after +1.3%). In Q1 2014, the production rebound is to be found in the positive contribution of inventory of manufactured products, whereas all other components of demand contributed negatively.

In Q2 2014, the business climate in industry remains close to its long-term average: industrialists consider their order book levels as still low and their production prospects deteriorated, but they believe their past activity has progressed (see Graph 3). So the moderate recovery in
domestic and external demand for manufactured products should allow only a slight progression in production in the manufacturing branches (+0.4%). In H2, the deterioration in expectations expressed by industrialists suggests another slowdown in manufacturing production (+0.1% per quarter). This sluggishness would be consistent with that of demand in manufactured products. For 2014 as a whole, manufacturing production is expected to progress by 1.2%, after -0.6% in 2013.

In construction, the decline in activity should ease

In Q1 2014, construction activity continued to deteriorate: -1.5%, after -0.3% in Q4 2013. This decline is perceptible both in building and in civil engineering.

At the beginning of the year, housing starts for new homes continued to fall, but the number of building permits seemed to have stopped falling back. In May, building contractors reported a deterioration in activity and order books that were still less full than usual (see Graph 4). In civil engineering, entrepreneurs’ opinions on expected activity also worsened again in April. These different indicators point to a continued decline in production in the construction industry in Q2 (-0.7%) and Q3 (-0.6%), before it stabilises in Q4.

For 2014 as a whole, production in the construction industry is expected to fall by 2.6%, after a decline of 1.2% in 2013.

Trade should rebound in the spring and then progress moderately

Trade slowed in Q1 2014 (+0.1% after +0.9% in Q4 2013), attributable in particular to the decline in household consumption (-0.5% after +0.2%).

According to business leaders surveyed in May, past activity remained sluggish overall. In both wholesale and retail, the business climate remains stable, slightly below its average level. However, the prospects for wholesale activity are slightly improved. Likewise, according to automobile dealers, their activity should progress during the coming months, as indicated by the healthy state of order intentions, with the balance returning to the level of late 2010.

These improvements, attributable to the catch-up effect of household consumption of manufactured products in Q2 (+0.6% after -0.7%), suggest a rebound in trade which should increase by 0.5% in Q2. In H2, it is expected to grow more moderately (+0.2% per quarter), giving an increase of +1.7% for the year.

Market services excluding trade should grow moderately between now and the end of 2014

In Q1 2014, activity in market services excluding trade progressed (+0.3%). Activity rebounded in catering and accommodation (+0.5% after -0.4%) and in transport services (+0.2% after -0.3%). It remained dynamic in information and communication (+0.8% after +0.7%), as well as in financial activities (+0.5%) and real estate (+0.3%). However, production stagnated in services to enterprises (after +0.5%).

Activity in market services excluding trade should continue to progress moderately through to the end of 2014 (+0.4% per quarter), well below its long-term average (+0.7% per quarter between 1988 and 2013). According to business leaders, the short-term outlook in services remained gloomy in recent months: the improvement that began in H2 2013 was halted in early 2014 and the composite business climate indicator settled at 90 in May, well below its long-term average (100).

For 2014 as a whole, production of market services excluding trade is expected to grow by 1.4%, after +1.0% in 2013.
2 - Sector contributions to growth in total production

3 - Opinion on production in manufacturing industry

4 - Prospects for activity in construction

Source: INSEE
In mainly non-market services, activity should gradually slow.

In mainly non-market services, activity increased slightly in Q1 2014 (+0.5%, after +0.4% in Q4 2013). Activity should slow gradually over the rest of the year (+0.3% in Q2, then +0.2% per quarter in H2).

All in all, production in this branch is expected to increase by 1.4% in 2014, after +1.5% in 2013.

Energy production set to rebound in the spring.

Production of energy-water-waste fell back in Q1 (-1.4%), for the third consecutive quarter, due to an unseasonably mild winter. It should rebound in the spring (+2.1%) and remain dynamic in Q3 (+2.1%), assuming in particular a return to normal heating expenditure. On average for the year, energy production is expected to decline by 0.7% in 2014, after +1.2% in 2013.
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France’s International Environment

In Q1 2014, economic activity slowed in the advanced economies (+0.3% after +0.5%), more substantially than was predicted in the Conjoncture in France report published in March 2014 (+0.5%), and international trade shrank, most notably in Asia. Activity saw a marked slowdown in the United States due to the effects of adverse weather conditions and unexpectedly weak levels of investment. Nonetheless, the results of the business tendency surveys, which saw a significant upturn in summer 2013, remained strong in May 2014. Activity should thus regain momentum by the end of the year, with growth of 0.4% in Q2 followed by 0.5% per quarter in the second half of the year.

In the emerging economies activity slowed once again in Q1, particularly in China and Russia. Despite calmer conditions on the financial markets, the business outlook was still poor in May: past monetary pressures should continue to weigh heavily on activity.

The ECB confronted with the risk of deflation

The central banks in the advanced economies have limited room for manoeuvre, their base rates currently standing at the lowest possible level. For the past three years, they have been using non-standard measures to further ease their monetary policies. Nonetheless, the Fed has slowed down its securities purchasing scheme and should continue to reduce these purchases by $10 billion per month until the end of the year. Furthermore, the rapid fall in unemployment has prompted the British and American central banks to bring forward their planned tightening of monetary policy, although the Fed has issued assurances that interest rates will remain at their current level until at least early next year.

On the other hand, the Eurozone saw high unemployment and low inflation (+0.5%) in May, compared with +1.9% in the USA. The gap should remain greater than one point throughout the rest of the year (see Graph 1). In an attempt to stave off the risk of deflation and bolster activity, the European Central Bank (ECB) once again cut its base rate in early June and announced further non-standard measures. However, the central bank’s balance sheet has been substantially reduced, as the banks have already paid back half of the loans issued as part of the refinancing operations conducted in late 2011 and early 2012.

Fiscal consolidation efforts should slow down on both sides of the Atlantic

In the United States, the general direction of budgetary policy was decidedly restrictive in 2013: taxes increased sharply and government spending contracted rapidly. The public deficit was thus cut from 9.3% of GDP in 2012 to 6.4% of GDP in 2013. However, following the approval of the 2014 budget by Congress in January, the rate of fiscal consolidation should slow significantly. In the Eurozone, the general orientation of fiscal policy

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1 - Inflation is very low in the Eurozone

Sources: Bureau of Labor Statistics, Eurostat
The business climate remains well oriented in advanced economies

In Q1 2014, growth was weaker than expected in the advanced economies (+0.3% after +0.5%), particularly the United States. Domestic demand has not fallen, but exports shrank in line with the downturn in demand from the emerging economies: the contribution of foreign trade was thus negative in almost all of the major advanced economies. With the exception of Japan, where it is suffering from the effects of the VAT increase, the business outlook remained strong in May 2014, both in the manufacturing industry (see Graph 3) and the service sector. All in all, activity in the advanced economies should be relatively dynamic between now and the end of 2014 (+0.4% in Q2 followed by +0.5% per quarter in H2). For 2014 as a whole growth should average out at +1.8%, up from +1.3% in 2013 and +1.4% in 2012.

Europe bounces back

Domestic demand should continue to rise in the United States and the United Kingdom, largely as a result of private sector consumption, stimulated by the decline in unemployment and corresponding wealth effects. Activity should also pick up a bit of momentum in the Eurozone, particularly in Spain, thanks to an increase in capital goods investment and the acceleration of household consumption, bolstered by the increase in purchasing power. On the other hand, the construction sector is still an obstacle to the tentative recovery of activity in Southern Europe. All in all, 2014 should see a sustained rise in activity in Germany and the United Kingdom and, to a lesser extent, in Spain. The upturn should be more modest in France and Italy.

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should be less stringent in 2014 than it was in 2013. In Japan, on the other hand, fiscal policy is set to become considerably more restrictive: VAT increased by 3 points on 1st April, and public investment in economic stimulus initiatives should continue to decline.

The emerging economies still progressing in slow motion...

The business climate has deteriorated considerably in the emerging economies since the start of 2013 (see Graph 2). Activity progressed only modestly in H1 2013. In H2 overall activity picked up pace, particularly in Central and Eastern Europe and in China, while imports to emerging nations also recovered. Nonetheless, since the start of 2014, due to the effects of further currency devaluation and tighter monetary conditions, the business climate has stalled again and in May it remained at a very low level in comparison with the average seen in the previous decade. Activity, which grew by 1.1% in Q1 (compared with a quarterly average of +1.7% between 1999 and 2011), should continue to grow at a reduced rate.

... without exception

No emerging economy appears to have been spared by this general sluggishness. GDP growth may be accelerating in China, after slowing down more dramatically than usual during the New Year festivities, but the business climate remains weak and all indications suggest that the construction sector, which has thus far propped up activity, is beginning to run out of steam. In South America and the emerging Asian economies, the combined effects of tighter monetary conditions and significant currency devaluation should weigh heavily on borrowers, whose debts are largely contracted in dollars, and activity should thus remain sluggish. In Russia, the Ukraine crisis has prompted a massive withdrawal of capital and a pronounced slowdown in investment. This has had a knock-on effect on the business climate in Eastern Europe, which has seen a marked slump since February, after a year of vigorous improvement.

The business outlook remains strong in the advanced economies

In Q1 2014, growth was weaker than expected in the advanced economies (+0.3% after +0.5%), particularly the United States. Domestic demand has not fallen, but exports shrank in line with the downturn in demand from the emerging economies: the contribution of foreign trade was thus negative in almost all of the major advanced economies. With the exception of Japan, where it is suffering from the effects of the VAT increase, the business outlook remained strong in May 2014, both in the manufacturing industry (see Graph 3) and the service sector. All in all, activity in the advanced economies should be relatively dynamic between now and the end of 2014 (+0.4% in Q2 followed by +0.5% per quarter in H2). For 2014 as a whole growth should average out at +1.8%, up from +1.3% in 2013 and +1.4% in 2012.

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An upturn in world demand for French products

World trade contracted sharply and unexpectedly in Q1 2014, for the first time since 2009 (-0.8% after +1.5%, see Table), impacted by the slowdown in the Chinese and American economies. For the global economy as a whole, the new export order figures derived from the PMI surveys indicate an upturn in May. Similarly, preliminary customs data from Asia lead us to expect a slight rebound in world trade in Q2, boosted by demand from the emerging economies (see Focus). All in all, world trade should therefore bounce back in Q2 (+1.3%), a dynamic which should endure to a slightly reduced extent until the end of the year (+1.2% per quarter). The acceleration of imports to the advanced economies, particularly in Europe, should bolster world demand for French products, which should grow at virtually the same rate as world trade in general.

3 - The business climate remains well oriented in the most advanced economies

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Sources: ISM, Markit

Reading note: imports, exports and world trade data concern only goods.

Sources: National statistical institutes, Centraal PlanBureau, International Monetary Fund, INSEE forecast

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**Forecasting international trade is important for our short-term analyses**

The export forecasts given in the Conjoncture in France reports represent an important resource when analysing the economic outlook. The standard method for calculating these forecasts is based on predicting the imports of France’s main trading partners. Nonetheless, to the extent that a country’s imports necessarily depend on the exports and thus imports of other countries, it is crucial that the starting point for this forecasting exercise be rooted in an external reality, i.e. a direct prediction of the levels of world trade. This article looks at the various techniques used to arrive at this external reference framework.

**The different indicators used to determine the external reference figures**

Every month the CPB publishes data on the global trade of goods. These monthly figures go back as far as January 1991, and are available two months after the end of the month in question: for example, the data for April are published at the end of June. During our forecasting operations, no monthly data for the first forecasting quarter is available. The forecasting exercise requires, as a starting input, a prediction for international trade. There are three main types of indicator which allow us to construct such an external reference framework: advance indicators from surveys; coincident indicators constructed using variables impacted by world trade; and finally the first available data for foreign trade. In these categories we shall consider, respectively: PMI and Ilo surveys; the Brent crude index, commodity prices and the maritime transport indicators (RWI/ISL and the Baltic Dry Index); Asian customs data.

These indicators may be of varying predictive utility depending on the date within the quarter on which they are employed. For our purposes, at the outset of the compilation of the Conjoncture in France report, we find ourselves at the start of the second month in the quarter. World trade data for the second month of the preceding quarter are therefore available. Commodity price data are available in real time. The PMI survey, the RWI/ISL index and the Baltic Dry index are available for the first month of the current quarter. Last quarter’s Ilo survey, focusing on the following quarter, is also available. Finally, Asian trade figures are available for the first month of the current quarter or the final month of the preceding quarter.

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**Asian trade statistics provide the first reliable indications of total world trade**

**Several advances indicators serve as useful reflections of developments in world trade**

- **Commodity prices**

  Commodity prices may be considered a good indicator of world trade, as they are available in real time and liable to increase in line with global imports. Indeed the majority of commodities are used for intermediate consumption purposes, and thus react in the same way as imports to the fluctuations of world demand. However, with the exception of the extraordinary economic period known as the Great Recession, the figures for international trade and commodity prices (excluding energy) actually diverge. There is also considerable divergence between world trade figures and the figures for "rare earth" exports from China and global silicon shipments, two materials which are essential ingredients in many manufactured goods.

  As with commodity prices, the going rate for a barrel of Brent crude is available in real time, with price records stretching back a long way. Oil also accounts for a significant, if falling, proportion of intermediate consumption. Since the 2000s oil prices have appeared to be pretty well correlated with world trade, although this correlation is not perfect (see Graph 1).

- **The maritime transport indexes**

  As a large proportion of world trade involves transportation by sea (80% of trade by volume, cf. Review of Maritime Transport, 2013, CNUCED), indicators of the current state of shipping are likely to be of use when forecasting developments in world trade.

  The RWI/ISL index (provided by the German institutions RWI and the Institute of Shipping Economics and Logistics) is constructed using data from 73 container ports, representing 60% of the world’s container traffic (see Graph 2). However, while this information is made available more rapidly than the CPB’s world trade data (one month later), the indicator has only existed since 2007.

  Another indicator which may potentially reflect developments in world trade is the Baltic Dry Index (see Graph 3), an indicator of the variations in the spot price of transporting major dry commodities (thus excluding petrol) in bulk by sea, on 24 main world trade lines. Derived from a comparison of the supply and demand of ships available to transport such commodities, the Baltic Dry Index can be seen as a gauge of international economic activity and, by extension, of world trade. Indeed, since the supply of cargo ships is inelastic in the short term this indicator should give us a reliable idea of the demand for commodities, and thus reflect the future direction of production and world trade. The Baltic Dry Index is published monthly, one month before the world trade indicator becomes available, but displays greater volatility and, ultimately, a fairly poor correlation with the world trade figures.

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(1) See in-depth explanation in the Conjoncture in France report for March 2009: “Better understanding of the evolution of individual countries’ foreign trade with the help of world trade forecasts.”

(2) The Centraal Planbureau (CPB) is an independent body attached to the Netherlands’ Ministry for Economic Affairs. It is the only institution to produce comprehensive monthly figures on world trade.
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1 - Price of Brent and global trade

![Graph showing the quarterly change in % for World Trade and Brent.]

Sources: DataInsight, CPB

2 - The RWI / ISL index

![Graph showing the quarterly change in % for World Trade and RWI/ISL.]

Sources: RWI/ISL, CPB

3 - The Baltic Dry Index

![Graph showing the quarterly change in % for World Trade and Baltic Dry.]

Sources: DataInsight, CPB
c) The PMI index for export orders

A more direct indicator of world trade is provided by the ‘new export orders’ section of the Purchasing Managers’ Index (PMI), published by Markit: in each country these new orders will result, within a more or less brief timeframe, in exports. The country-by-country figures can thus be aggregated to give an advance indicator of world trade. In practice, it turns out to be more of a coincident indicator (see Graph 4). The threshold figure of 50 more or less corresponds to a situation of zero growth in world trade: above this level we can expect world trade to grow, below 50 we can expect it to shrink. One advantage of the PMI index is its rapid availability.

d) Asian customs data

 Customs data from Asian countries can also be of use (see Graph 5). Value figures published by the customs authorities in South Korea, Taiwan, Singapore and Japan possess the considerable advantage of being the first available direct measurements of trade. These countries account for an increasingly substantial share of world trade, a proportion which grew from 23% to 32% of total international trade between 2003 and 2012. Furthermore, Asia acts as a driving force in the development of world trade on account of its knock-on effects for the rest of the world. Although geographically distant, Europe is thus affected by the indirect ripple effects, partly as a result of Germany’s stronger ties with Asia.

e) The Ifo survey

The six-month business tendency survey produced by the German agency Ifo is based on the predictions of a panel of forecasters. This information can thus be considered to reflect a certain consensus: it is neither ‘hard data’ (objective figures), nor data based on economic agents’ perception of their current situation or future plans. This survey implicitly synthesises all of the available forecasts, and as such is supposed to represent a synthesis of all available information. The results thus appear to be well-correlated with the year-on-year development of world trade. Moreover, the forecasting period of this survey covers the next two quarters, thus allowing us to make initial predictions for the following quarter.

Sources: DataInsight, Markit, CPB

(3) see focus of the ‘Note de conjoncture’ December 2010: ‘INSEE outlook surveys and PMI indicators: advanced tools for monitoring the economic outlook’.

(4) source: WTO

French developments

Selecting a model to forecast world trade

Based on this initial analysis, three principal indicators are retained: the international PMI index for export orders, Asian customs data and the Ifo index business climate forecast. The other indicators either offer insufficient historical depth to be of use (the RWI/ISL index), or have limited predictive capacity (Brent and the Baltic Dry Index), or else are simply too poorly correlated with the actual fluctuations in world trade (commodity prices excluding oil).

As for forecasts covering the current quarter, two types of model may be considered: the unconnected use of two data sources (surveys and customs data, for example), which has the merit of maintaining a certain independence, or else the cross-comparison of different data sources. In order to identify the best models, a process of automatic variable selection has been put in place.

The first model retained for our purposes is based on the export order figures from the international Purchasing Managers’ Index (including the PMI data for the first month in the forecasting period, the PMI quarterly growth overhang, the final month of the preceding quarter and previous quarterly levels). This model is then compared with a second model whose variables are derived from the selection performed on the Asian customs data (see Table 1). Finally, the Ifo index allows us to construct a third model which, while not entirely satisfactory, gives some indication as to the direction in which things will head in the second forecasting quarter.

The first two models satisfy all the standard tests (autocorrelation, homoscedasticity, normality of residuals and stability). The second model, based on customs statistics from several Asian countries, is more precise than the model based on global PMI results (see Table 2).

Asian customs figures thus represent the most pertinent advance data when producing forecasts of world trade in the current quarter.

For Q1 2014, at the start of the forecasting operation the model based on PMI results suggested an increase of just below 2%. The model based on Asian customs data predicted a rise of closer to 1%. World trade actually shrank by 0.8% in this period. For Q2 2014 both models yield similar predictions (+1.6%), slightly exceeding the forecast we settled on: in the light of customs data which have since become available, we expect to see a +1.3% upturn in world trade. ■

![World trade forecast model using Asian customs data](image)

<table>
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<th>p-value</th>
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<td>lagts (3,World_trade)</td>
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<td>2.2%</td>
</tr>
</tbody>
</table>

- ske_1: South Korea’s export overhang in the first month of the quarter
- sge_0: Singapore’s export overhang at the end of the preceding quarter
- twe_0: Taiwan’s export overhang at the end of the preceding quarter
- lagts(i,X): shortfall (i) in the variable

![Comparison of the statistical precision of the various models](image)

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<tr>
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<td>0.69</td>
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<tr>
<td>DW</td>
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<td>2.2</td>
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<td>SER</td>
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<td>0.8%</td>
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<tr>
<td>$\sum e(i)^2$</td>
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<tr>
<td>Forecast of T1 2014</td>
<td>+2.0%</td>
<td>+1.0%</td>
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<tr>
<td>Forecast of T2 2014</td>
<td>+1.6%</td>
<td>+1.6%</td>
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</tbody>
</table>

6 - Calibration of world trade

![Quarterly change in %](image)

Sources: CPB, DataInsight, INSEE calculations
In Q1 2014, world trade declined by 0.8% and world demand for French products increased weakly: the imports of France’s trading partners were slow, in particular with a decline in demand from outside Europe. France’s exports thus slowed considerably (+0.3% after +1.6%). In Q2, world demand for French products should again rise. Exports should therefore gain momentum (+0.8%), and then grow a little less dynamically in Q2 (+0.5% per quarter). Overall in 2014, exports should increase by 3.0%, after +2.4% in 2013.

After accelerating in Q1 2014 (+1.0% after +0.5%), imports are set to slow down in Q2 (+0.2%), and then progress at a sluggish rate in H2 (+0.7% then +0.5%) linked to the components of demand. For the year as a whole, imports are set to increase by 3.0%, after +1.9% in 2013.

All in all, after having a negative effect in Q1 2014 (-0.2 points), foreign trade should make a positive contribution in Q2 (+0.1 points) then have a neutral effect on growth through to the end of the year. On average in 2014, the contribution of foreign trade should be nil, after +0.1 points in 2013.
increase of 1.3% in Q2 then 1.2% per quarter (see Focus on the “International environment”). Demand for French products should be in line with world trade (see Graph 1). It should show a clear increase in Q2 (+1.2% after 0.4%) as a result of the rebound in imports in emerging countries and the strong growth in imports in advanced countries (see Graph 2). It should then slow down slightly, despite sustained demand from Eurozone partners, particularly Germany. After an increase over several quarters, the exchange rate is set to stabilise, but its recent appreciation should further penalise exports (see Graph 3).

Exports of manufactured products should increase by 0.8% in Q2. They should then progress moderately in Q2 (+0.4% then +0.5%). Exports of other goods (agriculture, energy) and services are set to rise slightly in Q2 before returning to a rate that is closer to their trend.

All in all, in 2014 exports should accelerate slightly (+3.0%, after +2.4% in 2013). French market share should decrease slightly through to late 2014, particularly due to the past appreciation of the Euro in 2013 (see Graph 4).

Imports set to slow slightly by late 2014

In Q1 2014, imports of goods and services picked up (+1.0% after +0.5%), as expected. However, purchases in manufactured goods slowed down slightly (+0.9% after +1.3%). Purchases accelerated for agrifood products (+1.9% after...
French developments

0.0%), capital goods (+1.6% after +0.9%) and "other industrial products" (+2.9% after +1.5%); purchases of chemical products, particularly pharmaceuticals, leapt up. On the other hand, purchases decreased for transport equipment (-3.8% after +1.8%) and refined oil products (-3.7% after +1.8%). Purchases of raw energy and agricultural products (fruit and vegetables) picked up and expenditure on services was dynamic.

In Q2 2014, imports should slow down (+0.2% particularly because of an expected backlash in chemicals and pharmacy purchases) then accelerate in H2 (+0.7% then +0.5%), in line with the expected profile of domestic demand. Purchases of manufactured products should increase by 0.6% per quarter in H2. Energy purchases should follow their downward trend (-0.5% per quarter), and purchases of agricultural products are likely to remain on their upward trend (+2.0% then +1.0% per quarter). Finally, imports of services should slow slightly.

On average for the year 2014, imports of goods and services should increase more noticeably (+3.0%) than in 2013 (+1.9%). Negative in Q1 (-0.2 points), the contribution of foreign trade to GDP should be close to zero through to the end of the year; on average, it should be nil in 2014 after +0.1 points in 2013.

3 - Equation of exports (goods and services) and econometric contributions

![Graph showing quarterly changes in % and contributions in points]

Sources: INSEE, DG Trésor

4 - Market share of France

![Graph showing market share of France with base 100 in 2000]

Sources: INSEE, DG Trésor
After a significant downturn in H1, employment in the non-agricultural market sectors picked up in H2 2013 (+14,000 jobs). In Q1 2014 it slipped back, impacted by the decline in temporary employment. Over the rest of the year, the increase in activity should be modest, and in spite of the improved growth in jobs generated by tax credits for competitiveness and employment (CICE), employment is likely to stagnate. All in all, employment should again decrease in these sectors in 2014 (-22,000 jobs), after -53,000 jobs in 2013.

At the same time, employment should increase in the non-market sectors (+60,000 jobs, after +76,000 in 2013) largely thanks to the ramping up of «Emplois d’avenir». All in all, total employment should progress by 54,000 jobs in 2014, after increasing by 55,000 in 2013.

The number of paid employees in the market sectors should fall in 2014

In 2013, paid employment in the non-agricultural market sectors declined (-53,000 jobs, see Table 1). The fall occurred in H1 (-67,000), with numbers improving in the second half of the year (+14,000).

This development is fairly consistent with the usual employment determinants (see Graph 1). The downturn in activity beginning in spring 2011 was transmitted to employment progressively, although apparent labour productivity has itself slowed considerably since 2012.

In Q1 2014, market-sector employment fell again, impacted particularly by the temporary employment sector, which had increased substantially in late 2013. Through to the end of the year, the expected growth in activity should be too modest to enable employment to pick up significantly. However, it should stabilise (see Graph 2), sustained by the effects of the improved growth in employment as a result of the tax credits for competitiveness and employment (estimated at more than 30,000 jobs per half-year, see Focus “What to expect from the CICE in 2014?” in the December 2013 Conjoncture in France). All in all, employment in the non-agricultural market sectors should decline by 22,000 jobs in 2014.
Temporary employment should stabilise by the end of 2014, while non-temporary tertiary sector employment should increase slightly

In 2013, tertiary market-sector employment increased (+23,000 jobs), benefiting from a turning point in H2 (+46,000 jobs after -23,000). This upturn was driven by the tertiary sector excluding temporary work (+20,000 jobs after -31,000) and in the increase in temporary work (+25,000 jobs after +8,000).

In Q1 2014, the fall in temporary employment (-26,000 jobs) cancelled out the improvement of late 2013, but employment increased slightly in the non-temporary market tertiary sector (+16,000). The temporary work resort ratio in the different user sectors should stabilise at the low level observed since early 2013, with the result that the number of temporarily employed people should remain virtually unchanged between now and late 2014. Influenced by weak activity, non-temporary employment should increase only slightly: +24,000 jobs in H1 and +16,000 in H2.

All in all, market sector tertiary employment should decrease by 2,000 jobs in H1 and increase by 23,000 in H2.

The fall in industrial employment set to continue, though at a more moderate pace in 2014

In 2013 as a whole, industrial employment declined (-35,000). Non temporary work fell by 51,000 jobs, with 30,000 job losses in H1 and 20,000 in H2. Temporary work in industry rose slightly (+15,000 jobs) and the rate of recourse to temporary work in the sector grew from 6.3% to 6.8%.

Non-market sector employment should continue to increase thanks to future contracts

In 2013, the non-market sector labour force increased more (+76,000 jobs) than in the previous year (+21,000 jobs). This upturn is due mainly to subsidised employment (+71,000 after stability in 2012), other non-market and non-subsidised employment having slowed down.

In 2014, non-market employment should rise in both H1 (+22,000) and H2 (+38,000). Non-market subsidised contracts should represent 372,000 new arrivals in 2014 in Metropolitan France of which 55,000 in «Emplois d’avenir», after 426,000 in 2013. This should translate into a variation of 16,000 in the number of beneficiaries in H1, mainly thanks to «Emplois d’avenir» (see Table 2). It should increase a little more in H2 (+29,000): in addition to the continued creation of «Emplois d’avenir», (+10,000), there should be positive net arrivals on integration contracts (CUI-CAE +19,000 jobs). For 2014, the number of beneficiaries of subsidised contracts in the non market sector should thus increase by 45,000, after +71,000 in 2013.

Net job losses should continue at the same rate in construction

Net job losses in construction continued in 2013 (-25,000, after -18,000 in 2012). In Q1 2014, employment continued to fall at the same rate as at the end of the previous year. With the business tendency surveys failing to indicate any improvement in employment perspectives in this sector, employment should continue to drop at the same rate through to late 2014 (-10,000 in H1 then -11,000 in H2).

2- Employment change in non-agricultural market sectors

After a rebound in the spring, industrial activity should remain sluggish in H2 and total industrial employment, including temporary work in the sector, should therefore continue to fall at a rapid pace in 2014 (-20,000 in H1 then -8,000 in H2). Non-temporary industrial job losses should be on a comparable scale in both half-years (-9,000 in H1 then -11,000 in H2).

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### French developments

#### Table 1

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**Forecast**

How to read it: 12,000 jobs should be created in the market sector during H2 2014.

(1) Sectors OQ (private workers)

(2) Sectors DE to MN and RU

Source: INSEE

#### Table 2

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<th>Change in subsidised employment in the non-market sector in thousands</th>
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<td>CUI-CAE (replaces CAE+CAV on 01/01/10)</td>
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<td>Total</td>
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**Forecast**

Scope: Metropolitan France

Sources: DARES, INSEE calculations
In Q1 2014, the unemployment rate stood at 10.1% of the active population (9.7% in Metropolitan France). It stabilised in relation to Q4 2013, in spite of an increase of 23,000 in the number of unemployed in Metropolitan France.

In Q2, the unemployment rate should again increase slightly: by mid-2014, it should stand at 10.2% (9.8% in Metropolitan France), then, with the expected slight increase in total employment, it should stabilise at this level in the course of H2.

In Q1 2014, the unemployment rate stood at 9.7% in Metropolitan France.

In Q1 2014, the number of unemployed increased by 23,000 in Metropolitan France, after an annual change fall of 28,000 at the end of 2013 (see Table). Over the same period, employment increased by 35,000, with the stabilisation in market-sector employment being offset by the dynamism of subsidised employment. All in all, the unemployment rate stabilised at 9.7% in Metropolitan France (see Graph) compared to the previous quarter.

Year on year, it dropped by 0.2 points: it declined a little more for women (0.3 points) than for men (0.1 points).

The unemployment rate for 15-24 year olds stabilised in early 2014

After peaking at 25.3% of the active population in late 2012, the unemployment rate among 15-24 year olds declined throughout 2013 before levelling out at 22.9% in early 2014. Young people benefited particularly from the support provided by “future jobs” (emplois d’avenir) for young people with few or no qualifications. The unemployment rate among 25-49 year olds declined slightly in Q1 2014 to stand at 9.0%. It remained virtually stable year on year (-0.1 points). However, the unemployment rate for workers aged 50 and over increased by 0.3 points back to the level of Q3 2013.

There was a one-off fall in the active population in 2013

In 2013 the active population decreased by 28,000. This contrasts sharply with what is suggested by the usual medium-term determinants (demography and participation trend, for an impact evaluated at +120,000) and the effect of public policies (training, subsidised employment and post-2011 retirement reforms representing -13,000). This divergence can be explained by three main factors. First of all, it is important to bear in mind that unemployment figures are the result of a survey that is subject to some uncertainties as to the sampling procedure. However, the divergence
seems to be too great to be caused purely by these uncertainties. Next, the estimations of the trends and impacts of public policies are based on models. They are therefore, by their nature, surrounded by uncertainties and are not designed to chart the fluctuations in the active population precisely from one year to the next. Lastly, the approach used here does not take into account the fact that, in a period when the outlook is deteriorating, the unemployed may despair of finding work and withdraw from the labour market, or the non-working population may delay their arrival on the market: this is the phenomenon known as the “discouraged worker effect” of the economic outlook. Until 2012, the models describing this behaviour were integrated into the Conjoncture in France forecasts. But since the 2008-2009 crisis, these effects seem to have become negligible (see “The crisis modified the effects of the outlook on labour force participation”, Conjoncture in France for March 2013). However, it is not out of the question that in 2013, after three years of a poor outlook, the effects of the despondency may be influencing trends in the active population.

In 2014, assuming a return to the usual determinants, the labour force should again rise (+124,000). This should be particularly supported by the extension of the legal retirement age to 61 years and 2 months. However, this increase should be limited by retirements of those who have had long careers (see “Estimated bending effects” in Table 1). With improved models of the ages at which people end their studies, the downward impact of this measure on the active population should be more pronounced than anticipated in the previous Conjoncture in France.

The active population should thus increase more rapidly (+124,000) than the net number of total job creations (+79,000). The number of unemployed should increase in H1, and then remain globally stable in H2, with the unemployment rate levelling out at 9.8% in Q2 2014 in Metropolitan France (10.2% including the French Overseas Departments) then remaining stable at that level until the end of the year.

| Changes to the active population, employment and unemployment in Metropolitan France |
|---------------------------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Population of the 15-64 age group | -24        | -23        | -23        | -22        | -22        | -22        | -22        | -22        | -22        | -22        | 127        | 8          | -95        |
| Population of the 15-59 age group | -20        | -22        | -21        | -17        | -14        | -11        | -9         | -9         | -9         | -11        | -121       | -80        | -76        |
| Labor force                       | 0          | 63         | 16         | -3         | -7         | -34        | 58         | 23         | 23         | 20         | 45         | 214        | 214        |
| including:                       |            |            |            |            |            |            |            |            |            |            |            |            |            |
| (a) Contribution of the population and the trend participation rate | 36         | 36         | 30         | 30         | 30         | 30         | 34         | 34         | 34         | 34         | 160        | 165        | 146        |
| (b) Estimated bending effects     | 2          | -1         | -4         | -2         | -3         | -5         | 0          | -3         | -3         | -6         | -66        | -6         | 23         |
| (c) Other short-term fluctuations (residual) | -39        | 27         | -10        | -32        | -34        | -60        | 23         | -8         | -8         | -8         | -49        | -54        | 45         |
| Employment                       | -34        | -45        | -27        | -16        | -1         | 44         | 35         | 4          | 18         | 23         | 136        | 165        | -42        |
| ILO unemployment                 | 34         | 108        | 43         | 13         | -6         | -78        | 23         | 19         | 6          | -3         | -92        | 49         | 255        |
| quarterly average                | Average in the last quarter of the period | |
| ILO unemployment rate (%)        | 9.4        | 9.9        | 9.9        | 9.9        | 9.9        | 9.7        | 9.7        | 9.8        | 9.8        | 9.8        | 8.8        | 8.9        | 9.7        |
| Metropolitan France              | 9.8        | 10.1       | 10.3       | 10.3       | 10.3       | 10.1       | 10.1       | 10.2       | 10.2       | 10.2       | 9.2        | 9.3        | 10.1       |
| France (including overseas departments) | 9.8        | 10.1       | 10.3       | 10.3       | 10.3       | 10.1       | 10.1       | 10.2       | 10.2       | 10.2       | 9.2        | 9.3        | 10.1       |

How to read it:
- the Employment line presents variations in the number of people in employment as a quarterly average, for consistency with the other data in the table.
- employment and unemployment are not estimated here within strictly equivalent scopes: total population for employment, population of households (excluding collective) for unemployment. As the impact of this difference is very minor (the population outside of households represents less than 1% of the active population), it is neglected here for the unemployment forecasting exercise.

Source: INSEE
In May 2014, consumer prices increased by 0.7% year-on-year. Inflation has been contained at less than +1.0% since last summer, and should remain at that very moderate rate through to the end of the year. By the end of 2014, year-on-year consumer prices should thus be stable at +0.7%.

In the absence of inflationary pressure and because of falls in telecommunications prices, core inflation should drop to +0.2% in December 2014, after +0.3% in May. Inflation should additionally be moderated by the decline in the prices of healthcare products and the slowdown in tobacco prices. However, the prices of energy products should increase again. Likewise, the rise in the prices of food commodities should begin to transfer to consumer prices between now and the end of the year, and the fall in the prices of seasonal products is likely to fade out.

Headline inflation still very moderate

Since the beginning of 2013, inflation has remained very moderate. The year-on-year price increase has not exceeded +1.0% since the end of last summer. It reached +0.7% in May 2014 (see Graph 1). This moderation is all the more notable as VAT rates went up again on 1st January 2014. As expected, part of the impact was absorbed in the margins of businesses, which were improved by the Tax Credit for Competitiveness and Employment (CICE) (see Focus in Conjoncture in France, December 2013, “Rise in VAT rates and effect of the CICE: opposite impacts on inflation”).

Through to the end of the year, inflation should remain extremely contained and the year-on-year increase in consumer prices is expected to settle at +0.7% in December 2014 (see Table). Core inflation1 should diminish slightly from +0.3% in May 2014 to +0.2% at the end of the year, in spite of month-on-month jolts due in particular to the effect of the specific collection schedule at the time of the summer sales (see Graph 2). This differential between headline inflation and core inflation results essentially of the expected rise in the prices of energy and seasonal products, which should offset the fall in inflation in services.

Rising energy inflation

After a low point in March 2014 (-1.6%), year-on-year energy prices have picked up (+1.1% in May) and should increase slightly to settle at +1.4% in December. Indeed, assuming a stable Brent price at around €79.40 ($108) between now and December 2014, the exits of sharp drops from the year-on-year figures observed in October and November 2013 should contribute, in a base effect, to a rise in prices of oil.

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1 (1) Core inflation is estimated by removing energy prices, fresh products and public tariffs from the headline index, and correcting for tax measures.

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1 - Inflation in France

Source: INSEE
products. Conversely, the regulated prices of gas should decrease gradually through to the end of the year (-2.0 points between May and December). Lastly, the increase in electricity prices in August should contribute to an overall rise in energy prices.

**Rising food inflation**

The one-off rise in the prices of imported food commodities in early 2014 should spread to food prices excluding seasonal products by the end of the year. Conversely, in the absence of any major production problems for seasonal products, the year-on-year change in this sector should fall to -10.0% in August (after +0.4% at the end of 2013), in a base effect (exits of the sharp rises from the year-on-year prices of seasonal products in mid-2013), then pick up again to -5.0% over the forecasting period. All in all, the year-on-year prices of food products should pick up in December 2014, to -0.3% after -0.9% in May, and should contribute an increase of +0.1 points to overall inflation.

**Decline in prices of manufactured products**

The year-on-year change in the prices of manufactured products, at -0.8% in May, is likely to slip back slightly, to -0.9% at the end of 2014. Inflationary pressures in the manufacturing sector should be limited by the low level of the production capacity utilisation rate, the still high level of unemployment, and the productivity gains in this sector. Furthermore, the prices of healthcare products should continue to fall through to the end of the year, to -3.9% (after -2.6% in May). On the one hand, this is the consequence of moderating measures in the Social Security Financing Act for 2014. On the other hand, this drop should be accentuated by the effect of the «Consumption» law (see Box). The «healthcare» item should contribute -0.2 points to the year-on-year variations in the prices of manufactured products.

Inflation in the clothing and footwear sector is likely to be almost stable, however: irrespective of month-on-month jolts due in particular to the summer sales, the year-on-year change in the prices of clothing and footwear should be +0.5% in December, after +0.2% in May.

**Slowdown in prices of services**

The rise in prices of services, to +1.8% year-on-year in May, should fall to +1.6% in December. Telecommunications prices should continue to fall month-on-month between now and December, and because of exits of the sharp rises from the year-on-year prices observed in September 2013 (linked to the disappearance of advantageous subscription packages), the year-on-year variation in prices of telecommunications should fall to -5.6% in December 2014, after +1.4% in May 2014. This sharp decline should therefore contribute -0.3 points to the slowdown in services inflation. Nevertheless, it should be partly offset by the acceleration in air transport prices, in reaction to the sharp fall in May.
## French developments

### Consumer prices

<table>
<thead>
<tr>
<th>CPI* groups (2014 weightings)</th>
<th>April 2014</th>
<th>May 2014</th>
<th>June 2014</th>
<th>December 2014</th>
<th>Annual averages</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Food (16.5%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>including:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>seasonal food products (2.1%)</td>
<td>-0.6</td>
<td>-0.1</td>
<td>-0.9</td>
<td>-1.4</td>
<td>-0.2</td>
</tr>
<tr>
<td>excluding seasonal food</td>
<td>0.3</td>
<td>0.0</td>
<td>0.2</td>
<td>-0.2</td>
<td>-0.2</td>
</tr>
<tr>
<td>products (14.4%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Tobacco (2.0%)</strong></td>
<td>6.9</td>
<td>0.1</td>
<td>6.9</td>
<td>0.1</td>
<td>6.9</td>
</tr>
<tr>
<td><strong>Manufactured products (26.6%)</strong></td>
<td>-0.7</td>
<td>-0.2</td>
<td>-0.8</td>
<td>-1.0</td>
<td>-0.9</td>
</tr>
<tr>
<td>including:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>oil products (4.8%)</td>
<td>-4.7</td>
<td>-0.2</td>
<td>-1.5</td>
<td>-0.1</td>
<td>-2.3</td>
</tr>
<tr>
<td><strong>Services (46.4%)</strong></td>
<td>2.0</td>
<td>0.9</td>
<td>1.8</td>
<td>0.8</td>
<td>1.2</td>
</tr>
<tr>
<td>including:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>rent-water (7.5%)</td>
<td>1.5</td>
<td>0.1</td>
<td>1.5</td>
<td>0.1</td>
<td>1.8</td>
</tr>
<tr>
<td>health services (5.5%)</td>
<td>0.2</td>
<td>0.0</td>
<td>0.2</td>
<td>0.0</td>
<td>0.2</td>
</tr>
<tr>
<td>transport-communications (5.0%)</td>
<td>3.0</td>
<td>0.2</td>
<td>1.3</td>
<td>0.1</td>
<td>-1.0</td>
</tr>
<tr>
<td>other services (28.4%)</td>
<td>2.3</td>
<td>0.6</td>
<td>2.3</td>
<td>0.6</td>
<td>2.1</td>
</tr>
<tr>
<td><strong>All (100%)</strong></td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.5</td>
<td>0.7</td>
</tr>
<tr>
<td>All excluding energy (91.5%)</td>
<td>0.8</td>
<td>0.8</td>
<td>0.7</td>
<td>0.5</td>
<td>0.7</td>
</tr>
<tr>
<td>All excluding tobacco (98.0%)</td>
<td>0.6</td>
<td>0.6</td>
<td>0.6</td>
<td>0.5</td>
<td>0.6</td>
</tr>
<tr>
<td><strong>Core inflation (60.5%)</strong></td>
<td>0.4</td>
<td>0.3</td>
<td>0.3</td>
<td>0.2</td>
<td>0.2</td>
</tr>
</tbody>
</table>

Forecast

yoy : year-on-year
cyoy : contribution to the year-on-year value of the overall index
*CPI* Consumer price index (CPI)

(1) Index excludes public tariffs and products with volatile prices, corrected for tax measures

Source: INSEE

### The «Consumption» Law

Between now and the end of 2014, the entry into force of the law of March 2014 on consumption should facilitate the online sale of glasses and contact lenses: prescriptions provided by doctors must indicate the distance between the pupils so that glasses ordered on the Internet can be adapted. The aim of these measures is to lower prices by about 25%.

While not all of these new types of sales are tracked for these goods in the consumer price index, their development will probably have an indirect impact, via the competitive pressure that these new products will exert on the sales of high-street opticians.

Opticians’ margins should allow them to lower their prices faced with this increased competition. The assumed scenario is where this measure would have a gradual effect on the prices of glasses and lenses, lowering them by 3% between now and the end of the year, contributing to a year-on-year change of -0.4 points in the price of healthcare products over this period.

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86 Conjoncture in France
In 2014, against a backdrop of moderately stabilised inflation, nominal wages in the market sector should progress more or less at the same rate as in 2013: +1.5% after +1.7% for the basic monthly wage, and +1.7% after +1.5% for the average wage per head, as annual averages.

In spite of an unemployment rate that is likely to continue to prohibit wage rises, real wages should progress (+1.0% for the real average wage per head after +0.8% in 2013), in line with the slight acceleration expected in apparent labour productivity.

In general government, the nominal average wage per head should accelerate in 2014 (+1.2% after +0.9%), enabling a rise in real wages (+0.5% after +0.3% in 2013) thanks to low inflation.

In 2014, nominal wages should progress at almost the same rate as in 2013

At the beginning of 2014, the increase in the minimum wage was modest (+1.1%) in comparison with previous years, albeit higher than the rise on 1st January 2013 (+0.3%). In a context of limited inflation, the high unemployment rate should however continue to weigh down on employees’ bargaining power and to limit global wages increases.

Consequently, in Q1 2014 the nominal wage indicators in the market sector are giving out contrasting signals. While the basic monthly wage is growing weakly (+0.3% in data corrected for seasonal variations), the average wage per head indicator estimated by the ACOSS and the URSSAF is picking up sharply (+0.7% after +0.2%). This suggests an acceleration in the average wage per head (AWPH) in the national accounts (+0.6% after +0.4%). This divergence between short-term indicators probably translates, at least in part, the payment of wages in the form of start-of-year bonuses.

Consequently, while the basic monthly wage should increase at the same rate over the rest of the year (+0.4% per quarter), the average wage per head is likely to suffer a slight reaction in Q2 (+0.3%). In H2, with prices progressing moderately (+0.3% then +0.2% per quarter, in data corrected for seasonal variations), the rise in nominal wages would be barely more dynamic (+0.4% per quarter): while the unemployment rate continues to take its toll on employees’ bargaining power, the slight acceleration expected in labour productivity should allow this wage rise in real terms.

Change in the nominal and real average wage per head

![Graph showing change in nominal and real average wage per head](image)

Scope: non-agricultural market sector

Sources: DARES, INSEE

(1) For a definition of BMW and AWPH, see on insee.fr website ‘Economic outlook terminology’
All in all in 2014, in a context of stabilised and moderate inflation (with consumer prices progressing by +0.7% as an annual average after +0.6%), the basic monthly wage should progress modestly, as in 2013 (+1.5% after +1.7%, see Table). The rise in the average wage per head should also be more or less stabilised (+1.7% after +1.5%).

In real terms, the average wage per head should accelerate slightly in the market sector as an annual average (+1.0% after +0.8%), in line with the small acceleration expected in labour productivity. Nevertheless, year-on-year, after regaining some dynamism in early 2014, probably attributable to temporary factors (bonus payments), the real average wage per head should slow by the end of the year (see Graph).

In the civil service, the index point is frozen in 2014 for the fourth consecutive year. Pending a modification of salary grids at the lower end of the scale, the civil service minimum index was not increased on 1st January 2014, leading to the payment of a differential allowance to the agents concerned in order to ensure they were paid more than the minimum wage in January. The increase in salary grids for category C employees and certain category B employees took place on 1st February 2014 and guarantees each employee a wage higher than the minimum wage. Lastly, the Individual Purchasing Power Guarantee should be renewed in 2014 according to the same terms as in 2013; it should contribute, in part, to the acceleration of the overall average wage per head.

All in all, the nominal average wage per head in general government should increase by 1.2% in 2014 after +0.9% in 2013. In real terms, the average wage per head should rise by 0.5% in 2014 (after a rise of 0.3% in 2013), bearing in mind the slight rise in inflation.

(2) The 2014 individual purchasing power guarantee is a compensation awarded to civil servants and certain State employees who suffered a loss in purchasing power between 2009 and 2013.

| Growth of the basic monthly wage and the average wage per head in the non-agricultural market sector and in general government | change as a % |
| --- | --- | --- | --- |
| Seasonally-corrected data | Quarterly growth rates | Annual averages |
| | 2013 | 2014 | 2013 | 2013 | 2014 |
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Basic monthly wage | 0.4 | 0.4 | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 2.1 | 1.7 | 1.5 |
| Average wage per head in the non-agricultural market sector (NAMS) | 0.4 | 0.5 | 0.2 | 0.4 | 0.6 | 0.3 | 0.4 | 0.4 | 1.8 | 1.5 | 1.7 |
| Average wage per head in general government (GG) | 0.4 | 0.5 | 0.2 | 0.4 | 0.6 | 0.3 | 0.4 | 0.4 | 2.0 | 0.9 | 1.2 |
| Household consumer price index (quarterly national accounts) | 0.3 | 0.0 | 0.2 | 0.0 | 0.3 | 0.1 | 0.3 | 0.2 | 1.4 | 0.6 | 0.7 |
| Real basic monthly wage | 0.1 | 0.5 | 0.1 | 0.3 | 0.0 | 0.3 | 0.1 | 0.2 | 0.7 | 1.1 | 0.8 |
| Real average wage per head (NAMS) | 0.1 | 0.5 | 0.1 | 0.4 | 0.3 | 0.2 | 0.1 | 0.2 | 0.4 | 0.8 | 1.0 |
| Real average wage per head (GG) | 0.1 | 0.5 | 0.1 | 0.4 | 0.3 | 0.2 | 0.1 | 0.2 | 0.6 | 0.3 | 0.5 |

Source: INSEE

Forecast
Stable in 2013, the purchasing power of household income should pick up in 2014 (+0.7%). In nominal terms, households’ gross disposable income (GDI) should accelerate (+1.4% in 2014 after +0.6% in 2013), due to a lower total tax burden (+2.5% after +4.2%) and a slight acceleration in earned income (+1.3% after +0.9%), and in spite of a slowdown in social benefits (+2.4% after +2.8%).

Earned income set to accelerate in 2014

In 2014, earned income received by households should be more dynamic than in 2013 (+1.3% after +0.9%, see Table 1). Gross wages received by households should accelerate (+1.4% after +1.0% in 2013, see Table 2), due in particular to the slowing fall in employment in the non-agricultural market sector (-0.2% after -0.7%) and to a slight acceleration in the average wage per head in that sector (see Graph). The gross operating surplus of sole proprietors should also accelerate in 2014, in a slightly more pronounced way than activity as a whole (+0.7% after 0.0% in 2013), as should property income (+1.7% after +1.0%). The gross operating surplus of pure households should progress as in 2013 (+1.1% after +1.0%).

(1) The GOS of pure households corresponds to the production of housing services minus the intermediate consumptions required for this production (most notably financial services linked to loans) and taxes (land tax). It corresponds to the rents that homeowners receive from their tenants or could receive if they put their dwelling up for rent (“imputed” rents).

Social benefits, partly frozen in 2014, should continue to slow down

In 2014, social benefits in cash received by households should be slightly less dynamic than they were in 2013 (+2.4% after +2.8%, see Table 3). In particular, social security benefits should slow down (+2.4% after +3.1%), notably in Q2. Firstly, supplementary pensions paid by the Agirc-Arrco were not increased on 1st April, in compliance with the agreement of March 2013; the same applies to general pension scheme, for which planned increases were first deferred from 1st April to 1st October, and then partly frozen in 2014 as part of the plan to save €50 billion between now and 2017 (only pensions below €1,200 per month are expected to be increased on 1st October). Secondly, family benefits were increased less in 2014 (+0.6% on 1st April) than in previous years (+1.3% on average during the five previous years). Lastly, after increasing markedly in 2013, unemployment benefit should slow down considerably, due in particular to the new unemployment insurance agreement which should enter into force on 1st July 2014. However, social assistance should accelerate in 2014 (+3.3% after +1.9% in 2013), sustained by the dynamism of the Specific Solidarity Allocation (ASS) and by the Earned Income Supplement (RSA). The RSA was increased on 1st January and should be again on 1st September, as part of the plan to fight against poverty and for social inclusion (which aims to increase it by 10% between now and 2017). All in all, after a slowdown in Q2 (+0.1% after +0.7% in

Breakdown of the total gross wages paid out to households in the competitive non-agricultural sector

Source: INSEE
**French developments**

Q1, social benefits in cash should return to a growth closer to their trend in H2 (+0.7% per quarter).

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The household tax burden should slow down in 2014

For 2014 as a whole, the household tax burden should slow down (+2.5% after +4.2%): household social contributions (+1.8% after +4.7%) should dip a little more than revenue from income and property tax (+3.0% after +3.9%). For the latter, the spontaneous broadening of the tax base should be added to the effects of new measures for 2014: particularly the cancellation of tax exemption for dependency pension increases, the cancellation of tax exemption for employer payments of supplementary insurance contributions, and the lowering of the ceiling for the dependents allowance. The effect of these measures in 2014 should, however, be lower than that of the measures adopted in 2013. In addition, the measure to reduce tax for modest household incomes, announced in the spring of 2014, should limit the scale of the overall rise.

As in previous years, these new tax measures should take place mainly in H2, when tax notifications are received. Because of this, the effects of the taxes should be uneven: in early 2014, income tax fell back (-4.2%) in a reaction to the dynamism of late 2013; it should increase slightly in the spring (+1.0%) then accelerate again in H2 (+2.0% in Q3 and +3.3% in Q4).

---

Purchasing power should return to growth in 2014

All in all, the nominal gross disposable income (GDI) of households should increase more quickly than in 2013 (+1.4% after +0.6%), with the reduction of the tax burden and the rise in earned income winning out over the deceleration in benefits. At the same time, consumer prices should increase at the same rate as in 2013 (+0.7% after +0.6%) and the purchasing power of GDI should pick up: stable in 2013, it should increase by 0.7% in 2014. Brought to an individual level to take into account demographic changes, purchasing power per consumption unit should be almost stable in 2014 (+0.1%), after a decline in 2013 (-0.6%, see Box). The profile for the year should be mainly marked by the impact of taxes: purchasing power should increase in H1 2014 in reaction to sharp rises in taxes at the end of 2013. In H2, it should decrease, due to the implementation of the extra tax rises planned for 2014.

---

**Table 1**

<table>
<thead>
<tr>
<th>Household gross disposable income</th>
<th>2013</th>
<th>2014</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross disposable income (100%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>including :</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earned income (70%)</td>
<td>1.3</td>
<td>0.3</td>
<td>0.0</td>
<td>-0.2</td>
<td>1.4</td>
</tr>
<tr>
<td>Gross wages (62%)</td>
<td>0.2</td>
<td>0.4</td>
<td>0.1</td>
<td>0.4</td>
<td>0.5</td>
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<tr>
<td>GOS of sole proprietors (9%)</td>
<td>0.1</td>
<td>0.5</td>
<td>0.2</td>
<td>0.3</td>
<td>0.4</td>
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<tr>
<td>Social benefits in cash (34%)</td>
<td>0.5</td>
<td>0.7</td>
<td>0.7</td>
<td>0.9</td>
<td>0.7</td>
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<td>GOS of “pure” households (13%)</td>
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<td>0.2</td>
<td>0.1</td>
<td>0.2</td>
<td>0.5</td>
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<td>Property income (8%)</td>
<td>0.7</td>
<td>0.1</td>
<td>0.0</td>
<td>0.8</td>
<td>0.4</td>
</tr>
<tr>
<td>Social contribution and tax burden (-25%)</td>
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<td>1.0</td>
<td>1.3</td>
<td>3.2</td>
<td>-2.6</td>
</tr>
<tr>
<td>Contributions of household (-11%)</td>
<td>0.8</td>
<td>0.8</td>
<td>0.7</td>
<td>1.0</td>
<td>-0.3</td>
</tr>
<tr>
<td>Income and wealth tax (including CSG and CRDS) (-14%)</td>
<td>-6.5</td>
<td>1.1</td>
<td>1.8</td>
<td>4.8</td>
<td>-4.2</td>
</tr>
<tr>
<td>Income before taxes</td>
<td>0.2</td>
<td>0.4</td>
<td>0.2</td>
<td>0.5</td>
<td>0.6</td>
</tr>
<tr>
<td>Household consumer prices (quarterly national accounts)</td>
<td>0.3</td>
<td>0.0</td>
<td>0.2</td>
<td>0.0</td>
<td>0.3</td>
</tr>
<tr>
<td>Purchasing power of gross disposable income</td>
<td>1.1</td>
<td>0.3</td>
<td>-0.2</td>
<td>-0.3</td>
<td>1.1</td>
</tr>
<tr>
<td>Household purchasing power by consumption</td>
<td>0.9</td>
<td>0.2</td>
<td>-0.4</td>
<td>-0.4</td>
<td>0.9</td>
</tr>
</tbody>
</table>

**Forecast**

How to read it: The figures in parentheses give the structure of the year 2013.

(1) The gross operating surplus (GOS) of sole proprietors is the balance of the operating accounts of sole proprietorships. It is mixed income, because it remunerates the work performed by the sole proprietor, and possibly the members of his family, but also contains the profit achieved as an entrepreneur.

Source: INSEE
Table 2
From the payroll of non-financial enterprises to that received by households

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Q1</strong></td>
<td>0.2</td>
<td>0.4</td>
<td>0.2</td>
<td>0.6</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td><strong>Q2</strong></td>
<td>0.3</td>
<td>0.5</td>
<td>0.3</td>
<td>0.6</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td><strong>Q3</strong></td>
<td>0.5</td>
<td>-0.1</td>
<td>-0.2</td>
<td>-0.8</td>
<td>0.7</td>
<td>0.2</td>
</tr>
<tr>
<td><strong>Q4</strong></td>
<td>0.2</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td><strong>Q1</strong></td>
<td>2.6</td>
<td>0.2</td>
<td>0.1</td>
<td>2.6</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td><strong>Q2</strong></td>
<td>1.8</td>
<td>1.0</td>
<td>1.4</td>
<td>1.8</td>
<td>1.0</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Q3</strong></td>
<td>1.6</td>
<td>0.8</td>
<td>1.5</td>
<td>1.6</td>
<td>0.8</td>
<td>1.5</td>
</tr>
<tr>
<td><strong>Q4</strong></td>
<td>1.7</td>
<td>1.5</td>
<td>1.7</td>
<td>1.7</td>
<td>1.5</td>
<td>1.7</td>
</tr>
<tr>
<td><strong>Non-financial enterprises (67%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>including: Average wage per head</strong></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td><strong>Financial corporations (5%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>General government (22%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Households excluding sole proprietors (2%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total gross wages received by households (100%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>including: Non-agricultural market sectors</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Forecast

How to read it: The figures in parentheses give the structure of the year 2013.

Source: INSEE

Table 3
Social transfers received and paid by households

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Q1</strong></td>
<td>0.5</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
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<tr>
<td><strong>Q2</strong></td>
<td>0.6</td>
<td>0.7</td>
<td>0.8</td>
<td>0.6</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td><strong>Q3</strong></td>
<td>0.1</td>
<td>0.8</td>
<td>0.9</td>
<td>0.7</td>
<td>0.8</td>
<td>0.5</td>
</tr>
<tr>
<td><strong>Q4</strong></td>
<td>0.2</td>
<td>0.3</td>
<td>0.9</td>
<td>0.6</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td><strong>Q1</strong></td>
<td>0.4</td>
<td>0.7</td>
<td>0.9</td>
<td>0.3</td>
<td>0.4</td>
<td>0.5</td>
</tr>
<tr>
<td><strong>Q2</strong></td>
<td>0.4</td>
<td>0.7</td>
<td>0.9</td>
<td>0.2</td>
<td>0.6</td>
<td>0.3</td>
</tr>
<tr>
<td><strong>Q3</strong></td>
<td>0.8</td>
<td>0.8</td>
<td>0.7</td>
<td>1.0</td>
<td>-0.3</td>
<td>0.5</td>
</tr>
<tr>
<td><strong>Q4</strong></td>
<td>0.6</td>
<td>0.3</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td><strong>Social cash benefits received by households (100%)</strong></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>Social Security benefits in cash (72%)</strong></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>Other social insurance benefits (20%)</strong></td>
<td></td>
<td></td>
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<tr>
<td><strong>Social assistance benefits in cash (8%)</strong></td>
<td></td>
<td></td>
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<tr>
<td><strong>Actual social contributions paid by households (100%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>including: Employers contributions (63%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Contributions of household (37%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Forecast

How to read it: The figures in parentheses give the structure of the year 2013.

(1) Employer contributions are both received and paid by households in the national accounts: they therefore have no effect on gross disposable income.

Source: INSEE

Different ways of measuring purchasing power

The household income that is presented and analysed in Conjoncture in France includes all the income received by all households. This is the relevant reference in macro-economic terms, for example when constructing the balance between resources (GDP and imports) and uses (consumption, investment, exports...) or forecasting GDP. The purchasing power of all households, which represents the quantity of goods and services that households can purchase with their income, is calculated as income corrected for the growth in consumer prices. In order to measure the average purchasing power of the French population, this value has to be corrected in order to account for both the growth in the number of households and their composition. The most relevant correction in this respect consists in dividing income by the number of consumption units in France, thereby taking account of demographic growth and also of the fact that some consumption may be shared within the household (for example, household appliances). A large household therefore makes certain “economies of scale” in relation to a smaller household. In 2013, growth in the number of consumption units was +0.6% (as a comparison, growth in the population was +0.4% and growth in the number of households +0.9%). Therefore, purchasing power per consumption unit is set to fall in 2014 (0.1% after -0.6% in 2013). Per household, the fall should be 0.3% and per inhabitant it should be 0.2%. ■
In Q1 2014, household consumption slipped back (-0.5% after +0.2%). Automobile expenditure in particular fell back (-1.2%), after having been dynamic in late 2013 due to public anticipation of the more stringent «malus» of 1st January 2014 (+2.6%). In addition, the decrease in energy spending intensified as a result of the mild winter. Services consumption increased slightly (+0.2% after +0.1%).

In Q2 2014, consumption of manufactured goods should rebound (+0.6% after -0.7% in Q1), particularly in the automobile sector. After declining over three consecutive quarters, and a particularly mild winter, energy consumption should rebound in Q2 (+1.2%) and should climb in Q3 (+1.9%). In H2 2014, household consumption should slow down slightly (+0.4% then +0.3%), bringing the increase over the whole year to +0.3%, as in 2013.

In Q1 2014, thanks to an upswing in purchasing power, the savings ratio appears to have jumped, by 1.4 points to 16.1%, the highest level since spring 2011. Taking into account the expected profile of the purchasing power of income, the savings ratio should decline progressively over the rest of the year 2014, standing at 14.7% in Q4, level as the previous year. As an annual average, it should rise by 0.3 points to 15.4%.

1 - Contributions of the various items to quarterly household consumption

In Q1 2014, consumption of manufactured goods declined (-0.5% after +0.2%, see Table and Graph 1), due to a drop in expenditure on goods (-1.0% after +0.6%). Food expenditure declined sharply after increasing at the end of 2013 (-0.9% after +0.8%): the rise in the price of cigarettes particularly contributed to the reduction in the volume of tobacco consumed. With the mild winter, the decline in energy-water-waste expenditure - consisting mainly of gas and electricity for heating purposes - intensified (-5.0% after -2.2%).

Expenditure on manufactured products stabilised (after +1.3%). Automobile purchases fell (-1.3%) after picking up in late 2013 (+2.5%) due to public anticipation of the more stringent «malus» of 1st January 2014. However, expenditure on clothing and housing equipment slowed although it did continue to grow. Finally, consumption of services remained sluggish (+0.2% after +0.1%): expenditure was in a negative trend in transport, services, automobile repairs and housing maintenance; however, it picked up in accommodation-catering and information-communication.

Source: INSEE
**French developments**

**In Q2 2014, consumption should rebound**

Total household consumption should rebound in Q2 2014 (+0.5% after -0.5%, see Graph 2). As temperatures return progressively to seasonal norms, energy-water-waste consumption should rebound (+2.0% after -5.0%). In addition, consumption of engineered goods should rebound (+0.7% after stability), with two effects: on the one hand, in the automobile sector the effects of the stricter «malus» should begin to fade; on the other, expenditure on «capital goods» should be dynamic, boosted particularly by a peak in the sale of televisions (and associated products), which is usual during the football World Cup (see Focus in Conjoncture in France for June 2010). Lastly, consumption of services should pick up slightly (+0.3% after +0.2%).

In H2 2014, consumption expenditure should return to a relatively moderate growth rate, whether for manufactured products (+0.2% in Q3 then +0.1% in Q4) or services (+0.2% then +0.3%). Only energy-water-waste expenditure is set to increase (+4.5%), assuming a return to normal heating expenditure. All in all, household consumption expenditure should grow by 0.4% in Q3 then by 0.3% in late 2014; as an annual average, the increase should be 0.3% in 2014, the same as in 2013.

**At end 2014, the savings ratio set to return to its level of late 2013**

With the fall in purchasing power in H2 2013, linked to new measures affecting household taxes, the savings ratio declined by 0.4 points in Q4 2013, to 14.7%. In Q1 2014, diverging developments in purchasing power and consumption should result into a rebound of 1.4 points, to 16.1%. This is the highest level since spring 2011. Taking into account the expected profile of the purchasing power of income by the end of the year, the savings ratio should decline (between -0.4% and -0.5 points per quarter). It should reach 14.7% at the end of the year, the same level as late 2013, with households smoothing the jolts in their income linked to the new tax measures. On average over the year, the savings ratio should progress by 0.3 points to 15.4%.

**Household investment set to decline sharply over the year**

In Q1 2014, household investment, mainly in housing, continued to decline for the ninth consecutive quarter (-2.6% after -2.2%). It is its lowest level since 1999. Although housing authorisations seem to have stabilised at the beginning of the year, the decline in house starts in Q2 2013 does not suggest a rapid improvement (see Graph 3). Expenditure in the maintenance-improvement sector should also feel the effects of the increase in VAT from 7% to 10% in Q1. Housing expenditure should thus continue to decline, though less steeply in Q2 (-1.5%) and Q3 (-0.9%), before stabilising (-0.1%) in late 2014. Over the year as a whole, household investment should decline very sharply (-6.7% in 2014 after -3.1% in 2013), the biggest drop since 2009.

---

2 - Savings rate and consumption growth rate and the purchasing power of gross disposable income

![Graph showing savings rate and consumption growth rate](https://example.com/graph.png)

Source: INSEE
French developments

3 - Household investment on construction and housing starts.
Last point: February 2014

![Graph showing household investment on construction and housing starts]

Source: SOeS

Household consumption and investment expenditure

<table>
<thead>
<tr>
<th></th>
<th>Quarterly changes in %</th>
<th>Annual changes in %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2013</td>
</tr>
<tr>
<td><strong>Total household consumption expenditures (B+S)</strong></td>
<td>0.5</td>
<td>-0.6</td>
</tr>
<tr>
<td><strong>Tourism balance</strong></td>
<td>6.9</td>
<td>12.8</td>
</tr>
<tr>
<td><strong>Services (S)</strong></td>
<td>0.2</td>
<td>-0.1</td>
</tr>
<tr>
<td><strong>Goods (G)</strong></td>
<td>1.0</td>
<td>-0.9</td>
</tr>
<tr>
<td><strong>including:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food (AZ-C1)</td>
<td>0.7</td>
<td>-0.4</td>
</tr>
<tr>
<td>Agriculture goods (AZ)</td>
<td>0.2</td>
<td>-0.9</td>
</tr>
<tr>
<td>Agri-food products (C1)</td>
<td>0.8</td>
<td>-0.4</td>
</tr>
<tr>
<td>Energy (DE-C2)</td>
<td>4.8</td>
<td>0.4</td>
</tr>
<tr>
<td>Energy, water, waste (DE)</td>
<td>8.3</td>
<td>1.3</td>
</tr>
<tr>
<td>Coke and refined petroleum(C2)</td>
<td>1.6</td>
<td>-0.4</td>
</tr>
<tr>
<td>Engineered goods (C3 à C5)</td>
<td>-0.2</td>
<td>-1.9</td>
</tr>
<tr>
<td>Manufactured goods (C1 à C5)</td>
<td>0.3</td>
<td>-1.2</td>
</tr>
<tr>
<td>Investment expenditure</td>
<td>-0.8</td>
<td>-0.7</td>
</tr>
</tbody>
</table>

Forecast
Source: INSEE
In 2013, the margin rate of non-financial companies fell back once again: it reached an annual average of 29.8% after 30.5% in 2012. This is its lowest level since 1985. Once again, the rise in real wages slightly exceeded productivity gains. The margin rate suffered from a deterioration in terms of trade (effect of -0.1 points on the margin rate), and tax and social security contributions on wages accounted for 0.5 points.

In Q1 2014, the margin rate should pick up considerably due to the impact of the CICE (Tax Credit for Competitiveness and Employment). Then it should continue progressing until the end of the year as a result of productivity gains that are bigger than the rise in real wages. At the end of 2014 it should reach 30.8%, or 1.3 points more than the year before. Averaged over the year, the rise should be more limited: +0.8 points to 30.5%.

In 2013, the margin rate reached its lowest level since 1985

The margin rate of non-financial companies fell almost continuously between 2011 and the end of 2013: it reached 29.5% in Q4 2013, its lowest level since the end of 1985 (see Graph 1). Over 2013 as a whole, the average margin rate of non-financial companies was 29.8%, or 0.8 points less than in 2012. The rise in real wages per head (contribution of -0.5 points, see Table) was only partially offset by the rise in apparent labour productivity (contribution of +0.4 points). Furthermore, labour and payroll taxes (contribution of -0.3 points) and employer contributions (-0.2 points) had a negative effect (see Graph 2).

In 2014, the margin rate should increase markedly

In Q1 2014, the CICE, recorded in the national accounts as wage subsidies, contributed in accounting terms to raising the margin rate by 1.1 points. Conversely, businesses absorbed part of the VAT rise on 1st January (which partly funds the CICE) in their margins, which translated to a negative contribution (-0.2 points) of value-added prices to the margin rate. In addition, real wages have continued to progress (contribution of -0.2 points), more quickly than productivity, which stabilised. All in all, the margin rate seems to have progressed by 0.7 points in Q1 2014, to 30.2%.

1 In national accounts, in compliance with international regulations, the CICE, as a tax credit, is recorded as an expenditure, or more precisely as a «production subsidy» (and not as lower revenue from corporation tax). It is based on the wages paid in 2013 but, bearing in mind its management methods, and particularly the moment when the amount of the debt is made known, the taxable event is when businesses notify the tax authorities, in 2014. In the quarterly accounts, corrected for seasonal variations, this translates to a first step in Q1 2014 and payments of the same amount each quarter.
Over the rest of the year, productivity should progress a little faster than real wages, which should contribute to the margin rate picking up. Moreover, the gradual spread of the VAT rise to consumer prices, via a rise in value-added prices, should result in a marginally positive contribution to the margin rate. All in all, the margin rate should increase again by 0.6 points over the final three quarters, reaching 30.8% at the end of 2014 (against 29.5% at the end of 2013).

On average for 2014, the margin rate should regain its 2012 level, reaching 30.5% after 29.8% in 2013. This level is 2.2 points less than its average for the period 1988-2007.

### Breakdown of the margin rate of non-financial companies (NFC)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Margin rate (in level)</td>
<td>30.9</td>
<td>30.5</td>
<td>30.7</td>
<td>30.2</td>
<td>30.1</td>
<td>30.1</td>
<td>29.5</td>
<td>30.5</td>
<td>30.2</td>
<td>30.5</td>
<td>30.7</td>
<td>30.8</td>
<td>30.5</td>
<td>29.8</td>
<td>30.5</td>
</tr>
<tr>
<td>Variation in margin rate</td>
<td>0.0</td>
<td>-0.5</td>
<td>0.2</td>
<td>-0.5</td>
<td>-0.1</td>
<td>0.0</td>
<td>-0.6</td>
<td>0.0</td>
<td>0.7</td>
<td>0.3</td>
<td>0.2</td>
<td>0.1</td>
<td>-0.6</td>
<td>-0.8</td>
<td>0.8</td>
</tr>
<tr>
<td>Contributions to the variation margin rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Productivity gains</td>
<td>0.2</td>
<td>-0.3</td>
<td>-0.3</td>
<td>-0.2</td>
<td>-0.0</td>
<td>0.6</td>
<td>0.0</td>
<td>0.0</td>
<td>-0.0</td>
<td>0.1</td>
<td>0.0</td>
<td>0.2</td>
<td>0.2</td>
<td>0.1</td>
<td>0.4</td>
</tr>
<tr>
<td>Real wage per head</td>
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<td>-0.1</td>
<td>-0.3</td>
<td>-0.0</td>
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<td>-0.1</td>
<td>-0.2</td>
<td>-0.1</td>
<td>0.1</td>
<td>-0.1</td>
<td>-0.1</td>
<td>-0.2</td>
<td>-0.5</td>
</tr>
<tr>
<td>Employer contribution ratio</td>
<td>0.1</td>
<td>-0.1</td>
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<td>-0.2</td>
<td>0.1</td>
<td>0.0</td>
<td>-0.2</td>
<td>0.2</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.2</td>
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</tr>
<tr>
<td>Ratio of the value-added price to the consumer price</td>
<td>-0.3</td>
<td>0.0</td>
<td>0.1</td>
<td>0.0</td>
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<td>-0.1</td>
<td>0.3</td>
<td>0.1</td>
<td>-0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.0</td>
<td>-0.2</td>
<td>-0.2</td>
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<tr>
<td>Other factors</td>
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<td>-0.1</td>
<td>0.2</td>
<td>-0.3</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Forecast

(1) The margin rate measures the share of value-added which remunerates capital. Its variation is broken down in accounting terms between:
- productivity changes (Y/L), with Y value-added and L employment, and the ratio of the value-added price to the consumer price, or terms of trade (Pva/Pc), which play a positive role;
- changes to the real average wage per head (SMPT/Pc) and the employer contribution ratio (W/SMPT, where W represents all compensation), which play a negative role.
- other factors: including taxes on production net of operating subsidies.

\[ TM = \frac{FBE}{VA} = 1 - \frac{W}{Y} \cdot \frac{1}{P_v} + \text{other factors} = 1 - \frac{1}{Y} \cdot \frac{W}{SMPT} \cdot \frac{P_v}{P_c} + \text{other factors} \]

Source: INSEE
Corporate investment shrank in Q1 2014 (-0.5% after +0.8%). Corporate expenditure on services held firm but expenditure on manufactured products (-0.9%) and construction (-1.1%) dropped. The decline in investment in manufactured products is due mainly to the expected backlash in the purchase of heavy goods vehicles, caused by new anti-pollution standards coming into force at the beginning of the year.

In Q2 2014, investment should increase slightly (+0.2%) then remain at the same level in H2. In 2014 on the whole, corporate investment expenditure should rebound moderately (+0.7% after -0.6% in 2013).

In Q1 2014, inventory change contributed greatly to GDP growth (+0.6 points after -0.3 points in Q4 2013). This contribution comes essentially from stocks of manufactured products. In Q2 2014 the contribution of inventory change to activity should be slightly negative (-0.1 point) and should then be neutral over the rest of the year. All in all for the year, corporate stocking behaviour should thus contribute +0.4 points to GDP growth and should be the principal growth factor in 2014 (+0.7%).

In Q1 2014, corporate investment declined again

The investment by non-financial enterprises (NFE) dropped by 0.5% in Q1 2014 (see Table 1), after an increase of 0.8% in Q4 2013. NFEs thus reduced their investment in manufactured products (-0.9% after +1.5% in Q4 2013). Expenditure on capital goods increased (+2.0% after +0.8%), but that on transport equipment fell (-6.7%) although it had been boosted in 2013 (+5.3%) by early purchases in order to avoid the increase of 1st January 2014 in the cost of heavy goods vehicles (in order to respect the new “Euro 6” standards). Registrations of heavy goods vehicles thus increased by 18% in Q4 2013 then fell by 16% in Q1 2014 in reaction.

The fall in expenditure on construction, which was interrupted in late 2013, resumed in early 2014 (-1.1% in Q1 2014 after +0.3%), thus following the jolts in investment in public works. In terms of level, expenditure in construction reached its lowest level since late 2006. Finally, expenditure on services slowed (+0.2% after +0.6%) with a contrasting profile between well-oriented expenditure on IT services and a drop in expenditure on services to companies. All in all, the investment rate of NFEs declined slightly to 20.9% in Q1 2014 (see Graph 1).

Investment should increase slightly in 2014

In Q2 then in H2, investment should increase at a moderate rate. This is specifically what the business tendency surveys in industry suggest: questioned in April, industrialists anticipated an increase in value of 4% in their investment in 2014 and the revision indicator of investment in manufacturing industry

(1) The level of the investment rate has been affected by the change of base in the national accounts (see Focus: “The quarterly accounts switch to 2010 base”).

Table 1

| Investment by non-financial enterprises (NFE) |
| VARIATIONS AT PREVIOUS YEAR’S CHAIN-LINKED PRICES, AS A % |
| Quarterly changes | | Annual changes |
| | 2012 | 2013 | 2014 | | 2012 | 2013 | 2014 |
| Manufactured products (43%) | | | | | | | |
| Q1 | -2.7 | -0.3 | -0.4 | -1.2 | -0.5 | 0.0 | 1.2 | 1.5 | -0.9 | 0.5 | 0.6 | 0.3 | -1.5 | -0.7 | -1.5 |
| Q2 | -1.8 | -1.2 | -1.8 | -0.3 | 0.0 | -0.4 | 0.3 | -1.1 | -0.3 | -0.5 | 0.0 | -4.1 | -2.6 | -1.5 |
| Q3 | 2.2 | 0.0 | 1.2 | 0.5 | -1.0 | 1.2 | -0.3 | 0.6 | 0.2 | 0.4 | 0.3 | 0.5 | 4.9 | 0.9 | 1.3 |
| Q4 | 0.5 | 0.3 | 0.0 | 0.7 | -0.6 | 0.5 | 0.2 | 0.8 | -0.5 | 0.2 | 0.2 | 0.3 | 0.3 | -0.6 | 0.7 |

(1) The level of the investment rate has been affected by the change of base in the national accounts (see Focus: “The quarterly accounts switch to 2010 base”).
French developments

was high (see Graph 2). In services, however, business leaders’ judgement of their investments has deteriorated since the beginning of the year.

Financing terms should continue to buoy up investment. The margin rate of NFEs should progress sharply in 2014, with company cash flow benefiting from CICE payments. After increasing in 2013 as a result of the unexpected reduction in inflation, the real interest rate should continue to decline until December 2014. In addition, the balance of opinion on credit terms indicates that they have remained stable for nearly two years. However, demand prospects remain low and production capacity utilisation rates, which still did not progress in April and remain at a low level (80.0%), should limit the investment rebound.

Investment should see renewed growth in Q2 (+0.2%) but at a moderate rate over the forecasting period: +0.2% in Q3 and +0.3% in Q4 2014. The investment rate of NFEs should be virtually stable in H2 2014, at 20.8%, the same level as in Q2 2013, which is not particularly low in relation to historic averages.

Moderate increase in expenditure on manufactured products

NFE investment in manufactured products should rebound moderately in spring (+0.5%) and should grow at a comparable rate in H2: +0.6% in Q3 then +0.3% in Q4. This moderate growth is endorsed by the opinion of wholesalers in capital goods (40% of investments in manufactured goods): in May, the wholesalers questioned in the business tendency surveys indicated that sales of computers and information-communication hardware had improved considerably since the beginning of the year, and order intentions had stabilised. Moreover, automobile purchases should be stable in Q2: the rebound in registrations of private vehicles in April should

1 - Investment rate and margin rate

2 - Investment revision indicator in manufacturing industry
compensate for the new drop in registrations of heavy goods vehicles. In H2, growth in activity should be too modest to force an increase in investment in manufactured products.

**Toward a stabilisation of investment in construction**

In the building sector, the entrepreneurs surveyed in May reported a slight improvement in their activity, at a level that is nevertheless still poor. The growth in building permits for housing and the increase in building starts for non-residential buildings suggest a less marked decline in NFE investments in building (-0.3% in Q2 2014, -0.5% in Q3), and even a stabilisation at the end of the year.

**Investments in services should increase**

Other investments, mainly in specialised scientific and technical activities (including research and development) and in IT services, should progress at a rate in line with their average increase over recent years: +0.4% in Q2, +0.3% in Q3 then +0.5% in Q4.

On average for the year 2014, NFE investment expenditure should progress by 0.7% (after -0.7% in 2013): manufactured products expenditure should increase again (+1.5% after -0.7%) and services expenditure should pick up (+1.3% after +0.9%); the downturn in construction expenditure should be less pronounced (-1.5% after -2.6%).

**Inventory change contributed strongly to growth in Q1 2014**

In Q1 2014, inventory change contributed greatly to GDP growth (+0.6 points, after -0.3 points in the previous quarter, see Table 2). This positive contribution can be almost exclusively attributed to inventory change in manufactured products (+0.6 points), particularly in pharmaceutics and chemistry.

In addition, the renewed activity in the coke and petroleum products branch led to a restocking of refined products.

**Inventory change in manufactured products should stabilise**

In Q2, the contribution to growth of stocks of manufactured products should be slightly negative (-0.1%). In the monthly business tendency survey in industry in May 2014, inventory is considered to be stable at a level slightly lower than normal. The pace of inventory change should thus stabilise as of Q3 2014. All in all, over the year, the stocking behaviour of enterprises should thus contribute +0.4 points to GDP growth, and should constitute the main growth factor in 2014 (+0.7%).

### Table 2

**Contribution of inventory changes to growth (in points of GDP)**

<table>
<thead>
<tr>
<th></th>
<th>Quarterly changes</th>
<th>Annual changes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2013</td>
</tr>
<tr>
<td><strong>Agricultural and agrifood products</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Q1</td>
<td>Q2</td>
</tr>
<tr>
<td>Manufactured products</td>
<td></td>
<td></td>
</tr>
<tr>
<td>including:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agro-food products</td>
<td>-0.1</td>
<td>-0.4</td>
</tr>
<tr>
<td>Coke and petroleum products</td>
<td>0.0</td>
<td>0.2</td>
</tr>
<tr>
<td>Machinery and equipment goods</td>
<td>0.1</td>
<td>-0.3</td>
</tr>
<tr>
<td>Transport equipment</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Others industrial goods</td>
<td>-0.2</td>
<td>-0.1</td>
</tr>
<tr>
<td><strong>Energy, water and waste</strong></td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td><strong>TOTAL</strong> 1</td>
<td>0.0</td>
<td>-0.3</td>
</tr>
</tbody>
</table>

*Forecast

(1) Inventory changes include acquisitions net of sales of valuables.

Source: INSEE
International developments
Since early 2014, the price of a barrel of Brent has remained at a high level ($108), due to high geopolitical tensions while those on the physical market remain low. In Q1, the drop in demand from the OECD countries was accompanied by a slight increase of world production.

In Q2 2014, demand should only increase slightly due to a seasonal lull in the OECD countries. Furthermore, certain OPEC nations (Libya, Saudi Arabia) should be able to once again increase their production, while American production should remain dynamic.

Demand should increase in H2 2014, essentially driven by the OECD countries, and supply, bolstered by a high level of production both in the OPEC nations and on the American continent, should meet this demand. The price of a barrel of Brent, forecast to remain at $108, is nonetheless subject to several uncertainties: about the rebound in production capacities in the OPEC nations, the international tensions engendered by the Ukrainian crisis and the agreement on the nuclear issue in Iran.

Demand shrank in Q1 2014, while supply increased

Demand shrank in Q1 in Europe where energy needs were low as a result of a mild winter. In the United States, despite a harsh winter, demand dropped off due to less traffic on the roads and the maintenance period of the refineries. Supply increased, especially in the OPEC nations, but less than had been expected because of lower production in the central European countries (Russia, Kazakhstan).

Nevertheless, the price of a barrel of Brent remained high (on average $108, see Graph 1). After a period of slight easing at the start of Q1, the rise in international tensions around the Ukrainian crisis served to maintain the price of oil at a high level.

In Q2 2014, supply and demand should increase in parallel

In Q2 2014, demand should only increase slightly (+0.7 Mbpd). It is likely to drop in the OECD countries (-0.5 Mbpd), mainly in Japan (-0.9 Mbpd) where the fall in consumption is seasonal at the end of winter. However, it should be more dynamic in the non-OECD countries (+1.2 Mbpd), in particular in the Middle East (+0.4 Mbpd) where higher temperatures lead to an increase in the electricity consumption required for air-conditioning.

Supply should also show a slight increase (+0.4 Mbpd), benefiting from both the seasonal rise in the production of biofuels (+0.4 Mbpd) and the resumption of production from the OPEC nations (see Graph 2), especially in Libya where a political compromise between central government and the

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**International developments**

**Oil and raw materials**

_The market is easing but the price of crude remains high_

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---

**1 - Price of Brent in € and in $**

_Last point: June 12th 2014_

Source: Financial Times
International developments

Rebel forces should enable the gradual restart of several terminals. In Iraq, production has once again been on the increase since the end of Q1 2014, but internal tensions make the continuation of this recovery uncertain. Finally, Saudi Arabia has pledged to increase its offer if necessary.

In H2 2014, the sustained dynamism of supply should match an increase in demand

In Q3, production should continue to increase in Libya, in Iraq and in Saudi Arabia. Moreover, production may also rise in Iran if an agreement is reached with the G5 countries and Germany in July. Production should however drop slightly in Europe (-0.3 Mbpd) due to the period of maintenance of the infrastructures in the North Sea. Demand should increase within the OECD countries (+1.0 Mbpd) as a result of the driving season, and in the Middle East (+0.4 Mbpd).

In Q4, production should be boosted by the restart of facilities in Europe, by an increase in the American capacities of shipping oil to the Gulf of Mexico and by continuing dynamic production by the OPEC nations. Demand should also continue to rise, boosted by the reinforcement of business in the OECD countries.

The price of the barrel of Brent crude likely to stabilise at around $108

All in all, given that the increases in supply and demand are likely to be equal, the price of Brent should stabilise through to the end of the year. By convention it is thus set close to its last observed price (on average $108 in April 2014). The

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2 - Oil production in Saudi Arabia, Libya, Iran and Iraq

Last point: May 2014

Source: AIE

3 - Prices of industrial metals

Last point: June, 12th 2014

Source: London Metal Market
In Q2, industrial commodity prices are picking up.

Marked by slow growth worldwide and by surplus production resulting in an increase in stocks, prices on the industrial metals market dropped in Q1 2014 (see Graph 3). This is particularly the case of the price of copper, due to an industrial slowdown in China. Prices are recovering in Q2 as a result of strong demand worldwide. Similarly, the prices of aluminium should rise sharply in Q2 because of the embargo on the export of raw ore in Indonesia and to extremely long supply lead times.

Prices of agricultural commodities increased in Q1 (see Graph 4), as a result of the tensions engendered by the crisis in Ukraine (one of the leading producers of cereals). The increase has however remained relatively modest, given the high level of maize production bolstered by record harvests in the United States. The same applies to wheat which benefited from better weather conditions and substantial reserves worldwide. Future price prospects depend on the evolution of the geopolitical tensions in central Europe.
International developments

Financial markets

Monetary policies put to the test of recovery

Faced with signs of economic recovery, albeit slow in the Eurozone but somewhat stronger in the other developed countries and in particular in the United States, the issue of the monetary policy to be adopted is critical on both sides of the Atlantic.

For the moment, the Fed, faced with the consolidation of the recovery and the upturn in the labour market, continues to maintain its strategy towards an end to quantitative easing by reducing the amount of its monthly securities purchases.

The ECB is faced with weak inflation, a lasting shrinkage of loans to the private sector and the high level of the Euro which has taken its toll on the competitiveness of the monetary union. In June 2014, it lowered its base rate to 0.15% and announced the implementation, as from the Q3 2014, of several very long-term refinancing operations.

Despite these persistent difficulties, the increasingly apparent return of growth in the Eurozone and the reallocation of international capital flows in Euros are all beneficial to the sovereign debt market, especially in the peripheral nations. This attractiveness is sustaining the Euro exchange rate which stands at a high level against the dollar despite the trend towards a tightening of monetary policy in the United States.

Over the forecasting period, the conventional assumptions for exchange rates against the Euro are 1.36 dollars, 139 yen and 0.81 pounds.

Monetary policy continues to return to normal in the United States but eases in the Eurozone

In Q2 2014, the Fed maintained the push to bring its monetary policy back to normal. It once again reduced the pace of its securities purchasing at the end of April 2014 for the fourth consecutive time. Since May 2014, the Fed’s monthly purchases are 20 billion dollars in mortgage backed securities (MBS) and 25 billion dollars in Treasury bonds, just half of what it was purchasing at the end of 2013. Its securities purchasing should end completely at the end of 2014, marking the end of the period of expansion of its balance sheet that began in 2008. At the same time, the interest rate policy of the Fed remains unchanged. Its base rate has stood at 0.25% since September 2009. Any change in that policy is conditional upon a new, substantial upturn in the labour market.

The gradual drop in inflation in the Eurozone is a matter of concern for the ECB. Consequently, at its meeting of June 5, 2014, the Board of Governors considerably eased the bank’s monetary policy. The deposit rate was lowered by 10 base points to 0.15% and the credit facility rate, where the banks deposit their surplus liquidity on a day-to-day basis, was lowered to 0.1%. Furthermore, as from September 2014, the ECB will undertake targeted longer-term refinancing operations in two stages:

- in September and December 2014, the ECB will offer European banks a four-year loan the amount of which may reach up to 7% of their outstanding loans to the non-financial private sector (to the exclusion of property loans to households) as recorded in April 2014, i.e. an amount of approximately €400 billion;

- between March 2015 and June 2016, each quarter the ECB will loan banks up to three times the amount of their new net loans to the non-financial private sector (again to the exclusion of property loans to households) at a rate close to the base rate.

Finally, the ECB will extend its list of collaterals eligible as backing for its refinancing operations and will maintain its procedure of calls for tender entirely serviced at a fixed rate for the main refinancing operations up to at least December 2016. It has also announced that it will be stepping up its preparation for the eventual implementation of a programme for the purchasing of securities backed by loans to non-financial enterprises.

In the United Kingdom, as in Japan, monetary policy has remained unchanged. The Bank of England (BoE) has kept its base rate (at 0.5%) and still holds a substantial amount (unchanged since the summer of 2012) of Treasury bonds to the amount of 375 billion pounds or 20% of GDP. The rapid drop in unemployment below the target of 7% initially quoted by the BoE suggests the end of the status quo in the coming quarters. In Japan, the central bank maintains its highly accommodative policy that began in early 2013 to enable the
country to put an end to deflation. It therefore continues to expand its monetary base at an annual rate of 60 to 70 trillion yen (approximately 15% of GDP per year between 2013 and 2015).

**In the Eurozone, the interbank market is picking up but lending continues to shrink**

Despite the reduction in the surplus liquidity held by the banks, a large number of European banks continue to refinance at the ECB counter thanks to the liquidity loaned during the extra-long-term refinancing operations at the end of 2011 and in early 2012. This is the case in particular in the peripheral nations where financial institutions remain fragile. Nevertheless, the interbank market has been showing signs of improvement since early 2014: the volumes traded on a day-to-day basis are definitely on the rise, leading to a return of some volatility. Exchanges are, however, still made preferentially between banks in countries at the «core» of the Eurozone to the detriment of those in the peripheral nations, resulting in persistent disparities.

Lending to businesses remains marked by the drop in outstanding loans in Q1 2014, albeit at a slightly slower pace than at the end of 2013. This drop is particularly noticeable in Italy and Spain (see Graph 1). The Bank Lending Survey undertaken by the ECB released in April 2014 attributes the smaller drop in outstanding loans to the fact that applications to the banks have gained momentum in a context of stability of supply. However, according to the survey on access by European SMEs to financing also undertaken by the ECB (the SAFE survey) covering the period from October 2013 to March 2014, 14% of European SMEs are still faced with difficulties in obtaining external financing (for an analysis of the impact of lending conditions on French firms between 2003 and 2013, see the report in this Conjoncture in France "The corporate credit market in France: is there an accelerator effect on the economy?"). Furthermore, within the Eurozone, there are still considerable disparities between the different bank loan rates charged to businesses. The average interest rates on new loans granted to Italian and Spanish business are in fact more than one point higher than those granted to German and French businesses (see Graph 2).

**The sovereign debt market continues gradually to return to normal**

In the Eurozone, the return to normal of the financing conditions of European sovereign debt continues and the main countries impacted by the sovereign debt crisis in 2011 are beginning to enjoy more favourable conditions. The sovereign 10-year yields in Spain and Italy continue to drop, and were around 2.9% and 3.0% respectively in May. The situation in the countries that were harder hit is also improving: in April, Greece made its first issue of long term sovereign debt since 2010 (€3 billion at 5 years at 4.9%), in May, Portugal exited the Troika bailout programme without opening any new line of credit. At the same time, Germany and France continue to benefit from very advantageous financing conditions (with rates at 1.4% and 1.8% respectively in May). Similarly, the United States and the United Kingdom have kept low and stable rates since the start of the year.

![Graph 1](image1.png)

**Outstanding bank lending to non-financial enterprises in the Eurozone**

*Last point: April 2014*

<table>
<thead>
<tr>
<th>Year-on-year changes in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
</tr>
<tr>
<td>---</td>
</tr>
<tr>
<td>Germany</td>
</tr>
<tr>
<td>Spain</td>
</tr>
<tr>
<td>France</td>
</tr>
<tr>
<td>Italy</td>
</tr>
<tr>
<td>Eurozone</td>
</tr>
</tbody>
</table>

Source: European Central Bank
The Euro remains strong

Despite the slowdown in American quantitative easing and the expected differentials in inflation and growth rates, the Euro remains strong against the dollar (see Graph 3). This can be partially explained by the renewed attractiveness of European investments and in particular the sovereign debt of the peripheral nations which present relatively high yields and that are again considered as bearing little risk. At the same time, the Yen has remained stable despite the continuation of the quantitative easing programme implemented by the Japanese central bank. On the other hand, the Pound continues its appreciation which started in the summer of 2013. Furthermore, the Chinese authorities have continued to allow the Yuan to depreciate against the dollar. As of May 1st, 2013, it was at its lowest level since the end of 2012.

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**2 – Average bank lending rate to non-financial enterprises**

*Last point: April 2014*

![Graph 2: Average bank lending rate to non-financial enterprises](image)

*Source: European Central Bank*

**3 – Euro exchange rates**

*Last point: June, 12th 2014*

![Graph 3: Euro exchange rates](image)

*Source: European Central Bank*
International developments

Eurozone

In Q1 2014, activity grew again in the Eurozone: +0.2%, after +0.3% in Q4 2013. This rise was on a smaller scale than expected, mainly because of a disappointing world trade. But the increase in domestic demand (+0.2% after +0.1%) confirmed the gradual return of growth inside the zone.

This trend should continue until the end of the year, with domestic demand still progressing moderately (+0.2% in Q2, then +0.3% per quarter in H2). Although sluggish (+0.3% per quarter), consumption should improve thanks to modest increases in real wages and the weakening of fiscal consolidation, while the upturn in corporate investment should gather pace.

All in all, GDP in the Eurozone should rise by 1.0% in 2014, after falling by 0.4% in 2013.

Moderate growth in Q1 2014

In Q1 2014, activity in the Eurozone rose moderately, as in late 2013 (+0.2% after +0.3%). This rise is not as much as was forecast in the Conjoncture in France for March 2013 (+0.4%), mainly due to the only slight increase in exports (+0.3%). However, gradual recovery in the Eurozone is confirmed: as expected, domestic demand excluding inventory rose slightly (+0.2% after +0.1%), particularly private consumption (+0.1% after +0.0%). Capital expenditure, although slowing slightly, also remains dynamic (+1.5% after +2.7%).

According to the business tendency surveys, activity should continue to grow

After a strong improvement between mid-2013 and late 2013, the business tendency surveys have been globally stable since the beginning of the year, at a level that is consistent with moderate growth. Only the construction sector continues to be in a clearly adverse phase (see Graph 1).

The surveys indicate continued modest growth in the order of +0.3% per quarter until the end of the year.

Growth mainly driven by domestic demand: consumption...

Household purchasing power should increase again in 2014 (+0.8%), after a slump of four consecutive years, with the conjunction of two favourable factors. On the one hand, growth in activity should generate growth in employment, at a rate comparable to that of late 2013 (+0.1% per quarter). However, this increase is unlikely to be sufficient to lower the unemployment rate, which should stabilise at its April level (11.7%). The upswing in activity should also foster moderate growth in real wages (particularly in Germany and

1 - Confidence index by sector

Source: European commission
Spain. On the other hand, with the rate of fiscal consolidation weakening, the tax pressure on households should lessen (particularly in Italy).

In these conditions, consumption should again grow (+0.7% on average over the year), after a slump of two consecutive years (-0.6% in 2013 after -1.4% in 2012).

... and corporate investment, in spite of the decline in construction

After a steep downturn between mid-2011 and mid-2013, corporate investment has returned to relatively dynamic growth since the middle of last year (+1.5% on average since H2 2013). It is forecast to maintain this pace, supported by improved demand prospects and the need to renew production capacities after a marked phase of adjustment. This solid growth in investment should be in evidence in the leading countries in the Eurozone, with the exception of France, where the need for renewal is limited by the relatively good level of capital expenditure since 2010.

However, investment in construction remained sluggish in Q1 and should fall in Q2 2014 (-0.7%, mainly in reaction to the mild winter in Germany). Expenditure should then stagnate in H2, with contrasting developments depending on the country: in Germany, construction expenditure should rise sharply, particularly thanks to the release of reconstruction funds after the floods of spring 2013; conversely, in Spain, Italy and France, investment should continue to fall, though at a progressively slower rate. These short-term phase differences in construction between Germany and its main partners account for about half of the GDP growth differentials forecast for 2014.

Foreign trade no longer contributing to growth

Having stagnated in Q1, exports should then develop in a manner that is consistent with world demand: +1.2% in Q2 in reaction to the sluggishness of Q1, then +0.8% per quarter. In the wake of domestic demand, imports should also increase again at a relatively sustained pace (about +1% per quarter) and the contribution of foreign trade to growth should be nil in 2014, a sign of renewed vigour in domestic demand (see Graph 2).

Inflation set to remain limited

In May 2014, headline inflation stands at +0.5% year-on-year. It should increase slightly to +0.8% by December, as a result of the new rise in energy prices. Assuming that the price of Brent remains stable at $108 (€79.4) and as the decline observed in October and November 2013 comes to an end, the year-on-year variation in energy prices should see an increase of +0.5% in December 2014, after 0.0% in May. Moreover, the upturn in the price of food commodities observed since the beginning of 2014 should contribute to stepping up food prices by the end of the year. On the other hand, core inflation should remain limited: +0.8% over one year in December, after +0.7% in May.

Source: Eurostat, INSEE calculations and forecasts

2 – Domestic demand set to take over from foreign demand

Graph 2

Sources: Eurostat, INSEE calculations and forecasts

Conjoncture in France
Economic activity in Germany picked up substantially in Q1 2014 (+0.8%, up from +0.4%) despite weak exports. Winter temperatures were particularly mild, producing an increase in construction expenditure (+3.6% after +0.2%). Household consumption also rebounded (+0.7% after -0.3%) and investment in equipment accelerated (+3.3%, up from +1.4%).

Economic activity should slow in Q2 (+0.4%), due to a backlash in the construction sector. It should then pick up slightly in H2 (+0.5% per quarter), strengthened by investment and household consumption. As an annual average, economic activity should grow by 2.1% in 2014.

Exports recover
World trade fell back in Q1 2014 and German exports grew only slightly (+0.2%). However, export order indices in the business tendency surveys remain at a high level, which bodes well for a rebound in exports in Q2 (+1.6%). They should then increase at the same pace as world trade (+1.1% per quarter).

In contrast, imports were very dynamic in early 2014 (+2.2% in Q1). They should slow in Q2 before growing at a sustained pace in H2, galvanised by strong domestic demand. All in all, the contribution of foreign trade to growth is likely to be null in H2 after a negative contribution in Q1 (-0.9 points) and after a rebound in Q2 (+0.6 points).

Dynamic investment expenditure
Investment in construction saw a strong increase this winter (+3.6%), as the number of days of frost was particularly low for the season. It is likely to shrink in reaction in Q2 (-2.3%) and should then increase at a sustained rate in H2 (+1.2% per quarter), due partly to low interest rates and partly to government expenditure to rebuild infrastructure damaged by floods in spring 2013.

In contrast, investment in capital goods increased sharply in Q1 (+3.3%). This dynamism should persist: the capacity utilisation rate is increasing (see Graph), as are domestic orders for capital goods. Overall, the investment rate should pick up, although it will not return to its 2011 level and investment in capital goods should grow by 7.3% in 2014, after -2.2% in 2013.

Consumption on the rise
In Q1 2014, the unemployment rate reached its lowest level since reunification (5.1%). The labour market situation should continue to improve for the rest of the year and employment is likely to increase by 1.1% in 2014, after +0.9% in 2013. While wages per head should remain at a moderate level (see Focus), the purchasing power of household income should improve in 2014 (+1.0% after +0.6%), bolstered by the drop in inflation. As a result, household consumption is also likely to pick up: +1.3% in 2014, after +1.0% in 2013.

Recovery of the investment in capital goods

Sources: ifo, Destatis
German wages remain moderate before the introduction of the minimum wage

German wages slowed down in 2013

Germany has a substantial trade surplus: in 2013, Germany’s current balance reached 7 GDP points. For a decade now, German growth has been driven more by exports than by domestic demand. The reduction of macroeconomic imbalances within the Eurozone therefore requires a rebalancing of German growth. This more specifically involves a perceptible acceleration of wages in Germany, both to support German domestic demand and to facilitate competitiveness adjustments within the Eurozone (see, for example, IMF - September 2013 - or European Commission - March 2014). However, German wages slowed down in 2013 (see Graph 1 and Destatis, 2014).

This slowdown in wages may have a short-term cause...

This slowdown may have a short-term cause: at the time when branch agreements were being renegotiated (around Q2 2013), activity in Germany had just gone through two very gloomy quarters (-0.5% then 0.0%), and the national-concept unemployment rate - the one that is most closely tracked in Germany - had increased in Q4 2012. In construction in particular, a sector in which nominal wages fell in 2013 (see Graph 2), activity shrank sharply during the winter due to unseasonably low temperatures.

… but the early signals for 2014 do not indicate any acceleration

In 2014, the economic signals are far more positive (GDP up by 0.8% in Q1 2014, unemployment rate falling continuously for more than a year) and offer a favourable context for wage demands. However, the first indications regarding the opening of wage negotiations suggest only moderate growth in German wages (in particular, an increase of 3.1% in construction, after +3.2% in 2013). So our forecast scenario assumes a relatively stable situation for nominal wage rises (+2.3% forecast in 2014, against +2.2% in 2013).

The implementation of a minimum wage should, however, lead to wage rises in 2015

Wages, however, could accelerate in 2015, with the implementation of a minimum wage in Germany. According to Germany’s main economic institutions, the introduction of this minimum wage will increase the average nominal wage per head by about 0.7%. This rise should lead to an acceleration in German wages². Moreover, the downward trend in the unemployment rate should end up causing growing tensions in the labour market and lead to a wage rise.

---

1 - Real wages

annual change, in %

How to read it: There are two main sources on wages in Germany. The first to be published, the quarterly wages survey, receives major press coverage; it indicates a fall in real wages of 0.1% in 2013 (after +0.5% in 2012). The second, the national accounts data, states that real wages increased by 0.6% over the year (after +1.3% in 2012). Beyond the difference in the deflator (consumer price index or consumption deflator), the differential stems principally from the nominal wages series, and hence partially from a different scope: the national accounts cover the whole of the economy (including the non-market sector), whereas the wages survey covers only companies with more than five employees. So data from the national accounts should be preferred when considering wages in Germany.

Sources: Destatis, INSEE calculations
International developments

2 - Contribution to the growth in nominal wages

Sources: Destatis, national accounts, INSEE calculations

Bibliography

Destatis, Reallöhne 2013 um 0,2 % gesunken, February 2014.
Projektgruppe Gemeinschaftsdiagnose, Deutsche Konjunktur im Aufschwung - aber Gegenwind von der Wirtschaftspolitik, Frühjahr 2014.
International developments

Italy

Slow recovery

Economic activity declined by 0.1% in Q1 2014, while growth had only turned positive in Q4 2013 (+0.1%), after nine quarters of recession. This decline was unexpected (+0.2% forecast in the March Conjoncture in France and according to the April consensus). However, it should be only temporary: activity should pick up in Q2 (+0.1%), before accelerating slightly in H2 (+0.2% per quarter).

Business tendency surveys still showing a positive trend

Despite the decline in activity in Italy in Q1 (-0.1%), the recent upturn in the business tendency surveys suggests a slight acceleration in activity (see Graph). In the manufacturing sector in particular, the PMI surveys are up to 53.2 in May, indicating that the sector is in an expansionary phase. The improvement in services is less dramatic, but available indicators in May do not suggest any further contraction in activity. Lastly, the contraction in the construction sector should ease off by the end of the year, according to the slight improvement seen in recent surveys. All in all, activity should grow in Q2 (+0.1%), before accelerating slightly in H2 (+0.2% per quarter).

Consumption slightly more dynamic in H2

This acceleration in activity in H2 should be driven by the implementation of a stimulus package (especially tax reductions for modest households) announced by the Renzi government. Household purchasing power should therefore increase significantly in Q3 (+0.9%), despite the decline in employment (-0.1% per quarter) and sluggish real wages. After growing slightly in Q1 (+0.1%), consumption should increase again in Q2 (+0.1%) before becoming even more dynamic in Q3 (+0.3%) and Q4 2014 (+0.2%, see Focus).

Investment in equipment set to pick up, contribution of foreign trade to growth remaining virtually at a standstill

Investment should follow two different trends in 2014. On the one hand, investment in capital goods should grow (+0.5% in Q2 then +1.2% per quarter in H2), stimulated by low interest rates and the gradual recovery of companies operating margins. On the other hand, spending on construction is likely to decline further over the forecasting period (-0.5% per quarter in H2).

Exports should pick up again by the end of 2014 (around +0.5% per quarter), while imports should accelerate slightly (+0.4% per quarter) in line with domestic demand. The contribution of foreign trade to growth should be virtually nil. After two years of recession, economic activity should increase by 0.1% in 2014, but with a strong acceleration throughout the year: year-on-year GDP growth should increase from -0.9% at the end of 2013 to +0.4% at year’s end in 2014.

Sources: Markit, Eurostat

GDP and composite PMI index of activity
How to account for the sharp drop in the savings ratio of Italian households throughout the Great Recession?

Italian households have stood out since the beginning of the crisis by the continuous fall in their savings ratio

Since the start of the financial crisis in 2008, household savings ratios in the Eurozone (and more generally in the major developed countries) have followed a path that matched economic intuition very closely: a raise during the peak of the crisis (2009), linked with the rise in unemployment (which encourages households to increase precautionary savings) and with the fall in asset prices (which reduces household wealth), then the gradual return to the pre-crisis level. Although the scale of these trends varied substantially in the different countries (very steep rise then fall in Spain, virtual stability in Germany and France), this phenomenon was widely broadcast.

The behaviour of Italian households was unusual (see Graph 1): the savings ratio dropped continuously from 2007 (15.5%) until 2012 (11.9%), even during the peak of the Great Recession, and did not pick up until 2013. While an international comparison of savings ratios may be fragile, savings of Italian households were far below the average in the Eurozone, despite the rise in the unemployment rate (from 6.1% in 2007 to 12.2% in 2013).

This unusual development in the savings ratio could be linked to the very strong purchasing power decline of Italian households since 2008

In an analysis of household behaviour, the hypothesis generally put forward is that households have a target savings ratio (which depends mainly on unemployment, inflation or on household wealth) which suggests that households are able to adjust their consumption to any variation in their income in order to keep their savings ratio close to their target value. While this assumption is usually verified, in Italy this did not seem to be the case when the purchasing power of disposable income dropped sharply between 2008 and 2012 (-8.2%). Facing a major drop in their income (due to a rise in taxation and a reduction in their wages), households should have drawn on their savings, over and above what their theoretical target suggests, in order to guarantee a given level of consumption. This seems to be confirmed by the Eurostat survey on ‘the inability of households to make ends meet’ which suggests that Italian households are those who meet the most difficulty in balancing their budget (17.2% experienced difficulties in 2012, compared with 14.7% in Spain and 4.4% in France).

In order to model this specific behaviour, we use a traditional econometric equation, but in which consumption reacts, in the short term, only to income increases. In this specific equation, there is no effect on consumption in the short term if there is a drop in disposable income. This model is therefore unusual because variations in disposable income have an asymmetrical impact on consumption, depending on whether they are positive or negative.

(1) One of the most symbolic programmes (“Salva Italia”) introduced by the Monti government at the end of 2011, included a €20 billion reduction in government deficit and €10 billion stimulus package, funded in part by huge tax rises.

1 - Change in household savings ratio

Sources: Eurostat
International developments

The equation is written as follows:

\[d(1_{\text{conso}}) = -0.58 - 0.08 \left[ l_{\text{conso}}(-1) - l_{\text{rdbr}}(-1) \right] + 0.16 \cdot d(1_{\text{rdbr\_plus}}) - 0.01 \cdot d(taux\_long\_plus) - 0.16 \cdot d(l_{\text{def\_conso}}(-1)) - 0.01 \cdot (chomage - \log(chomage(-2)))\]

where:
- \(d\): first difference;
- \(l\): logarithm;
- figures in parentheses are the Student’s T test.

The variables are:
- conso: effective consumption;
- rdbr: real GDI;
- d(\(1_{\text{rdbr\_plus}}\)) growth of GDI when this is positive;
- def_conso: consumption deflator;
- taux_long_plus: variation in interest rates when this is positive

This econometric model provides a good understanding of household consumption behaviour (see Graph 2).

2 - Econometric estimation of the equation for private consumption in Italy: simulated consumption versus effective consumption

Sources: Istat, INSEE calculations

3 - Confidence of Italian households

Sources: Istat, DG Ecfin

How to read it: Istat has made a change in methodology from June 2013, resulting in a discontinuity in the series

Sources: Istat, DG Ecfin
After three years of uninterrupted decline, Italian household consumption should increase in 2014

From 2010 to 2012, consumption in Italy declined, but less than the steep fall in disposable income would suggest. Since 2013 however, the situation of households has gradually improved, with a rise in purchasing power in the second half of the year. In the model selected here, we find a more standard relationship between consumption and income: in the short term, wage rises contribute in part to building up their savings. Indeed, the household savings ratio was once again moving upwards throughout 2013, even though confidence was gradually returning (see Graph 3). At the same time, consumption seemed better oriented over the quarters (see Graph 4).

Recent short-term indicators (retail sales, new car registrations; see Graph 4) suggest that consumption is likely to rise again in spring 2014 (after +0.1% in Q1). Then in H2 2014, household consumption should pick up (+0.3% mainly in Q3), as a result of a stimulus package which should increase gross disposable income by 0.9%. However, as suggested by the model, Italian households should use this income rise to increase their precautionary savings: the savings ratio would then rise by 0.6 points in 2014.

(2) In accordance with the announcements made by Mr Renzi when he took office in March 2014, the budget presented by P.C. Padoan in April 2014 included a €100 reduction in income tax for households earning less than €25,000 per year, in other words an increase in income of around €1,000 net per year for monthly wages of less than €1,500 per month. The total cost of this measure is estimated by the government at €10 billion, and it could affect almost 10 million people.

4 - Private consumption, retail sales and new car registrations

Sources: Association of car makers, Istat
Economic activity in Spain has found its way back to growth since mid-2013, and should maintain this Q1 momentum until the end of 2014 (+0.5% per quarter). Foreign trade shouldn't contribute to Spanish growth, only sustained by domestic demand. Investment in capital goods should keep the rapid growth rate of 2013 (+2.4% per quarter). Private sector consumption should also increase throughout the year, supported by small purchasing power gains generated by the improvement in the labour market. Finally, the rate at which construction investment is shrinking should slow, with the end of the fallout from the real estate bubble in prospect.

**Activity set to increase sharply in 2014**

The Spanish economy accelerated in early 2014 (+0.4% after +0.2%) and should continue this momentum over the forecasting period (+0.5% per quarter). Purchasing Managers Index (PMI) surveys and the national surveys are again announcing significant growth in activity in services and in manufacturing. In construction, however, they are still at a very low level. This sector is likely to continue to suffer from the period of adjustment in the property market and the slow recovery of the Spanish economy.

**Private sector consumption should once again be the main contributor to economic activity**

At the start of the year, consumer confidence reached a higher level than the average for the 2000s. Spanish households are indeed much less worried about future rises in unemployment. Their opinion of their financial situation is also improving. Employment should stabilise in H1 before increasing in H2. Household purchasing power should benefit in particular from the rebound in wages, while inflation is likely to be very low. In addition, tax rises should slow, they should rise by an average of 1.0% per quarter in 2014 (compared with +2.0% on average per quarter in 2013). Thus purchasing power should increase slightly between Q2 and Q4 2014, after four years of sharp decline. After falling from 2010 to 2013, the savings ratio of Spanish households should decline slightly in 2014 to settle at a lower level than its long-term average. All in all, consumption should increase sharply, as the recent rise in consumer credit would suggest (see Graph 1).

**Investment in equipment showing strong progress**

There was a sharp increase in investment in equipment throughout 2013, sustained on the one hand by the need to reinvest after a marked phase of adjustment, and on the other hand by the high level of business margins. It should continue to grow over the forecasting period, at an annual rate of around 10%.

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**Household consumer credit**

*Including non-profit institutions serving households (NPISHs)*

Sources: Bank of Spain, INSEE calculations
International developments

United Kingdom

Still dynamic

The upturn in the United Kingdom economy has been vigorous since the beginning of 2013 with activity growing by 0.8% in Q1 2014. This recovery should continue at more or less the same pace in Q2, as suggested by the very high levels in the business tendency surveys, especially for services, and the dynamism of domestic demand supported by a well oriented household confidence which remains high. Activity should slow slightly in H2, linked with the current levelling off of the property market.

Business tendency surveys at their highest levels since 1989

Economic activity in the United Kingdom increased substantially once again in Q1 2014 (+0.8% after +0.7% in Q4 2013 and +0.8% in Q3). In Q2 2014, growth in the United Kingdom should remain dynamic (+0.7%). The Markit business tendency surveys and the CBI surveys maintained their high levels in April (the highest since 1989 for the CBI). Growth should be particularly dynamic in the service sector and in manufacturing. In H2 2014, activity should increase at a more moderate pace (+0.5% per quarter) because of the slowdown in both domestic and foreign demand. All in all, United Kingdom growth should reach +2.8% in 2014, after +1.7% in 2013. GDP should regain its pre-crisis level in mid-2014, i.e. three years after France and Germany.

Domestic demand likely to slow in H2

Household consumption and investment once again drove growth in Q1 2014. Consumer confidence has picked up substantially (see Graph), in line with the improvement in the labour market and the wealth effects generated by the rise in property prices. Households should therefore continue their upsurge in consumption expenditure in Q2 (+0.7% after +0.8%). In H2, household expenditure should slow slightly. On the one hand, the amounts of mortgage credit available have decreased over the last few months, probably as a result of the tightening of the Funding for Lending Scheme. On the other hand, the increase in real wages should remain weak and the dynamism of employment is likely to run out of steam, which will tend to reduce household purchasing power. As for businesses, increased production constraints and the high level reported in investment intentions surveys suggest that investment should maintain its dynamism.

Contribution of foreign trade should be negative in H2

In the last two years, the increase in exports has remained modest and the United Kingdom’s market share has continued to shrink. In addition, the strong pound is likely to hinder competitiveness. Exports should therefore increase more slowly than world trade over the forecasting period. Bolstered by the dynamism of domestic demand, imports should increase significantly; as a result, the contribution of foreign trade should be negative until the end of the year.

Household consumption and confidence: strong recovery since 2013

Sources: ONS, DG Ecfin, INSEE calculations
International developments

United States

Growth holds firm, but without taking off

Activity dropped in Q1 (-0.2% after +0.7%), as a result of extreme weather conditions and the decline in exports, but it should rebound in Q2 in reaction to the previous quarter (+0.8%). In H2, the catch-up effects should disperse with activity slowing slightly (+0.6% per quarter). Overall, growth is unlikely to take off in 2014 (+2.0% after +1.9%) despite the boost to purchasing power (+2.1% after +0.7%) and consumption (+2.7% after +2.0%). Indeed, after a vigorous upswing lasting two years, residential property should be at a standstill (+1.4% after +12.2%).

A clear improvement in the labour market

The American economy created 924,000 jobs between February and May and the unemployment rate fell once again to settle at 6.3%. This drop should continue until the end of the year and be matched by a slight upturn in wages. Overall, despite a slight increase in prices, purchasing power gains from income should remain solid in 2014 (+2.1% after +0.7%).

In Q1, despite the cold which curbed purchases of goods, household consumption of both goods and services was sustained (+0.8%), due to soaring expenditure on healthcare with the introduction of the Affordable Care Act. Consumption should remain dynamic until the end of 2014, sustained by the increase in the purchasing power of income, the drop in unemployment and the continuing rise in health expenditure, even though this may be at a more moderate rate.

Government spending no longer slowing activity

Fiscal policy was restrictive in 2013: the budget deficit fell from 9.3% in 2012 to 6.4% in 2013 as an annual average, and federal spending has declined sharply in the last six months as a result of the shutdown at the end of 2013 then the cold weather in early 2014. However, the 2014 budget approved by Congress in January has significantly reduced automatic cuts: all in all, federal spending should increase at a moderate rate between now and the end of the year.

Investment ready to recover

Corporate investment declined in Q1, for the first time in a year (-0.4%), the harsh winter having delayed deliveries of materials. Investment should bounce back as a reaction to this decrease in Q2 (+1.7%, see Graph). Household investment has been declining for six months due to the rise in interest rates in summer 2013 and the cold winter of 2014. These two effects should fade and investment in the residential sector should pick up once again before the end of the year, as suggested by the increase in the number of new housing starts and planning permits registered since January.

Exports fell in Q1 (-1.5%) as a result of the decline in world trade and the reduction in sales of hydrocarbons. They should take off again in Q2 (+1.8%), in line with world trade (see Focus). Imports too should recover some of their momentum, backed by the dynamism of domestic demand.
The United States has been increasing market share since 2005, a fact which is fully explained by the fall of the dollar.

American market share has decreased by three points in value since 2000 but has not fallen back since 2008...

Since 2002, the United States is no longer the world’s first exporter. American exports, which represented about 11% of world trade in goods between 1974 and 2000 (12.5% for all goods and services) fell abruptly between 2001 and 2007, under the dual effect of the appreciation of the dollar and increased competition from emerging countries, particularly China [see Graph 1]. Then, since 2008, the American share of exports stabilised at around 8.0% and has even slightly increased since 2011.

... in volume, it has even picked up a little since 2005

Market share in volume also fell between the end of the 1990s and the middle of the 2000s, in relatively identical proportions (between -16.9% and -23.9%) depending on the sources used1 [see graph 2]. Since 2005, market share has risen again (between +2.7% and +8.4%). For goods alone, the IMF, the CPB and the WTO value it around +6% to 8%; for goods and services, the estimates of the IMF and the OECD are both around +5.5% (see Table 1).

How can this upturn in market share since 2005 be explained? Did the United States increase its competitiveness beyond fluctuations in the dollar’s exchange rate?

1 The difference is due partly to the number of countries included in the calculations by different institutions, and partly to the primary sources used (national accounts or customs). The WTO and the CPB use customs data, whereas the IMF, the OECD and the Treasury Department use national accounting data. Moreover, the WTO uses customs unit prices to deflate the data in value and therefore ignores the quality effects. However, with the exception of the WTO, which reprocesses the series, all the other institutions use the series of American exports in volume calculated by the US Department of Trade.

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Graph 1: American exports’ share of world exports in value

Graph 2: American market share in volume

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1 - American exports’ share of world exports in value

2 - American market share in volume
International developments

This positive development results in part from geographical orientation

The geographical orientation of American exports explains about three points of the fall in market share between the end of the 1990s and the middle of the 2000s, and an equivalent rise since then. The United States is profiting from its proximity to the countries of Latin America, whose imports have been much more dynamic than the rest of the world’s since 2009, whereas the opposite was true between 1999 and 2007.

A development in line with the development of cost competitiveness

We used a similar method than in Borey and Quille (2013) to estimate United States’ exports as a function of its principal standard determinants (world demand for American products and cost competitiveness index) in one step from Q1 1991 to Q4 2007. Several models were developed, according to different world trade sources and by testing four cost competitiveness indicators: unit labour costs, American exports of manufactured products prices (relative to world prices), the real effective exchange rates calculated by the Fed and those calculated by the Treasury Department (see Graph 3).

According to the world trade series used, the estimated loss in the level of market share from 2001 was between 14% and 30% (see Table 2). The estimated elasticity of exports to cost competitiveness is even more sensitive to the series used: it varies between 0.0 and 1.0. At all events, it is low when compared with estimated elasticity in the European case reported by Borey and Quille (2013).

All in all, in spite of the wide divergences in level depending on the sources used, American exports are globally in line with the dynamic simulation of the model, which indicates that geographical orientation (world demand for American products) and the dollar’s past depreciation suffice to explain the increase in market share (see Graph 4): hence there is no increase in competitiveness in the American export, beyond fluctuations in cost competitiveness, and perhaps even the dollar’s exchange rate.

![Graph 3](image)

### Table 1

<table>
<thead>
<tr>
<th>Source</th>
<th>The development of the United States’ exports share (in %)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Source Champ</td>
</tr>
<tr>
<td>WTO</td>
<td>Goods</td>
</tr>
<tr>
<td>IMF</td>
<td>Goods</td>
</tr>
<tr>
<td>DG Trésor</td>
<td>Goods</td>
</tr>
<tr>
<td>CPB</td>
<td>Goods</td>
</tr>
<tr>
<td>IMF</td>
<td>Goods and services</td>
</tr>
<tr>
<td>OECD</td>
<td>Goods and services</td>
</tr>
</tbody>
</table>

### 3 - Indicators of cost competitiveness in the United States

![Graph 4](image)

Source: WTO, IMF, OECD, CPB, BEA, DG Trésor

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Table 2

<table>
<thead>
<tr>
<th>Explained variable</th>
<th>world trade</th>
<th>Estimate of loss of market share from 2001 (in %)</th>
<th>Estimate of long term elasticity of exports to the real effective exchange rate</th>
<th>Exports differential from the simulated dynamic as a % in Q4 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exported quantities - WTO</td>
<td>WTO Goods</td>
<td>-14 -15 -15 -15 0,1 0,1 0,1 0,2 2,6 3,8 2,6 3,1</td>
<td></td>
<td></td>
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<tr>
<td>Exports of goods - BEA</td>
<td>IMF Goods</td>
<td>-18 -19 -19 -20 0,1 0,2 0,2 0,3 -0,4 0,4 -0,8 1,2</td>
<td></td>
<td></td>
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<tr>
<td>Exports of goods - BEA</td>
<td>DG Trésor Goods</td>
<td>-24 -24 -24 -30 0,5 0,7 0,9 1,0 -9,7 -5,1 -9,9 -5,7</td>
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<tr>
<td>Exports of goods - BEA</td>
<td>CPB Goods</td>
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<tr>
<td>Exports of goods and services - BEA</td>
<td>IMF Goods and services</td>
<td>-18 -18 -18 -21 0,3 0,3 0,4 0,5 -2,0 0,3 -2,1 -0,3</td>
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<tr>
<td>Exports of goods and services - BEA</td>
<td>OECD Goods and services</td>
<td>-22 -21 -21 -25 0,5 0,5 0,6 0,8 -5,5 -1,4 -5,3 -1,8</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

How to read it: The quarterly series consistent with world trade calculated by the WTO and the IMF are rebuilt by calibration-adjustment, with the aid of three world trade series available on a quarterly basis (DG Trésor, CPB and OECD). Likewise, the WTO’s quarterly series of American exports is estimated by calibration-adjustment with the aid of the Department of Commerce’s series of goods exports. The series of real effective exchange rates are calculated monthly by the Fed and DG Trésor. The relative ULC are published quarterly by the OECD. The relationship between prices and exports is constructed with the aid of the monthly series of American export prices by the BEA and world export prices of manufactured products by the CPB. This is where we made the choice of modelling the loss of market share from 2001, the date when China entered the WTO, with a break in the constant of long-term relations: we thus estimate that it was an irreversible loss linked to the appearance of a new competitor in world trade, but not a linear trend for loss of market share. Lastly, the series on geographical orientation is the relationship between world demand for US products and world trade estimated by the Treasury Department to obtain an approximation of series of world demand for US products.
International developments

Japan

The VAT increase puts pressure on activity in the spring

Activity in Japan increased sharply in Q1 2014 (+1.6% after +0.1%) boosted by advance purchasing not only by households but also by businesses before the VAT increase came into force on 1st April 2014 (from 5% to 8%). In Q2 2014, activity should fall as a reaction to this (-1.0%) before reviving with a modest increase in H2 2014 (+0.3% per quarter).

According to the business tendency surveys, activity in Q2 should decline significantly

In April, the business tendency surveys reached a turning point and activity is now set to decline in the spring. The PMI indicator for the manufacturing sector lost more than 4 percentage points (49.4 after 53.9 in March) due to the drop in production and orders, and stabilised in May. The decline in activity in Japan is also visible in the deterioration in the business climate for SMEs, as reported by the survey carried out by the Shoko Chukin Bank. However, the feeling about future activity in the national surveys (Economic Watchers Survey) is picking up (53.8 in May compared with 34.7 in March, see Graph) paving the way for an upturn in activity in H2, after the negative shock caused by the VAT increase.

Domestic demand should decline

In reaction to the purchases made in Q1 in anticipation of the rise in VAT, household consumption should fall steeply in Q2 (-2.0% after +2.2%). In addition, inflation is likely to exceed 3% before the end of the year, for the first time in twenty years, while the rebound in wages, although real should nevertheless remain modest: the purchasing power of wages is therefore likely to decline and consumption to be lacklustre in H2. Households will probably also cut back drastically on their investment spending between now and the end of the year: deeds of sale signed before 1st October 2013 were still charged VAT at 5%, and so housing starts took off towards the end of 2013, before collapsing at the start of 2014. Finally, productive investment is also set to decline in Q2 (-1.4%) after a very dynamic Q1 (+7.6%). However, it should return to modest growth in H2 (+0.5% per quarter) as hinted at by the rebound in orders recorded in March.

The trade deficit should remain high

The business tendency surveys suggest a clear slowdown in exports after the lively progress in Q1 2014, and exports should slow markedly in Q2 in a backlash effect (+0.5%). Then, in line with world trade, exports should grow in H2 (+0.6% per quarter). Imports should fall in Q2 (-1.5%) in the wake of domestic demand, to bounce back somewhat in H2 (+0.5% per quarter). Overall, the balance of goods and services deficit should climb to almost 4% of GDP in 2014, after 2.8% in 2013, its highest level for forty years.

Sources: Shoko Chukin Bank, Cabinet office
International developments

Emerging economies

Concerns about China, Russia falling behind

In Q1 2014, economic activity in the major emerging economies continued to grow much slower than its trend: +1.1% after +1.2%, compared with an average of +1.7% from 2000 to 2010. Imports in the emerging countries were at a standstill (-0.1%) while exports shrank significantly (-2.5%), especially in Asia.

It appears likely that activity will just be ticking over through to the end of the year. After Q1 was disrupted by the New Year, activity in China should pick up in spring; but this upturn will probably be limited because of the downturn in the construction sector recorded since January. The crisis in Ukraine has caused a collapse in investment in Russia and is harming prospects in Eastern Europe. In Brazil, the business climate in industry and construction is deteriorating just as the country is hosting the football World Cup.

No improvement in sight despite a period of financial calm

The prospect of a slowdown in money creation in the United States led to a first wave of withdrawal of capital invested in the emerging countries and a sudden depreciation of their currencies in summer 2013, particularly in those countries with a high current deficit. After a period of calm in autumn, capital withdrawals picked up again in December, giving rise to a new fall in both markets and currencies, especially in Russia, Turkey and Argentina. The central banks intervened on the foreign exchange market and once again tightened their monetary policies (Brazil, India, Indonesia, Russia, Turkey). Since March, tensions over the financial markets have cooled and both share prices and currencies have picked up. However, it is likely that this monetary tightening in the past will continue to affect activity which is likely once again to just tick over. Indeed, the business climate has slumped since November 2013 and was still at a very low level in May 2014, compared with the average for the 2000s (see Graph 1).

Imports should pick up slightly after marking time in Q1, but overall they should slow to +4.9% in 2014 after +6.2% in 2013, a long way below the average annual rate between 2000 and 2010 (+9.6%).

Property slipping back in China

Activity once again slowed in Q1 2014 in China (+1.4% after +1.7%). Although the temporary shocks that affected activity in Q1 have faded away (shrinking world trade, Chinese New Year) giving a slight boost in spring, it should still be limited according to the first indicators available. In May, industrial production had picked up by only 8.8% in a year, one of the lowest increases since 2009. The business climate in the industrial sector is still relatively lacklustre. As for demand, investment clearly seems to be slowing (see “Slowdown in China: what risks for the world economy?”): the increase in the acquisition of fixed assets reached +17.2% in May, its lowest since 2001. As a result of the tightening of credit conditions, the property market has reached a turning point: housing starts have collapsed (-20% year-on-year for the first four months of the year), as have sales of commercial properties (-7%) and land (-8%). Property prices have also settled down after a surge in 2013.

Sources: Markit, Centraal PlanBureau, INSEE forecasts

Graph 1 - Emerging economies idling

PMI - Emerging economies - Industry
PMI - Emerging economies - Services
Imports of emerging economies

June 2014
International developments

A struggling Brazilian economy welcomes the World Cup

In Brazil, monetary easing and fiscal stimulus measures enabled activity to rebound as from Q2 2012. This stimulation in demand has caused a serious deterioration in the country’s trade balance: it barely reached equilibrium in 2013 whereas it had a major surplus until 2012. However, a succession of monetary tightening policies in the last year along with social movements have contributed to a reversal of the business climate. In May 2014, household confidence was at its lowest since 2009 (see Graph 2) and the confidence of business leaders was deteriorating, especially in industry and construction. Support from this sector is likely to moderate considerably when projects linked with hosting the World Cup are completed.

The Ukrainian crisis has shaken Russia and weakened Eastern Europe

Activity in Russia had been showing signs of picking up for the last six months, but it shrank in Q1 2014 (-0.5%). Since the beginning of the year the Ukrainian crisis has led to a massive withdrawal of capital and caused the rouble to decline: investment has dropped (-4.9% in volume year-on-year in Q1), as have imports of goods (-7.5% in value over one year, see Graph 3). The business tendency surveys have deteriorated sharply since January, against a background of successive monetary tightening (increase in base interest rates from 5.5% to 7.5% between February and April). As a result, the Russian economy could be entering recession in Q2 2014. Probably as a repercussion of the crisis in Ukraine, the business climate in Poland and the Czech Republic has also been reversed, signalling a slowdown in activity.

2 - A struggling Brazilian economy welcomes the World Cup

Source: Fondation Getulio Vargas

3 - Investment slipping back in Russia

Source: Russian Central Bank
Countries Accounts
### Eurozone

#### Supply and use table (in real terms)

<table>
<thead>
<tr>
<th></th>
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<td>Public consumption (21%)</td>
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#### Contributions to GDP growth

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<td>-0.2</td>
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<tr>
<td>Foreign trade</td>
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<td>0.2</td>
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### Consumer prices in Eurozone

#### Changes in a % and contributions in points

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<th>May 2014</th>
<th>June 2014</th>
<th>December 2014</th>
<th>Annual averages</th>
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<tr>
<td>CPI groups (2014 weightings)</td>
<td>yoy</td>
<td>cyoy</td>
<td>yoy</td>
<td>cyoy</td>
<td>yoy</td>
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<tr>
<td>All (100.0%)</td>
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<td>0.7</td>
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<td>0.4</td>
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<tr>
<td>Food (incl. Alc. and Tobacco) (19.8%)</td>
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<td>0.1</td>
<td>0.1</td>
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<tr>
<td>Food (15.7%)</td>
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<td>-0.6</td>
<td>-0.1</td>
<td>-1.0</td>
</tr>
<tr>
<td>Alcohol beverages and tobacco (4.0%)</td>
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<td>0.1</td>
<td>3.1</td>
<td>0.1</td>
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<tr>
<td>Energy (10.8%)</td>
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<td>0.0</td>
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<tr>
<td>&quot;Core&quot; inflation (69.4%)</td>
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<td>0.7</td>
<td>0.7</td>
<td>0.5</td>
<td>0.7</td>
</tr>
<tr>
<td>Manufacturing goods (26.7%)</td>
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<td>0.0</td>
<td>0.0</td>
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<tr>
<td>Services (42.8%)</td>
<td>1.6</td>
<td>0.7</td>
<td>1.1</td>
<td>0.5</td>
<td>1.3</td>
</tr>
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</table>

### France (21%)

#### Supply and use table (in real terms)

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<th></th>
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<tbody>
<tr>
<td><strong>GDP</strong></td>
<td>0.2</td>
<td>-0.3</td>
<td>0.3</td>
<td>-0.3</td>
<td>0.0</td>
<td>0.6</td>
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<td>0.0</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Private consumption (56%)</td>
<td>0.5</td>
<td>-0.6</td>
<td>0.1</td>
<td>-0.1</td>
<td>0.3</td>
<td>0.2</td>
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<td>-0.5</td>
<td>0.5</td>
<td>0.4</td>
<td>0.3</td>
</tr>
<tr>
<td>Investment (20%)</td>
<td>-0.2</td>
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<td>-0.2</td>
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<td>-0.9</td>
<td>-0.1</td>
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<td>-0.2</td>
</tr>
<tr>
<td>Public consumption (27%)</td>
<td>0.6</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.5</td>
<td>0.7</td>
<td>0.3</td>
<td>0.5</td>
<td>0.4</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Exports (27%)</td>
<td>-0.5</td>
<td>0.1</td>
<td>0.4</td>
<td>-0.5</td>
<td>0.3</td>
<td>0.2</td>
<td>0.7</td>
<td>-0.4</td>
<td>1.6</td>
<td>0.3</td>
<td>0.8</td>
<td>0.5</td>
</tr>
<tr>
<td>Imports (30%)</td>
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<td>-0.2</td>
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<td>1.7</td>
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<td>1.0</td>
<td>0.2</td>
<td>0.7</td>
<td>0.5</td>
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</table>

#### Contributions to GDP growth

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Domestic demand excluding inventories</td>
<td>0.4</td>
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<td>0.1</td>
<td>0.0</td>
<td>0.2</td>
<td>0.4</td>
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<td>-0.4</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
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<tr>
<td>Inventories</td>
<td>0.1</td>
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<td>0.0</td>
<td>-0.3</td>
<td>-0.1</td>
<td>0.0</td>
<td>0.4</td>
<td>-0.3</td>
<td>0.6</td>
<td>-0.1</td>
<td>0.0</td>
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</tr>
<tr>
<td>Foreign trade</td>
<td>-0.3</td>
<td>0.1</td>
<td>0.1</td>
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</tbody>
</table>

Forecast

How to read it: % in brackets represent the weight in the nominal GDP in 2012

yoy: year-on-year
cyoy: contributions year-on-year

(1) Share in Eurozone GDP

Sources: Eurostat, INSEE GDP

Conjoncture in France

128
### Germany (28%)<sup>1</sup>

#### Supply and use table (in real terms)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Private consumption (57%)</th>
<th>Investment (18%)</th>
<th>Public consumption (19%)</th>
<th>Exports (52%)</th>
<th>Imports (46%)</th>
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<td>2012</td>
<td>0.7</td>
<td>0.0</td>
<td>-0.4</td>
<td>0.2</td>
<td>1.7</td>
<td>0.1</td>
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<tr>
<td>2013</td>
<td>-0.1</td>
<td>0.0</td>
<td>-1.7</td>
<td>-0.1</td>
<td>1.4</td>
<td>0.7</td>
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<tr>
<td>2014</td>
<td>-0.2</td>
<td>0.0</td>
<td>-0.1</td>
<td>0.3</td>
<td>0.8</td>
<td>0.3</td>
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</table>

#### Contributions to GDP growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic demand excluding inventories</th>
<th>Inventories</th>
<th>Foreign trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>0.0</td>
<td>0.1</td>
<td>0.8</td>
</tr>
<tr>
<td>2013</td>
<td>0.2</td>
<td>0.0</td>
<td>0.4</td>
</tr>
<tr>
<td>2014</td>
<td>0.3</td>
<td>0.2</td>
<td>0.5</td>
</tr>
</tbody>
</table>

### Italy (17%)<sup>1</sup>

#### Supply and use table (in real terms)

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<tr>
<th>Year</th>
<th>GDP</th>
<th>Private consumption (61%)</th>
<th>Investment (18%)</th>
<th>Public consumption (21%)</th>
<th>Exports (30%)</th>
<th>Imports (29%)</th>
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<tbody>
<tr>
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<td>-3.9</td>
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<td>2014</td>
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<td>-1.1</td>
<td>-0.4</td>
<td>-1.0</td>
<td>-1.7</td>
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#### Contributions to GDP growth

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<thead>
<tr>
<th>Year</th>
<th>Domestic demand excluding inventories</th>
<th>Inventories</th>
<th>Foreign trade</th>
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<tbody>
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<td>2012</td>
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<td>0.1</td>
<td>0.9</td>
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<tr>
<td>2013</td>
<td>0.2</td>
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<tr>
<td>2014</td>
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### Spain (11%)<sup>1</sup>

#### Supply and use table (in real terms)

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<th>Private consumption (59%)</th>
<th>Investment (19%)</th>
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<th>Exports (32%)</th>
<th>Imports (31%)</th>
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<td>2013</td>
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#### Contributions to GDP growth

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<th>Year</th>
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<th>Foreign trade</th>
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<td>2014</td>
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Forecast

How to read it: % in brackets represent the weight in the nominal GDP in 2012

yoy: year-on-year
cyoy: contributions year-on-year

[1] Share in Eurozone area GDP

Sources: Eurostat. INSEE forecasts

June 2014 129
**United States of America**

<table>
<thead>
<tr>
<th></th>
<th>Quarterly change in %</th>
<th>Annual change in %</th>
</tr>
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<tbody>
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<td>2013</td>
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<td>Private consumption (69%)</td>
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</tr>
<tr>
<td>Private investment (15%)</td>
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<tr>
<td>Government expenditures and public investment (19%)</td>
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</tr>
<tr>
<td>Exports (13%)</td>
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<td>0.9</td>
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<tr>
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<tr>
<td><strong>Contributions to GDP growth</strong></td>
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<td>Inventories</td>
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**United Kingdom**

<table>
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<tr>
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<th>Quarterly change in %</th>
<th>Annual change in %</th>
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</thead>
<tbody>
<tr>
<td></td>
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<td>2013</td>
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<td><strong>GDP</strong></td>
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<tr>
<td>Private consumption (63%)</td>
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<tr>
<td>Investment (14%)</td>
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</tr>
<tr>
<td>Public consumption (24%)</td>
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</tr>
<tr>
<td>Exports (32%)</td>
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<tr>
<td>Imports (34%)</td>
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<tr>
<td><strong>Contributions to GDP growth</strong></td>
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<td>-0.3</td>
</tr>
<tr>
<td>Domestic demand excluding inventories</td>
<td>-0.8</td>
<td>0.7</td>
</tr>
<tr>
<td>Inventories</td>
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<td>-0.8</td>
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**Japan**

<table>
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<tr>
<th></th>
<th>Quarterly change in %</th>
<th>Annual change in %</th>
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<tr>
<td></td>
<td>2012</td>
<td>2013</td>
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<td>Private consumption (61%)</td>
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<td>Public consumption (20%)</td>
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<td>Exports (15%)</td>
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<td>Imports (17%)</td>
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<td>Domestic demand excluding inventories</td>
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<td>Inventories</td>
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Forecast

How to read it: % in brackets represent the weight in the nominal GDP in 2012

Sources: BEA (USA), ONS (UK), Japanese government (Japan), INSEE forecasts
Statistical French Appendix
## Goods and services: sources and uses at chain-link previous year prices

**billion euros and percentage changes from previous period**

**working-day and seasonally adjusted data**

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<td><strong>Gross domestic product (GDP)</strong></td>
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<td>510.9</td>
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<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>-0.7</td>
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### Contributions: (in point)

- **Domestic demand excluding inventory changes**: -0.3
- **Inventory changes**: 0.1
- **Net foreign trade**: -0.3

### Manufactured goods: sources and uses at chain-linked previous year prices

**percentage changes from previous period**

**working-day and seasonally adjusted data**

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<td>-0.1</td>
<td>0.1</td>
<td>0.7</td>
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<td>1.4</td>
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<td>0.9</td>
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<td>0.2</td>
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### Forecast

*Includes consumption expenditures by non-profit institutions serving households (NPISHs)

**Inventory changes include acquisitions net of sales of valuables

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<td>0.3</td>
<td>0.1</td>
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<td>-2.1</td>
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<tr>
<td>% change</td>
<td>-0.3</td>
<td>-0.2</td>
<td>-0.1</td>
<td>0.1</td>
<td>0.7</td>
<td>-0.6</td>
<td>0.1</td>
<td>0.5</td>
<td>0.4</td>
<td>0.1</td>
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<tr>
<td><strong>General government’s individual consumption expenditures</strong></td>
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<td>0.3</td>
<td>1.3</td>
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<tr>
<td>% change</td>
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<td>0.0</td>
<td>0.1</td>
<td>-0.5</td>
<td>-0.7</td>
<td>1.2</td>
<td>0.4</td>
<td>-0.4</td>
<td>0.6</td>
<td>0.6</td>
<td>0.4</td>
<td>1.0</td>
</tr>
<tr>
<td><strong>Total resources</strong></td>
<td>-0.5</td>
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<td>-1.3</td>
<td>0.4</td>
<td>1.7</td>
<td>1.4</td>
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<tr>
<td>% change</td>
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<td>-0.2</td>
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<td>0.2</td>
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### Forecast

*Inventory changes include acquisitions net of sales of valuables

---

**Conjoncture in France**
### Goods and services: sources and uses

**Chain-linked previous year prices index**
- **Percentage changes from previous period**
- **Working-day and seasonally adjusted data**

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<td>0.2</td>
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<td>-0.7</td>
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<td>-1.0</td>
<td>-0.3</td>
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<td>-0.1</td>
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<td>0.1</td>
<td>0.3</td>
<td>0.3</td>
<td>0.0</td>
<td>0.2</td>
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<td>0.3</td>
<td>0.1</td>
<td>0.3</td>
<td>0.2</td>
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<tr>
<td><strong>General government’s consumption expenditures</strong></td>
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<td>0.1</td>
<td>0.3</td>
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*Forecast*

*Inventory changes include acquisitions net of sales of valuables

**Manufactured goods: sources and uses**

**Chain-linked previous year prices index**
- **Percentage changes from previous period**
- **Working-day and seasonally adjusted data**

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<td>0.3</td>
<td>0.4</td>
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<td>-0.6</td>
<td>-0.1</td>
<td>0.0</td>
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<td><strong>of which: Value added</strong></td>
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<td>-0.4</td>
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<td>-0.3</td>
<td>0.0</td>
<td>-0.4</td>
<td>-0.3</td>
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<td>0.0</td>
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<td>-0.2</td>
<td>-0.7</td>
<td>0.2</td>
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<td>-0.1</td>
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<td>-0.3</td>
<td>-0.4</td>
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<td><strong>General government’s individual consumption expenditures</strong></td>
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<td>-0.1</td>
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<td><strong>GFCF</strong></td>
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<td><strong>of which: Non-financial enterprises</strong></td>
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*Forecast*

*Inventory changes include acquisitions net of sales of valuables

**Production by sector**

**Chain-linked previous year prices index**
- **Percentage changes from previous period**
- **Working-day and seasonally adjusted data**

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*Forecast*
### Inventory changes (per product) at chain-linked previous year prices

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### Imports (CIF) at chain-linked previous year prices

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### Exports (FOB) at chain-linked previous year prices

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*Including territorial correction
### Households' consumption expenditures at chain-liked previous year prices

Percentage changes from previous period

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### Operating account of non-financial corporations and unincorporated enterprises

Percentage changes from previous period

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Forecast
### Non-financial corporations' income account

#### percentage changes from previous period

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<td><strong>Total resources</strong></td>
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<td><strong>Compensation of employees</strong></td>
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<td><strong>Taxes</strong></td>
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<td>-4.8</td>
<td>3.2</td>
<td>1.2</td>
<td>1.4</td>
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<tr>
<td><strong>Net interests and dividends</strong></td>
<td>3.7</td>
<td>0.6</td>
<td>1.7</td>
<td>-3.2</td>
<td>-4.8</td>
<td>4.6</td>
<td>-3.5</td>
<td>-2.2</td>
<td>-0.1</td>
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<tr>
<td><strong>Other net charges</strong></td>
<td>-1.4</td>
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<td>-0.4</td>
<td>0.1</td>
<td>0.4</td>
<td>-0.5</td>
<td>0.8</td>
<td>0.3</td>
<td>0.4</td>
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<tr>
<td><strong>Gross disposable income</strong></td>
<td>0.3</td>
<td>-3.6</td>
<td>2.6</td>
<td>-5.4</td>
<td>2.6</td>
<td>2.8</td>
<td>-4.6</td>
<td>4.3</td>
<td>2.7</td>
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#### Decomposition of non financial corporations' profit share

**percentage changes from previous period**

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<tbody>
<tr>
<td><strong>Profit share (in %)</strong></td>
<td>30.9</td>
<td>30.5</td>
<td>30.7</td>
<td>30.2</td>
<td>30.1</td>
<td>29.5</td>
<td>29.5</td>
<td>30.2</td>
<td>30.5</td>
<td>30.6</td>
<td>30.8</td>
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<td><strong>Profit share % change</strong></td>
<td>0.0</td>
<td>-0.5</td>
<td>0.2</td>
<td>-0.5</td>
<td>-0.1</td>
<td>0.0</td>
<td>-0.6</td>
<td>0.0</td>
<td>0.7</td>
<td>0.3</td>
<td>0.2</td>
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<tr>
<td><strong>Contributions to profit share variation</strong></td>
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<td></td>
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<tr>
<td><strong>Productivity (+)</strong></td>
<td>0.2</td>
<td>-0.3</td>
<td>0.4</td>
<td>-0.2</td>
<td>0.0</td>
<td>0.6</td>
<td>0.0</td>
<td>0.1</td>
<td>0.0</td>
<td>0.3</td>
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<tr>
<td><strong>Real wages (-)</strong></td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.3</td>
<td>0.0</td>
<td>0.0</td>
<td>-0.4</td>
<td>-0.1</td>
<td>-0.3</td>
<td>-0.2</td>
<td>-0.1</td>
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<tr>
<td><strong>Employers' social contributions rate (-)</strong></td>
<td>0.1</td>
<td>-0.1</td>
<td>0.0</td>
<td>-0.2</td>
<td>0.1</td>
<td>0.0</td>
<td>-0.2</td>
<td>0.2</td>
<td>0.0</td>
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<tr>
<td><strong>Ratio of value added price and consumption price (+)</strong></td>
<td>-0.3</td>
<td>0.0</td>
<td>0.1</td>
<td>0.0</td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.3</td>
<td>0.1</td>
<td>-0.2</td>
<td>0.1</td>
<td>0.1</td>
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<tr>
<td><strong>Other</strong></td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.1</td>
<td>-0.2</td>
<td>-0.1</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>1.1</td>
<td>0.0</td>
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#### Main ratios (non-financial corporate sector)

**percentage changes from previous period**

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<tbody>
<tr>
<td><strong>Wage costs / Value added (VA)</strong></td>
<td>65.4</td>
<td>65.9</td>
<td>65.6</td>
<td>66.0</td>
<td>65.9</td>
<td>65.9</td>
<td>66.5</td>
<td>66.4</td>
<td>66.8</td>
<td>66.5</td>
<td>66.3</td>
</tr>
<tr>
<td><strong>Taxes on production / VA</strong></td>
<td>5.2</td>
<td>5.3</td>
<td>5.3</td>
<td>5.5</td>
<td>5.6</td>
<td>5.6</td>
<td>5.6</td>
<td>5.6</td>
<td>5.6</td>
<td>5.6</td>
<td>5.6</td>
</tr>
<tr>
<td><em><em>Margin ratio (GOS</em> / VA)</em>*</td>
<td>30.9</td>
<td>30.5</td>
<td>30.7</td>
<td>30.2</td>
<td>30.1</td>
<td>29.5</td>
<td>29.5</td>
<td>30.2</td>
<td>30.5</td>
<td>30.6</td>
<td>30.8</td>
</tr>
<tr>
<td><strong>Investment rate (GFCF / VA)</strong></td>
<td>22.8</td>
<td>22.8</td>
<td>22.7</td>
<td>22.6</td>
<td>22.6</td>
<td>22.5</td>
<td>22.6</td>
<td>22.7</td>
<td>22.5</td>
<td>22.5</td>
<td>22.4</td>
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<tr>
<td><strong>Saving ratio (savings / VA)</strong></td>
<td>17.8</td>
<td>17.2</td>
<td>17.5</td>
<td>16.6</td>
<td>17.0</td>
<td>17.4</td>
<td>16.7</td>
<td>17.3</td>
<td>17.8</td>
<td>18.0</td>
<td>18.2</td>
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<tr>
<td><strong>Tax pressure (Income taxes / gross disposable income before taxes)</strong></td>
<td>15.4</td>
<td>16.2</td>
<td>16.2</td>
<td>19.4</td>
<td>18.4</td>
<td>17.9</td>
<td>19.7</td>
<td>17.1</td>
<td>17.9</td>
<td>17.9</td>
<td>19.7</td>
</tr>
<tr>
<td><strong>Self-financing ratio (cash earnings)</strong>**</td>
<td>78.1</td>
<td>75.2</td>
<td>77.3</td>
<td>73.5</td>
<td>75.4</td>
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<td>73.7</td>
<td>76.3</td>
<td>78.8</td>
<td>80.0</td>
<td>81.3</td>
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Forecast

*Gross operating surplus

**Savings / GFC
## Household Income

**percentage changes from previous period**

**working-day and seasonally adjusted data**

<table>
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<tr>
<td><strong>Gross operating surplus</strong></td>
<td>0.5</td>
<td>0.3</td>
<td>0.2</td>
<td>-0.1</td>
<td>0.1</td>
<td>0.3</td>
<td>0.3</td>
<td>0.4</td>
<td>0.3</td>
<td>1.4</td>
<td>0.6</td>
<td>1.0</td>
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<tr>
<td>of which:</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Unincorporated enterprises</td>
<td>0.6</td>
<td>0.3</td>
<td>0.2</td>
<td>-0.3</td>
<td>-0.1</td>
<td>0.4</td>
<td>-0.3</td>
<td>0.0</td>
<td>0.1</td>
<td>0.4</td>
<td>0.4</td>
<td>0.5</td>
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<tr>
<td>Households excluding unincorporated enterprises</td>
<td>0.4</td>
<td>0.4</td>
<td>0.2</td>
<td>0.3</td>
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<td>0.2</td>
<td>0.1</td>
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<td>0.5</td>
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<td>Gross wages and salaries</td>
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<td>0.4</td>
<td>0.0</td>
<td>0.2</td>
<td>0.4</td>
<td>0.2</td>
<td>0.4</td>
<td>0.5</td>
<td>0.2</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Net interests and dividends</td>
<td>-2.2</td>
<td>-1.4</td>
<td>-0.3</td>
<td>0.7</td>
<td>0.7</td>
<td>0.1</td>
<td>0.0</td>
<td>0.8</td>
<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
<td>0.3</td>
</tr>
<tr>
<td>Social benefits (in cash)</td>
<td>1.3</td>
<td>1.0</td>
<td>1.0</td>
<td>0.7</td>
<td>0.5</td>
<td>0.7</td>
<td>0.7</td>
<td>0.9</td>
<td>0.7</td>
<td>0.1</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td>Other net resources</td>
<td>-19.5</td>
<td>-20.7</td>
<td>-21.8</td>
<td>-22.2</td>
<td>-21.4</td>
<td>-19.0</td>
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<td>-3.6</td>
<td>8.4</td>
<td>5.0</td>
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<tr>
<td><strong>Total resources</strong></td>
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<td>0.4</td>
<td>0.5</td>
<td>0.2</td>
<td>0.3</td>
<td>0.4</td>
<td>0.2</td>
<td>0.5</td>
<td>0.5</td>
<td>0.2</td>
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<td>Income and wealth taxes</td>
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<td>7.8</td>
<td>-6.5</td>
<td>1.1</td>
<td>1.8</td>
<td>4.8</td>
<td>-4.2</td>
<td>1.0</td>
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<td>Households’ contributions</td>
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<td>1.3</td>
<td>2.4</td>
<td>0.8</td>
<td>0.8</td>
<td>0.7</td>
<td>1.0</td>
<td>-0.3</td>
<td>0.5</td>
<td>0.6</td>
<td>0.6</td>
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<tr>
<td><strong>Total charges</strong></td>
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<td>5.6</td>
<td>-3.6</td>
<td>1.0</td>
<td>1.3</td>
<td>3.2</td>
<td>-2.6</td>
<td>0.8</td>
<td>1.4</td>
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<tr>
<td><strong>Gross disposable income (GDI)</strong></td>
<td>0.3</td>
<td>0.4</td>
<td>-0.2</td>
<td>-1.1</td>
<td>1.3</td>
<td>0.3</td>
<td>0.0</td>
<td>-0.2</td>
<td>1.4</td>
<td>0.1</td>
<td>0.2</td>
<td>0.0</td>
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<td><strong>Consumption deflator</strong></td>
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<td>0.1</td>
<td>0.1</td>
<td>0.3</td>
<td>0.3</td>
<td>0.0</td>
<td>0.2</td>
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<td>0.3</td>
<td>0.1</td>
<td>0.3</td>
<td>0.2</td>
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<tr>
<td><strong>Real GDI</strong></td>
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<td>0.3</td>
<td>-0.2</td>
<td>-1.4</td>
<td>1.1</td>
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<td>-0.2</td>
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<td>1.1</td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.3</td>
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<tr>
<td><strong>Social benefits (in kind)</strong></td>
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<td>0.6</td>
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<td>0.6</td>
<td>0.5</td>
<td>0.5</td>
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<tr>
<td><strong>Adjusted gross disposable income</strong></td>
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<td>0.2</td>
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Forecast

## Main ratios (households)

**percentage points**

**working-day and seasonally adjusted data**

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<td>Saving ratio</td>
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<td>14.7</td>
<td>16.1</td>
<td>15.7</td>
<td>15.2</td>
<td>14.7</td>
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<td>Financial saving ratio*</td>
<td>5.6</td>
<td>6.2</td>
<td>6.0</td>
<td>4.9</td>
<td>5.6</td>
<td>5.9</td>
<td>6.0</td>
<td>5.6</td>
<td>7.2</td>
<td>7.0</td>
<td>6.6</td>
<td>6.0</td>
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<tr>
<td>Weight of taxes and social contributions**</td>
<td>19.9</td>
<td>19.9</td>
<td>20.4</td>
<td>21.4</td>
<td>20.6</td>
<td>20.7</td>
<td>21.0</td>
<td>21.5</td>
<td>20.8</td>
<td>21.0</td>
<td>21.2</td>
<td>21.5</td>
</tr>
<tr>
<td>Gross wages and salaries / gross disposable income</td>
<td>61.1</td>
<td>61.1</td>
<td>61.4</td>
<td>62.1</td>
<td>61.4</td>
<td>61.5</td>
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<td>62.0</td>
<td>61.5</td>
<td>61.6</td>
<td>61.7</td>
<td>61.9</td>
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<tr>
<td>Social benefits (cash) / gross disposable income</td>
<td>33.3</td>
<td>33.5</td>
<td>33.9</td>
<td>34.5</td>
<td>34.2</td>
<td>34.3</td>
<td>34.6</td>
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<td>34.7</td>
<td>34.7</td>
<td>34.9</td>
<td>35.1</td>
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</table>

Forecast

*Savings excluding dwelling / gross disposable income

**Taxes and social contributions / gross disposable income before taxes and social contributions
Economic Outlook
Terminology
Economic Outlook Terminology

BUSINESS TENDENCY SURVEYS

Business tendency surveys are qualitative surveys intended to track the economic situation of the moment and to forecast short-term trends. Business leaders or householders are regularly surveyed. The results of these surveys are obtained very quickly - at the end of the month under observation - and their findings are crucial to short-term analysis and forecasting.

They provide an overview of a given sector and shed light on areas that are only covered much later, if at all, by classical statistics, for example household surveys.

For businesses, the surveyed sectors are industry, services, retail and automobile sales and repairs, wholesale, and construction.

Some of these surveys (on households, industry, investment in industry, services, retail and automobile sales and repairs, building industry and civil engineering) are part of a harmonised European system of business tendency surveys to which the member States of the European Union contribute. The questionnaires, classifications and processing methods are all harmonised.

The data gathered in these business tendency surveys are called qualitative because the respondents are asked to provide qualitative assessments rather than quantities in regard to the variables covered by the survey. For example, in this type of survey entrepreneurs are asked to specify whether their order books are “fuller than normal”, “normal” or “not as full as normal”, and whether their cash flow is “better”, “equivalent”, or “worse” than it was in the previous survey. By contrast, in conventional quantitative surveys, respondents will be asked to supply the actual amount of orders underway. The Investment in Industry survey combines quantitative and qualitative questions.

Composite indicator

The composite business climate indicator summarises the mood of the responses given by business leaders in the Business Tendency Surveys: the higher it is, the more positive the view industrialists have of the economic outlook. It is built with a long-term average taking a value of 100.

This composite indicator is calculated by factor analysis. This technique can summarise the concurrent trends of several variables whose movements are closely correlated. Changes in the composite indicator therefore provide a relevant insight into the economic situation, influencing all the balances of opinion in the business tendency surveys.

Turning point indicator

The turning point indicator attempts to detect, as early as possible, the moment when economic trends are reversed. Each month it plots the difference between the probability of the economic trend being positive and the probability of it being negative.

The indicator varies between +1 and -1: a point very close to +1 (or -1 respectively) indicates that activity is in a distinct upturn phase (or distinct downturn phase, respectively). The moments when the indicator is very close to 0 are considered phases of stabilisation, i.e. the growth rate is returning towards its long-term average. During these phases the signals received are very mixed and do not show any pronounced movement upwards or downwards.

The value of the indicator for the latest month may be revised the following month, and it is therefore advisable to wait for at least two consecutive months before interpreting a big variation as being the signal of a major change in economic trends.

Balance of opinion

The balance of opinion is defined as the difference between the proportion of respondents having expressed a positive opinion and the proportion of respondents having expressed a negative opinion.

The questions in business tendency surveys usually call for a response chosen from three possibilities: “up”, “stable” or “down”.

From these responses, the percentage of respondents (households or entrepreneurs) saying “up” (positive responses), “stable” or “down” (negative responses) is calculated for each question, taking account, in the case of enterprises, of the relative size of the enterprise and of the sub-sector concerned.

A balance of opinion is then established for each question as being the difference between the percentage of respondents giving a positive response and the percentage of respondents with a negative response.

In business tendency surveys on industrialists, for example, the balance of opinion on past sales or on business prospects is calculated. In the surveys on households, a balance of opinion on unemployment in France or on the current financial situation of households is calculated.

NATIONAL ACCOUNTING TERMS

Final (or actual) consumption of households

Household consumption as a whole. It is the sum of household consumption expenditure and the individualised consumptions included in the final consumption expenditure of general government.

Household consumption expenditure is restricted to the expenses that households bear directly. It includes the share that they pay towards healthcare, education and accommodation after any reimbursements. It also includes “imputed rents”, i.e. the rent which households that own their main residence implicitly pay to themselves.
Economic Outlook Terminology

The individualised consumptions included in the final consumption of general government are those for which the beneficiaries can be precisely defined. This is the case, in particular, of expenditure on education and healthcare.

**Gross operating surplus (GOS)**

Gross operating surplus is the balance of the trading account of companies. It is equal to value-added minus payroll and other taxes on production, and plus operating subsidies.

Gross operating surplus can be calculated net, after deduction of the consumption of fixed capital, i.e. depreciation of the capital further to foreseeable wear and tear or obsolescence.

**GOS of pure households**

The rents received by pure households are what is known in national accounting as the gross operating surplus (GOS) of pure households. It corresponds to the rents that homeowners receive from their tenants or would receive if they rented out their property ("fictional rents"), minus property tax.

**Investment or Gross fixed capital formation (GFCF)**

In the national accounts, corporate investment, particularly that of non-financial companies, is called gross fixed capital formation (GFCF). It represents the acquisitions of net fixed assets (minus the sales of same) made by resident producers.

Fixed assets are tangible or intangible assets resulting from the production process and used either repeatedly or continuously in other production processes over a period of at least one year.

**Purchasing power of income**

The purchasing power of income is the quantity of goods and services that can be bought with an income unit. Its growth is linked to that of prices and incomes.

If prices increase while income is constant, there is a drop in purchasing power. If the increase in income is greater than that of prices, the purchasing power of income will rise.

**Gross domestic product (GDP)**

Gross domestic product (GDP) is a measure of the national wealth produced each year.

It is an aggregate representing the final result of the production activity of resident production units.

It can be defined in three ways:

- GDP is equal to the sum of the gross added values of the various institutional sectors or of the various branches of activity plus taxes and minus the subsidies on products (which are not attributed to the sectors and branches of activity);
- GDP is equal to the sum of the final domestic uses of goods and services (actual final consumption, gross fixed capital formation, inventory change) plus exports and minus imports;
- GDP is equal to the sum of uses in the operating accounts of the institutional sectors: payment of wages, taxes on production, imports minus subsidies, gross operating surplus (GOS) and mixed income (GOS of sole proprietorships). Its growth is linked to that of prices and income.

**Gross disposable income (GDI)**

Gross disposable income is the proportion of income left for households to consume and save once social security contributions and taxes have been deducted.

Gross disposable income includes earned income (wages, salaries, etc.), own income (dividends, interest, rents), transfers (most notably insurance proceeds net of premiums) and social benefits (including pensions and unemployment benefit), net of direct taxes. Four direct taxes are generally taken into account: income tax, council tax, general social contribution (CSG) and contribution for the reimbursement of the social debt (CRDS).

**Adjusted disposable income**

For households, this is gross disposable income plus social transfers in kind, the counterparty to the consumption that can be isolated in general government expenditure (see final consumption of households).

**Property income**

Income received by the owner of a financial asset or a tangible non-produced asset in exchange for making this asset available to another institutional unit. It mainly includes the dividends paid by companies, interest, and rent from land (rent from housing is a tangible produced asset and is considered as payment for a service).

**Basic monthly wage (BMW)**

Changes in the basic monthly wage reflect the average variation in wages at a constant qualification structure. The basic monthly wage does not include bonuses of any kind, or overtime.

It is an index that is estimated from the Acemo quarterly survey conducted by the DARES (survey on the activity and employment conditions of the workforce). This survey covers quarterly 20,000 to 30,000 establishments or companies with 10 employees or more in the non-agricultural market sector. The basic monthly wage is listed for 16 professional categories. Each establishment or company declares the basic wage of a work position considered as representative of a professional category. This position is tracked from survey to survey.

**Average wage per head (AWPH)**

Changes in the average wage per head reflect variations in the wages paid by all companies. This indicator is built by comparing changes in the total payroll and in the number of employees, both of which are measured from comprehensive sources (tax data from companies).

Unlike the basic monthly wage, it includes micro-enterprises and also integrates structuring effects (changes in qualifications and in the proportion of part-time work), short-term effects (level of overtime) and seasonal effects (bonuses).
Real wages and nominal wages
Compensation of employees can be measured either at current currency values, in other words at current prices, or at constant prices, i.e. after inflation is deducted. The former is known as the nominal wage and the latter as the real wage.

Household savings ratio
The proportion of the disposable income (or adjusted disposable income) of households which is not used for consumption expenditure (or final consumption) is their savings. The difference between disposable income and adjusted disposable income - which corresponds to social transfers in kind - is also the difference between consumption expenditure and final consumption. There is only one definition of savings. However, there may be several savings ratios depending on which definition of income the savings are plotted against. In short-term analyses, the savings ratio calculated against gross disposable income is preferred.

Margin rate
The margin rate measures the share of added value which services capital. It is the ratio of gross operating surplus to added value.

The margin rate:
- grows when labour productivity or terms of trade increase;
- diminishes when the real average wage per head or the employers' contribution rate increases.

For further information, read the special report in Conjuncture in France, June 2003.

Margin rate at factor cost
The margin rate at factor cost (meaning the cost of production factors) measures the share of added value at factor cost which services capital. Added value at factor cost is calculated as gross added value minus taxes on production plus operating subsidies. The margin rate at factor cost is around 1% higher than the margin rate as defined in the national accounts.

Self-financing ratio
Ratio of gross savings to gross fixed capital formation (GFCF).

Consumption unit
A weighting system assigning a coefficient to each member of the household and used to compare standards of living between households of different sizes and compositions. With this weighting, the number of people is converted into a number of consumption units (CU).

To compare the standard of living of households of different sizes or compositions, we use a measurement of income corrected by the consumption unit using an equivalence scale.

The most widely used scale at present (known as the OECD scale) uses the following weighting:
- 1 CU for the first adult in the household;
- 0.5 CU for the other persons aged 14 years or older;
- 0.3 CU for the children under 14 years.

Value added
Value added is equal to the value of production minus intermediate consumption.

ECONOMIC TERMS

Unemployed person (ILO)
In application of the international definition adopted in 1982 by the International Labour Organisation (ILO), an unemployed person is a person of working age (15 or over) who meets three conditions simultaneously:
- they were without employment, meaning that they did not work, even for one hour, in the course of the reference week;
- they are available to take up employment within two weeks;
- they have actively looked for a job in the previous month or have found one starting within the next three months.

Note: An unemployed person (ILO) is not necessarily a person registered with Pôle Emploi (and vice versa).

Competitiveness
The competitiveness of an economy or a company is its ability - or otherwise - to gain market share from its competitors. To sell its products, a company can rely on its price competitiveness or its non-price competitiveness. The former is directly linked to the sale price. Non-price competitiveness depends on the quality of the product, its degree of innovation, and after-sales service, among other things.

At the level of an economy, price-competitiveness can be seen in the real effective exchange rate (see definition).

Potential growth and output gap
The potential growth of an economy is the maximum speed at which it could grow without causing inflation to accelerate, in other words without creating excessive tension in the goods and labour markets. It is a function of production factors, capital stock, the active population and technical progress. Econometric techniques can be used to determine this potential growth, consisting in extracting a trend from a cycle. The Hodrick-Prescott filter is one of these techniques. The idea is that on average over the long term, an economy progresses in line with its potential growth. Short-term incidents may cause it to deviate momentarily from this potential. It is also possible to build a production function that takes the various factors into account. Estimating these factors is the most difficult part.
The output gap is the difference between the observed growth of the economy and its potential growth.

**World demand for French products**

This is calculated from estimated imports for each of France’s trading partners, weighted by the share of France in these imports. It is an indicator of foreign demand and, along with competitiveness, is an important determinant of exports.

**French demand for products of trading partners**

French demand for products of trading partners is calculated by weighting each item of demand (from companies, households, general government and exports) by its content in imports.

**Flexion effects**

When the economic outlook is poor, a proportion of the population may decide not to join the labour market, or prefer to withdraw from it (young people may decide to pursue their studies, unemployed people may stop looking for jobs, etc.). Symmetrically, a good economic outlook encourages more people to enter the labour market.

So depending on the outlook, the activity rate, which is the ratio between the job-seeking population and the population of a working age, may vary: this variation is called a flexion of the activity rate driven by the economic outlook. A calculation of these flexion effects allows an estimation of the active population.

**Employment (ILO)**

Persons employed in the sense of the International Labour Organisation (ILO) are those aged 15 or older who worked for any amount of time, if only for one hour, in the course of the reference week. This notion is different from that of employment in the sense of the population census, which concerns persons having declared they had a job on the census form.

The notion of employment in the sense of the ILO is therefore broader than that in the sense of the population census. Some people may consider that occasional jobs are not worth declaring in the census.

The measurement of employment in the sense of the ILO can be made only through specific questions, such as those of the Labour Force Survey, one of the primary objectives of which is to make this measurement.

**Core inflation**

For the purposes of economic analysis, the INSEE publishes a core inflation index. It allows us to observe deeper trends in the changes in prices. It does not include prices which are subject to government intervention and products whose price is volatile, i.e. which experience high variability due to climatic factors or tensions on the global markets. Seasonal products, energy, tobacco and public service charges are all excluded. The core inflation index is also corrected for tax measures. It is a seasonally-adjusted index.

Additionally, the core inflation index is corrected for tax measures (rise or fall in VAT, specific measures imposed on products etc.) in order to neutralise the effect on the price index of variations in indirect taxation or government measures which directly affect consumer prices. Core inflation is thus better suited to analysis of inflationary tensions, as it is less sensitive to exogenous phenomena.

**Active population**

The active population includes all people with a job, constituting the occupied labour force, and the unemployed. Its growth mainly depends on demographics, trends in the activity rate, and flexion effects (see definition).

**Real effective exchange rate**

To get an idea of the competitiveness of a country or a zone, we have to be able to evaluate its currency in relation to all the exchange rates of its main trading partners, taking into account the weight of each one.

This is what economists call the effective exchange rate, the rate that allows us to take into account the structure of the country or zone’s foreign trade. To prevent competitiveness studies from being distorted due to prices changing in different ways in different zones, economists calculate a “real effective” exchange rate which also takes account of the rate of inflation of trading partners.

**Terms of trade**

This is an indicator allowing an assessment of the advantage that a given economy gains from its trading relations with foreign countries. It is calculated as the ratio between a country’s export price and its import price.

**Activity rate**

The activity rate is the ratio between the number of active persons (occupied labour force and the unemployed) and the corresponding total population.

It can be calculated for women, men, or a specific age group.

**Unemployment rate**

The unemployment rate is the percentage of unemployed people in the active population (occupied labour force + the unemployed).

An unemployment rate per age can be calculated by calculating the ratio of the unemployed persons in an age group to the labour force of that age. Likewise, unemployment rates can be calculated by gender, by socio-professional category, by region, by nationality, by qualification level, etc.

**STATISTICAL TERMS**

**Growth overhang (ovhg)**

The growth overhang of a variable for a year N corresponds to the growth rate of the variable between year N-1 and year N that would be obtained if the variable remained until the end of year N at the level of the last known quarter.
For example, when the last known quarter for a year N is the third quarter, the variable’s growth overhang for year N is equal to the growth rate between N-1 and N that would be obtained if the variable remained at the same level in the fourth quarter as in the third quarter.

Contribution to GDP growth

GDP growth may be broken down into the sum of contributions from its various components: consumption expenditure of households and general government, investments, changes in inventories and trade balance.

In simple cases, the contribution of a component to an aggregate (GDP for example) is equal to the product of that component’s growth rate by its weight in the aggregate on the previous period.

This formula is not valid with chain-linked volumes at the price of the previous year, a concept of volume according to which the national accounts are published. However, as a first approximation the previous calculation with the growth of the component in chain-linked volume and weight in value provides a relatively accurate measurement of the contribution.

Dynamic contributions

Dynamic contributions are a technique used in econometrics. The starting point is an equation linking an explained variable (consumption, investment, exports, prices, wages, employment, etc.) to its economic determinants (income for consumption, demand for investment, etc.). The calculation of dynamic contributions gives an insight into the respective weight of the various determinants of the level or rate of growth of the explained variable. These contributions are termed dynamic, as opposed to static contributions which are obtained simply through an accounting breakdown. They explicitly take into account the lag(s) with which the explanatory variables have an effect on the explained variable: for example, the variation in consumption in a given quarter may also depend on the variation in income in the previous quarter.

Seasonal and working-day adjustment

The development of a statistical series may in general be broken down into three factors: a trend, a seasonal component and an irregular component. Seasonal adjustment is a technique that statisticians use to eliminate the effect of normal seasonal fluctuations on data, so as to bring out fundamental trends (trend and irregular component).

For example, the seasonally adjusted unemployment rate eliminates variations due to the seasonal habit of hiring in the summer and dismissing in the winter in sectors such as agriculture and the building industry.

Additionally, to compare periods that do not have the same number of working days as each other, a working-day adjustment is made.

Year-on-year change and average

A year-on-year change compares a value at two dates, generally a year or a quarter apart.

For example, the year-on-year change in a variable in a given Quarter Q corresponds to the change (as a %) obtained between the level of the variable in Q and its level in the same quarter of the previous year (Q-4). The quarter-on-quarter change is obtained by calculating the difference between the variable in Q and its level in the previous quarter (Q-1).

When the variable is monthly, year-on-year change is calculated between the level in a given month and that in the same month of the previous year (for example, December in year N and December in N-1). However, the change in the annual average compares the average of one year and the average of the previous year.

For example, a phrase such as ’In 2012, salaried employment increased by...’ can have two meanings, depending on whether reference is being made to average salaried employment in the course of 2012 and the average for 2011, or whether a year-on-year comparison is being made between the situation on 31 December 2012 and on 31 December 2011.

These two trends may be very different. For example, if there was strong growth in year N-1 and a small decline in year N, then the change in annual averages may be positive, while year-on-year change is negative.

When events are no longer included in the year-on-year calculation - for example, a sharp rise in oil prices in a given month will affect the measurement of year-on-year inflation for the following eleven months, before disappearing from the calculation - this is called the 'base effect'.

FINANCIAL TERMS

Yield curve

The yield curve gives a view of the relationship between the values of interest rates and their terms. This curve is usually ascending because of the existence of a risk premium (long rates higher than short rates). However, it may reverse, most notably when operators expect a drop in inflation.

Nominal and real interest rates

An interest rate is either the cost of a loan to the borrower or the remuneration of an investment. It is expressed as a percentage, usually over a reference period of one year. The nominal interest rate is also known as the apparent interest rate. It is calculated in current euros, without taking account of the fact that inflation mechanically depreciates the amount of the loan. The real interest rate is the nominal rate corrected for inflation. It is calculated in constant euros. If inflation is denoted p, the nominal interest rate n and the real interest rate r, and assuming that p and n are not too high, we can write:

\[ r = n - p. \]

Otherwise, the following equation is used:

\[ 1 + r = \left(1 + n\right) / \left(1 + p\right). \]