



FRANCE 2020-2021 SCENARIO

REBOUND AMID MANY SOURCES OF UNCERTAINTY

October 2020

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WORKING EVERY DAY
IN YOUR INTEREST



GROUP ECONOMIC RESEARCH

CONTENTS

- 1 | **Summary**
- 2 **Recent trends in activity**
- 3 **Focus: Rising debt and business failure risks**
- 4 **Focus: Stimulus plan and expansionary fiscal policy**
- 5 **Our scenario for 2020-2021**

SUMMARY

TOWARDS A REBOUND DOGGED BY UNCERTAINTY IN 2021, SUPPORT FOR INVESTMENT AND HOPE FOR CONFIDENCE TO RETURN

Growth is projected to shrink by a record 9.1% in 2020. The economy went into recession, punished by lockdown measures that shuttered businesses and shut down many industries, including construction. Growth contracted 5.9% qoq in the first quarter and 13.8% in the second quarter.

We expect a near-automatic rebound in the third quarter and growth of 15.6%. Consumer spending on goods when businesses reopened largely accounts for this bounce back.

Investment should also pick up, especially in construction as work resumed on sites in April/May.

We expect international trade will continue to exert a negative pull on growth. At the peak of the crisis, exports fell harder than imports. What's more, exports are not expected to return to pre-pandemic levels in the immediate future, given their structure and their reliance on the tourism and aerospace industries.

Despite the sharp rebound, the recovery remains unevenly spread across sectors of the French economy. New restrictions to halt the rise in infection rates in recent months tilt our outlook towards caution. We see growth slowing sharply in Q4 as downside risks weigh on our outlook. Whereas we expect growth to pick up a

significant 7.1% in 2021, GDP will still not return to pre-pandemic levels.

Main components of the scenario:

- **Household spending** will remain the main growth driver in 2021. Consumer spending was crushed during the lockdown and sank to 30% below levels considered normal, but it quickly revived once restrictions were lifted in May and throughout the summer months. New measures to halt the spread of the virus and further closure will dent the recovery in services. Provided confidence returns and infection rates fall, dipping into at least some of the involuntary savings hoarded in 2020 could boost consumer spending.
- **Corporate investment** will also be a key factor in the recovery from the pandemic. Companies stand to gain massively from the government's stimulus plan in 2021. Aiming to kick-start investment and make the French economy more competitive in the medium term, all the outcomes will not be visible until after 2021.
- **International trade** may hamper growth. We estimate it will make a negative contribution (-2.2 points of GDP) to growth in 2020. The recovery has been

uneven around the world and France's main exports are very exposed to the ongoing economic crisis. All of which points to exports failing to keep pace with imports in 2021.

- While the blow to the **jobs market** has been softened by the raft of support measures introduced since March, it strikes us as inevitable that unemployment will rise at the end of this year and the start of 2021. The jobless rate could increase to 9.9% in mainland France by end of 2020, from 7.8% in Q4 2020 and climb to an average of 10.1% in 2021, peaking in the second quarter.

SUMMARY

THE RECOVERY SHOULD BE FUELLED BY DOMESTIC DEMAND

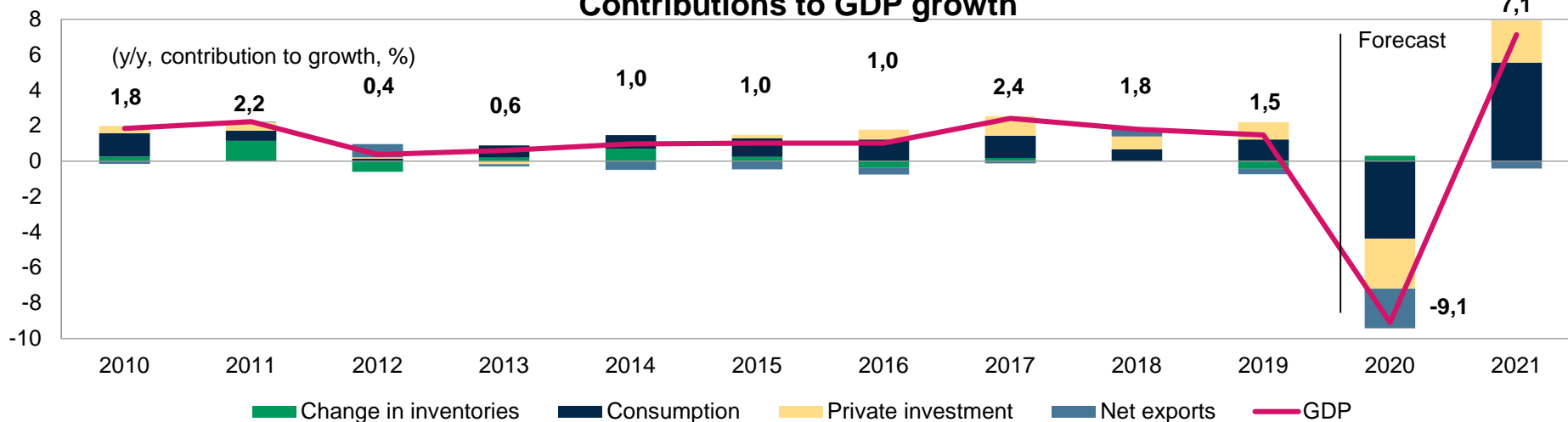
Key figures of our scenario

France	Annual average (y/y, %)				Quarterly growth (q/q, %)							
	2018	2019	2020	2021	2019				2020			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP	1,8	1,5	-9,1	7,1	0,5	0,2	0,2	-0,2	-5,9	-13,8	15,6	0,9
Household's consumption	0,8	1,5	-6,4	6,9	0,6	0,3	0,4	0,3	-5,8	-11,5	16,3	1,0
Investment	3,2	4,3	-11,9	10,4	1,1	1,3	1,2	0,2	-10,0	-14,9	16,9	3,2
Corporate investment	3,9	4,5	-10,5	9,5	1,1	1,3	1,3	0,2	-8,9	-13,4	15,0	3,0
Change in inventories*	0,0	-0,4	0,3	0,0	0,1	-0,2	-0,1	-0,5	0,5	0,9	-0,7	-0,3
Net exports*	0,4	-0,3	-2,2	-0,4	-0,2	-0,2	-0,4	0,0	0,0	-2,4	-0,5	-0,3
Unemployment rate (Insee)	8,7	8,2	8,5	10,1	8,4	8,2	8,2	7,8	7,6	7,0	9,6	9,9
Inflation (y/y) Insee	1,9	1,1	0,6	0,7	1,2	1,1	1,0	1,1	1,2	0,3	0,5	0,3
Public balance (% of GDP)	-2,5	-3,1	-10,2	-6,8								

* Contribution to GDP growth

Source : Crédit Agricole SA, forecasts

Contributions to GDP growth



Sources: Insee, Crédit Agricole S.A. / ECO

1 Summary

2 Recent trends in activity

3 Focus: Rising debt and business failure risks

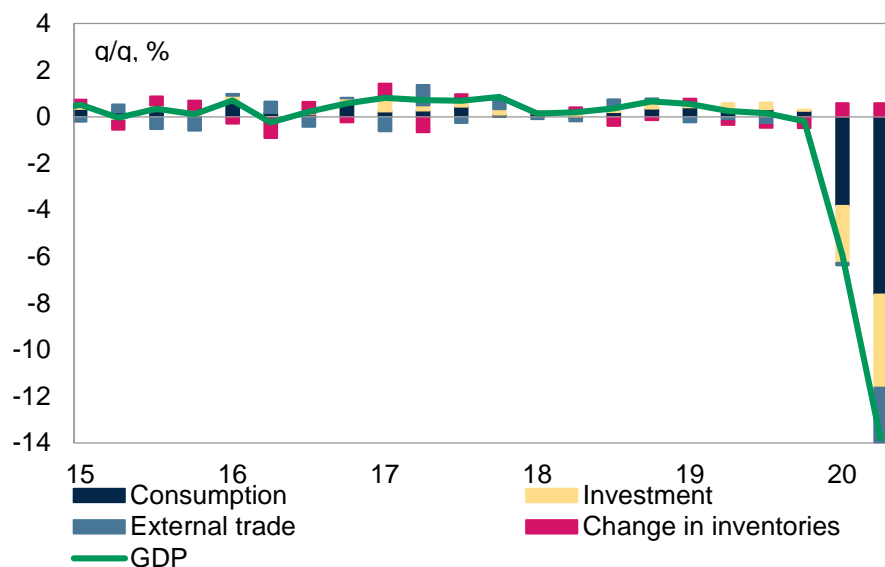
4 Focus: Stimulus plan and expansionary fiscal policy

5 Our scenario for 2020-2021

RECENT TRENDS IN ACTIVITY

RECORD CONTRACTION IN GDP IN THE FIRST HALF

Quarterly growth and contributions



Sources: Insee, Crédit Agricole S.A. / ECO

The eight-week lockdown derailed growth in the first half. GDP shrank 5.9% in the first quarter, compared with the fourth quarter of 2019, plunging further to lose 13.8% in Q2. French economic output now stands 18.9% below what it was before the virus hit. Domestic demand (consumption and investment) dragged down growth, as did international trade. Since demand dried up more abruptly than output, variations in inventories made a positive contribution to growth in the first half.

Some sectors hit harder than others

Business sectors	Calculation by the Banque de France	
	Activity loss in april (%)	Activity loss in July (%)
Industry:	-49	-13
• Automotive	-89	-28
• Pharmaceuticals	-20	-3
• Food industry	-22	-3
Construction	-75	-4
Merchant services :	-50	-15
• Tourist accomodation	-99	-50
• Food services	-94	-26
• Transportation and storage	-29	-5
• Information and communication	-19	-3
Total	-30	-7

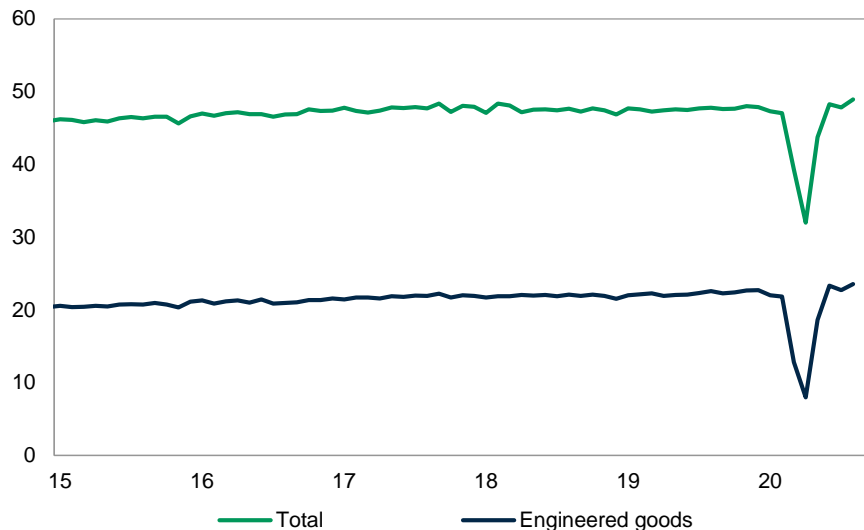
Sources: Banque de France, Crédit Agricole S.A. / ECO

Impacts varied considerably by industry. The sectors directly affected by virus containment measures (restaurants, hotels and retail) took the biggest hit, but other industries were not immune either. Take for example transport equipment and construction: the slump in construction mostly explains the sharp decline in investment. Other sectors, such as pharmaceuticals and agrifoods, were also hit but have since seen business return to close to pre-pandemic levels.

RECENT TRENDS IN ACTIVITY

TOWARDS A SIGNIFICANT, QUASI-AUTOMATIC BUT UNEVEN REBOUND IN THE THIRD QUARTER

Household spending on goods (€bn)

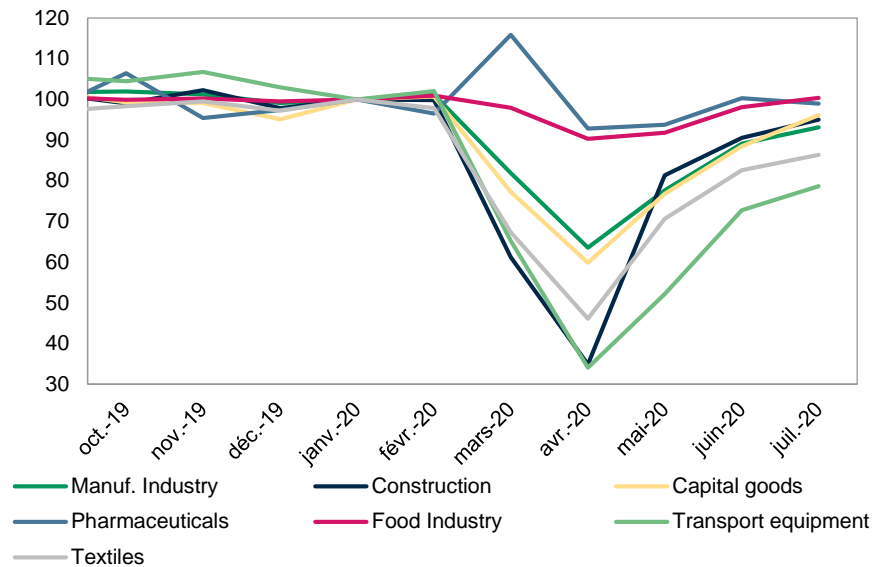


Sources: Insee, Crédit Agricole S.A. / ECO

Consumer spending bounced back substantially from the latter half of the second quarter. Going on spending data for goods such as household equipment, some consumers merely postponed their planned purchases during the period of lockdown and went to the shops in May/June. The rapid rebound in imports also shows that domestic demand has picked up again. But the recovery in services has been more gradual. In the regions, more French customers than in prior years helped offset the dearth of foreign tourists.

On the output side, we note differences in the recovery between

Industrial output (January 2020 = 100)



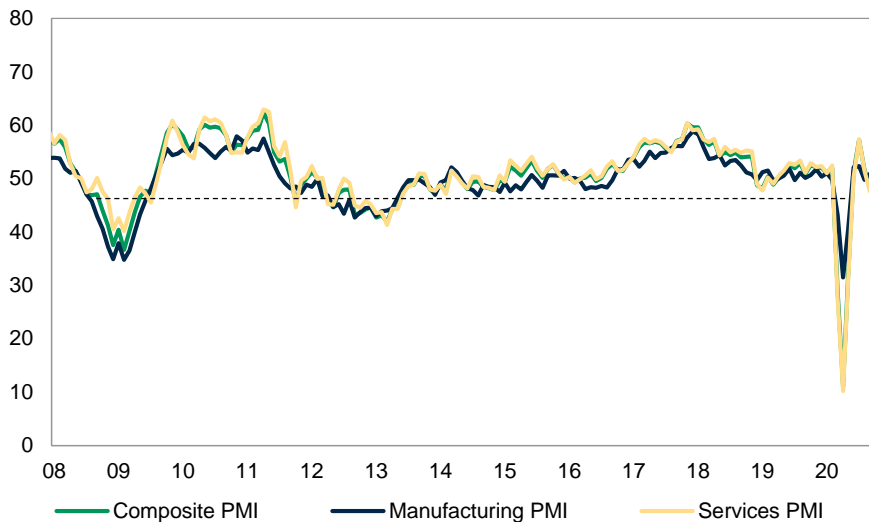
Sources: Insee, Crédit Agricole S.A. / ECO

sectors. Production of capital goods resumed quickly and construction sites lost no time in reopening. In contrast, activity in some sectors, especially transport equipment, remained about 30% below where it was before the pandemic in August. This is due to the need to sell off stocks in the automotive industry at a time when households are not inclined to make big purchases. The aeronautics industry has been punished by the slump in air transport.

RECENT TRENDS IN ACTIVITY

RECOVERY SLOWING PERCEPTIBLY

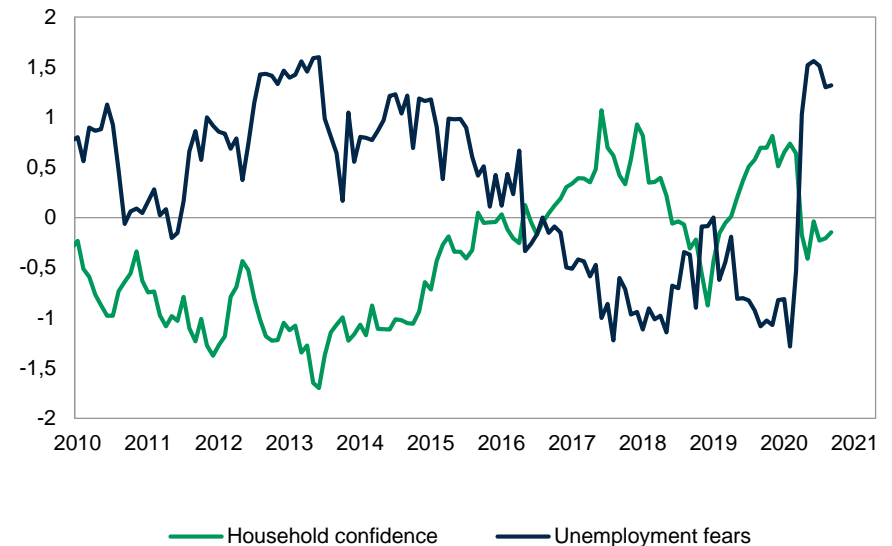
Business climate



Sources: IHS Markit, Crédit Agricole S.A. / ECO

The business climate brightened in May, June and July before darkening again in August and September, especially in the services sector. The rising Covid-19 case numbers appear to be clouding the outlook for services business leaders. Order indicators also seem to have taken a turn for the worst recently. Recent measures to close bars and gyms in some of France's major cities will hamper the recovery in these sectors, even though support from Mr Macron's government is intended to cushion the impact of the rules designed to

Fears of unemployment remain high (normalised indicators)



Sources: Insee, Crédit Agricole S.A. / ECO

contain the spread of the virus. The latest restrictions may also dent public confidence as people need a clearer picture of health indicators for confidence to return. Despite a slight bounce, household confidence is below its long-term historical average. Moreover, not only is the fear of rising unemployment at a record high, but it has intensified sharply since the second quarter. Without a clear idea of the path ahead for the epidemic – and therefore the economy, both household spending and corporate investment could suffer.

- 1 Summary
- 2 Recent trends in activity
- 3 | **Focus: Rising debt and business failure risks**
- 4 Focus: Stimulus plan and expansionary fiscal policy
- 5 Our scenario for 2020-2021

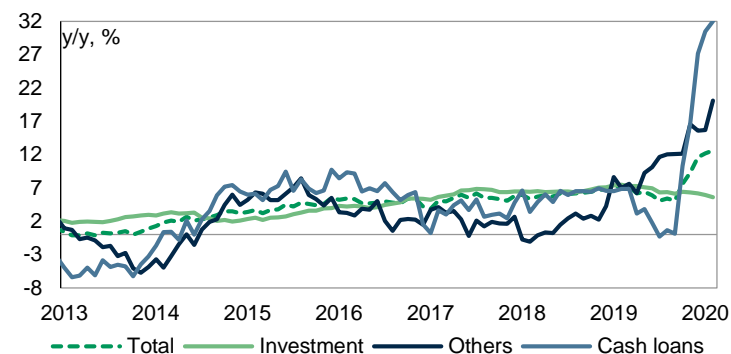
FOCUS: RISING DEBT AND BUSINESS FAILURE RISKS

SHARP RISE IN DEBT SINCE THE ONSET OF THE CRISIS

Since March, outstanding loans to non-financial companies (NFCs) have risen sharply. Micro-businesses and SMEs have tapped the €300 billion package of state-guaranteed loans for liquidity support, while growth in outstanding capital expenditure loans has slowed slightly. At 25 September, €120 billion in these government-backed loans, or 40% of the total allocation, had been granted to 585,000 companies. French companies have massively used the state-guaranteed loans compared to companies from other European countries that have set up similar systems. Since SMEs and large companies have easier access to market financing under more favourable conditions, the system has mainly benefited micro-businesses (50% of the government backed loans granted), SMEs (36%) and, to a lesser extent, mid-tier companies. Broken down by sector, the leading recipients of the loan scheme were retail (23% of recipients), accommodation/food service (15%) and construction (13%), the sectors hardest hit by the pandemic.

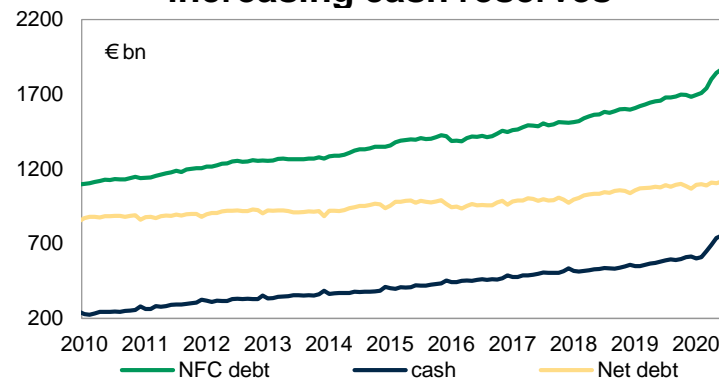
The programme has not only allowed companies to meet their payment deadlines, but also massively beefed up their supply of cash, judging by the steep increase in deposits. However, the accumulated liquidity may only be temporary when we consider the impact of upcoming deadlines for repaying deferred social security contributions and taxes and higher working capital requirements as business picks up. Companies' cash reserves are likely to diminish in the coming months. Firms that were unable to build up cash reserves could even scramble to meet liquidity needs, leading to an increase in insolvencies.

Outstanding corporate debt: rapid growth in state-guaranteed loans



Sources: Banque de France, Crédit Agricole SA / ECO

NFC debt and cash: increasing cash reserves



Sources: Banque de France, Crédit Agricole SA / ECO

FOCUS: RISING DEBT AND BUSINESS FAILURE RISKS

WHAT COULD DRIVE A POTENTIAL INCREASE IN FAILURE RATES?

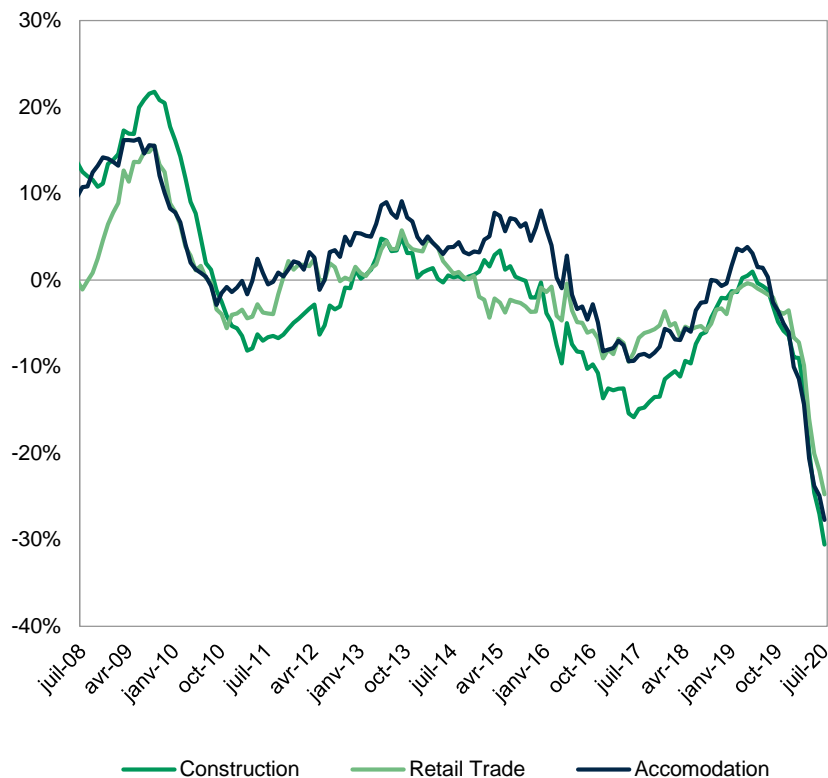
The expected increase in business failures has yet to materialise. Since the onset of the crisis, the rate has actually dipped below what is seen as normal. Business failures fell 25.1% year-on-year in June 2020, according to the Banque de France. This decline reflects the impact of lockdown on commercial court proceedings and regulatory changes that temporarily changed the deadlines for declaring companies as insolvent. It is not expected to last.

We have identified a number of risk factors in the medium term that could push up the rate of failures. First, the rule for declaring payment difficulties was reintroduced on 24 August. Companies now have 45 days to declare insolvency if they cannot meet their invoice and tax obligations (after due dates for taxes and social security contributions were deferred). In our view, the numbers declaring insolvency could surge from October (the end of the 45-day period that began on 24 August).

Other factors will also add to pressure on cash in the near future for many companies. The pick-up in business, which may be partial as demand has not recovered to pre-crisis levels, entails higher costs for companies. Working capital requirements will increase as rent and payment holidays end, the furlough scheme is withdrawn (or extended but on less favourable terms) and production starts up again.

In addition, the six-month deferral granted to companies by banks in April is about to end and repayments on loans taken out before pandemic will resume. However banks could extend these moratoriums on a case-by-case basis. Similarly, the bulk of social security and tax payments deferred by the government during the lockdown are due by the end of the year; however some €5 billion in exemptions from social security contributions for the most hard-hit sectors will not be due until 2021. On the other hand, no payments are due on the government-backed loans in the first year. Payments are spread over a five-year period, which should alleviate pressure on cash resources in the short term.

Changes in the one-year bankruptcy rate for the most exposed sectors (12 m cumulative)



Sources: Banque de France, Crédit Agricole SA / ECO

- 1 Summary
- 2 Recent trends in activity
- 3 Focus: Rising debt and business failure risks
- 4 | Focus: Stimulus plan and expansionary fiscal policy
- 5 Our scenario for 2020-2021

FOCUS: STIMULUS PLAN AND EXPANSIONARY FISCAL POLICY

BOOST SUPPLY AND KICK-START COMPETITION

Supply-side policy with three headline priorities

Ecology (€30 bn)		Competitiveness (€34 bn)		Social cohesion and employment (€36 bn)	
Investment in hydrogen	€ 7 bn (by 2030)	Cut in production taxes	€ 20 bn	Preserve employment (long term partial unemployment and training)	€ 7,6 bn
Energy-efficient building renovation	€ 6,7 bn	Investment in emerging technologies	€ 11 bn	Investment plan in health	€ 6 bn
Support plan for the railway sector	€ 4,7 bn	Strengthening the capital base of SMEs	€ 3 bn (€ 2 bn of state guarantees to raise € 10-20 bn of equity loans)	Support of local authorities	€ 5,2 bn
Biodiversity and agricultural transition	€ 2,5 bn	Supporting relocations in the industrial sector	€ 1 bn	Aid for recruiting young or handicapped people	€ 3,2 bn
Green mobility (cycling, public transportation)	€ 1,2 bn			Research and higher education	€ 3 bn
				Training of the youth in emerging technologies	€ 1,6 bn

Sources: French Government – “France Relance” plan, Crédit Agricole S.A / ECO

Mr Macron's government unveiled its €100 billion France Relance stimulus plan on 4 September. The plan is built around three headline priorities (green transition, competitiveness and cohesion) and seeks to provide support for business and create jobs. Some of the stand-out measures include the €20 billion reduction in production taxes, with most gains going to SMEs and mid-tier companies.

The stimulus package also includes new measures aimed at strengthening the capital of micro-businesses, SMEs and mid-tier enterprises. Over and above short-term liquidity support, to address their worsening balance sheets and the surge in debt, some small and medium companies will need an injection of equity capital to restore their investment capability. The stimulus package unveiled last week offers clear supply-side support for the coming years, with

cuts in production taxes as its flagship measure for businesses. While we could wonder why the plan does not include demand side supports, the government considered that households do a substantial savings buffer built up during lockdown, which should support consumer spending.

While any return to normal levels of economic activity remains contingent on the changing public health situation, the government's package is designed to inject fresh momentum into the economic recovery and provide support that will make a lasting impact through forward-looking investment in competitiveness and the ecological transition. The government's stated goal for this package is to boost growth by 1.5 percentage points and create 160,000 jobs in 2021.

FOCUS: STIMULUS PLAN AND EXPANSIONARY FISCAL POLICY

WHAT IMPACT ON PUBLIC FINANCES?

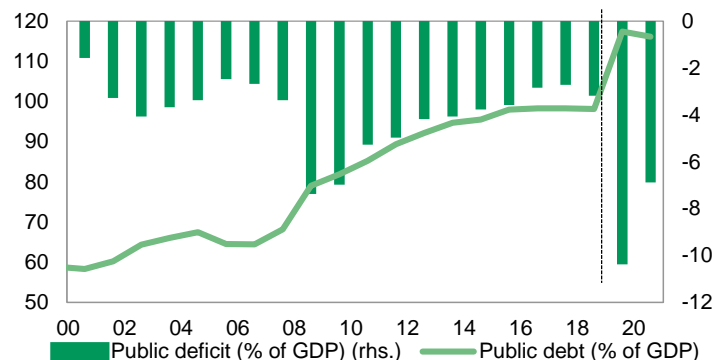
By temporarily abandoning its budget rules, Europe has allowed governments to opt for expansionary budgets and to pour money into their economies. Following the measures introduced in March, which will widen the deficit even further in 2020, the stimulus plan confirms long-term government support for the economy.

France introduced a huge package of emergency measures in 2020, spending big to mitigate the shock to the economy from lockdown (from March to May) and ongoing restrictions to contain the spread of the virus. The cost to the public deficit is €65 billion – plus the lower tax revenues in a record recession. The deficit could swell to 10.2% of GDP and the debt-to-GDP ratio to 117.5% in 2020, from 98% in the prior year.

The budget deficit could be pared back to 6.7% of GDP in 2021, largely due to the rebound in GDP, or in other words to an improvement in the cyclical elements of the budget deficit. On the other hand, the stimulus plan will widen the structural deficit, which will remain in negative territory (-3.6% in 2021 from -3.8% in 2020, including the emergency measures). Most of the new government expenditures and revenues for 2021 are included in the €100 billion stimulus package. The main measures are the €10 billion reduction in production taxes to boost the competitiveness of French industry. Spending measures will amount to €27 billion under the stimulus plan. These are primarily policies to kick-start investment plus the additional expenditure called for in the *Ségur de la santé* overhaul of the healthcare system. The European recovery fund will contribute €17 billion of the €37 billion stimulus spending in 2020, with the remainder added to the budget deficit. We expect government debt to decline slightly to 116.2% in 2021, based on the projections of the Ministry of the Economy and Finance.

Despite the widening deficit, the European Central Bank's monetary policy and emerging European solidarity should keep debt service low. The imputed debt service rate (the average interest on the stock of debt) is estimated at 1.4% in 2021.

Government debt and deficit



Sources : Insee, Crédit Agricole S.A./ ECO

Government forecasts

(as % of GDP)	2019	2020	2021
Real GDP	1.5	-10,0	8,0
Real potential GDP	1.25	1.25	1.25
Public balance	-3,0	-10.2	-6.7
Cyclical balance	0.2	-6.5	-2.8
Structural balance	-2.2	-1.2	-3.6
One-offs	-1,0	-2.6	-0.2
Public debt	98.1	117.5	116.2

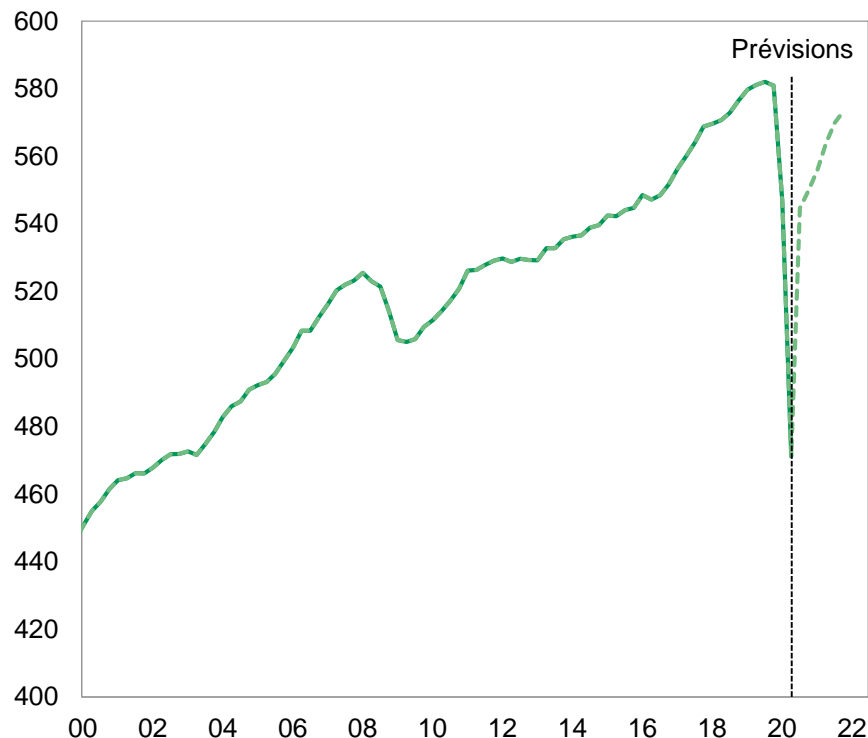
Sources: Ministry of the economy, Crédit Agricole SA / ECO

- 1 Summary
- 2 Recent trends in activity
- 3 Focus: Rising debt and business failure risks
- 4 Focus: Stimulus plan and expansionary fiscal policy
- 5 | Our scenario for 2020-2021

OUR SCENARIO FOR 2020-2021

STRONG BUT PARTIAL REBOUND

Quarterly GDP (€bn)



The French economy saw an almost automatic upturn starting in May/June 2020. However, it will take time to return to pre-pandemic levels. Consumer spending will be the prime mover, which, provided confidence returns, could be bolstered by the savings accumulated during the months of lockdown.

The government's stimulus plan should boost investment spending by business. The France Relance Plan clearly provides supply side support aimed at improving companies' bottom line through reductions in production taxes and support for investment in the form of multiple subsidies. As the stated aim of the stimulus is to make French companies more competitive in the medium term, the effects may not be immediate.

Moreover, we see some obstacles to recovery persisting. For one, the resurgence in infections with some services businesses forced to shutter again will dampen consumer spending in the fourth quarter of 2020. We expect Q4 growth to peter out to +0.9%, vs. +15.6% in our Q3 forecast. We also fear that exports will struggle to pick up, given their structure and the different pace of recovery in economies around the world. With imports bouncing back faster than exports, France's trade gap could widen, dampening growth in 2020 and – to a lesser extent – in 2021.

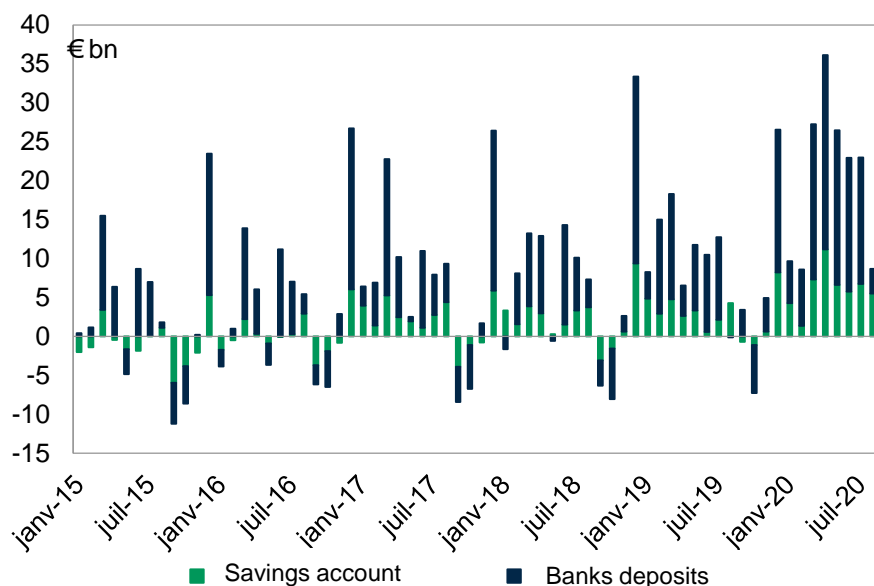
One final point: although a tsunami of insolvencies does not strike us as the most likely of outcomes, business failures could increase over the next few quarters. As a result, a hike in the jobless rate seems inevitable – with negative impacts on both output and demand.

Sources: Insee, Crédit Agricole S.A. / ECO

OUR 2020-2021 SCENARIO

WILL PEOPLE SPEND THEIR LARGE SAVINGS PILE?

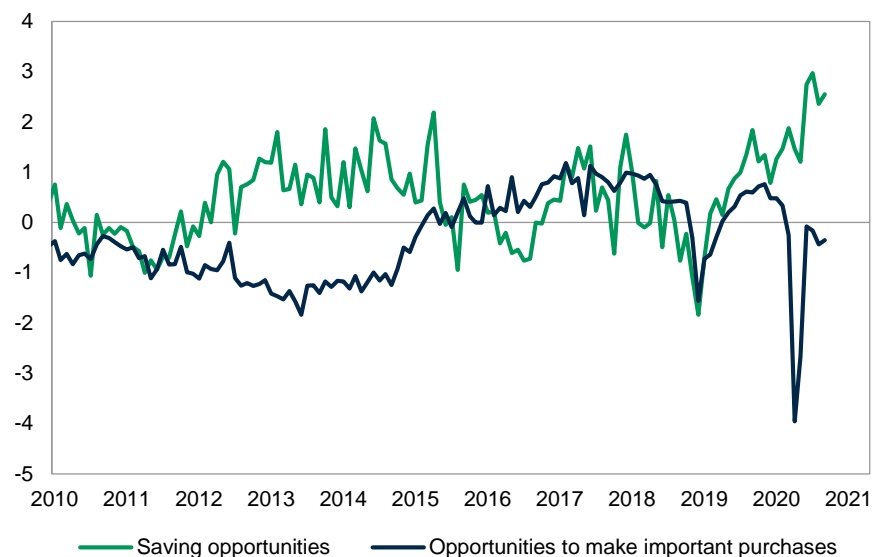
Flows of household savings to bank accounts and passbook savings accounts



Sources: Banque de France, Crédit Agricole S.A. / ECO

Households were saving more than a quarter of their income (27.6%) in the second quarter. This record ratio came about as opportunities to spend dried up while income was relatively protected by government support measures and massive uptake of the furlough scheme. People stashed away significant surplus savings during the period of restrictions. Initial bank deposit inflow data also confirm that savings have been accumulating. Bank deposits grew by around €20 billion a month on average between March and July 2020, a figure much greater than the monthly average in recent years (about €5 billion per

Household confidence, balance of opinion on opportunities to save and purchase big-ticket items (standardised)



Sources: Insee, Crédit Agricole S.A. / ECO

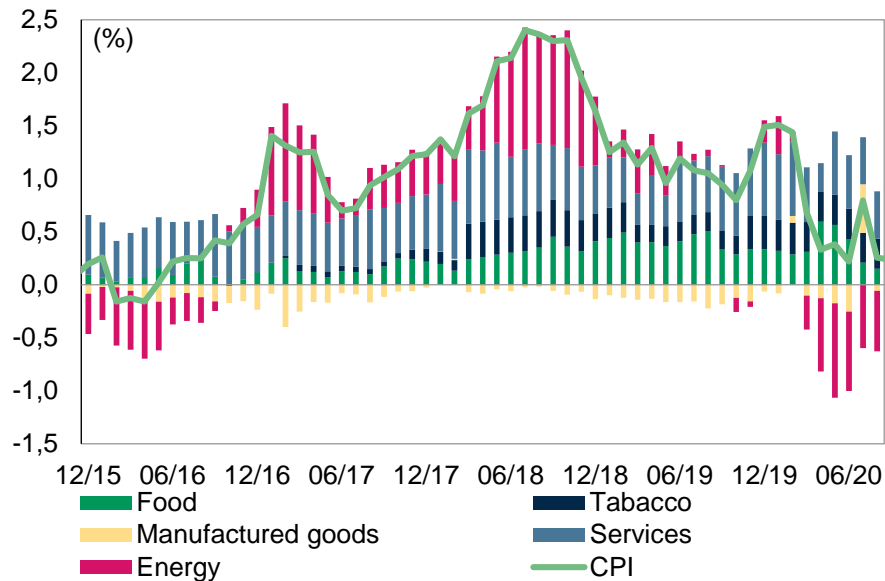
month since 2015).

This savings glut should revive consumer spending, but remains dependent on consumer confidence returning. As things stand, households remain cautious. The balance of opinion regarding opportunities to make large purchases is below the historic average, despite a clear improvement relative to the worst of the crisis. What's more, opportunities to save and fear of losing one's job are both high, indicating that people may well retain substantial precautionary savings over the coming months.

OUR SCENARIO FOR 2020-2021

CONSUMER PRICES: SUSTAINED LOW INFLATION

Contributions to changes in the consumer price index

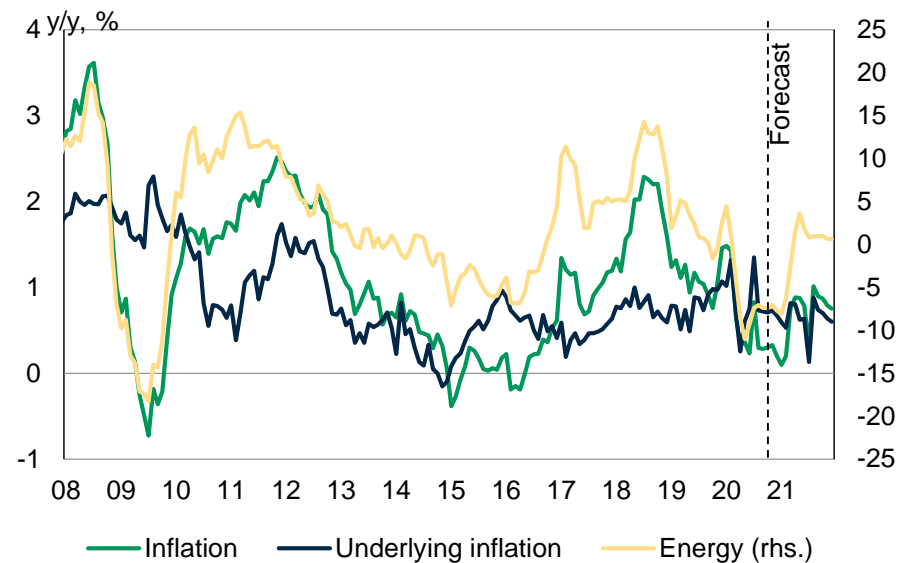


Sources: Insee, Crédit Agricole S.A. / ECO

Inflation fell during the crisis and is expected to remain low, far from the European Central Bank's 2% target. It stood at 0.2% in August 2020. Lower energy prices in particular have chipped away at inflation for the past few months, as global demand for raw materials dried up and international trade collapsed. In addition, OPEC countries and Russia continue to flood the oil markets maintaining downward pressure on the price per barrel.

We expect annual average inflation of 0.6% in 2020 with practically no

Price trend



Sources: Insee, Crédit Agricole S.A. / ECO

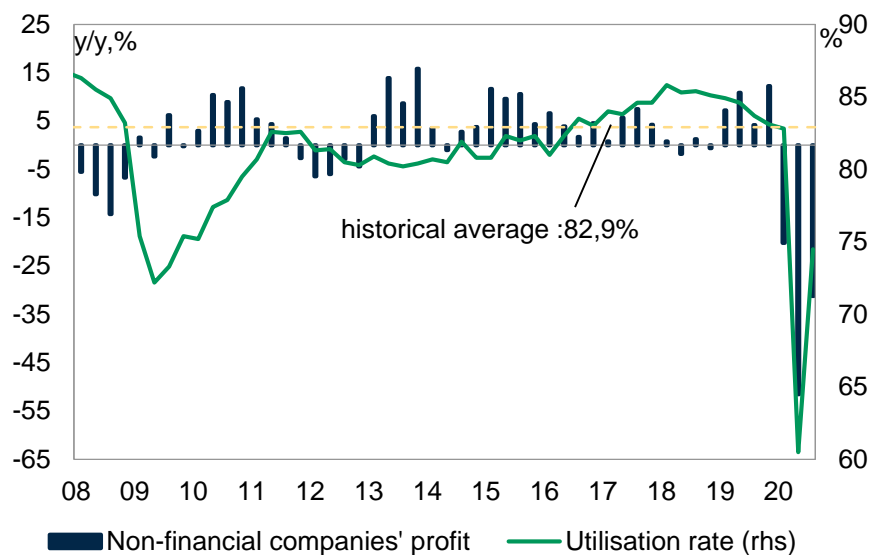
change in 2021 (0.7%).

Looking at the detail, despite a slowdown, price increases in services should continue to support underlying inflation. Higher tobacco prices should make a positive contribution, while the global economic recovery could generate a moderate increase in energy prices. Weak demand and lower disposable income power this year (despite an expected rebound next year) will also keep consumer prices in check.

OUR 2020-2021 SCENARIO

CORPORATE INVESTMENT KEY TO THE RECOVERY

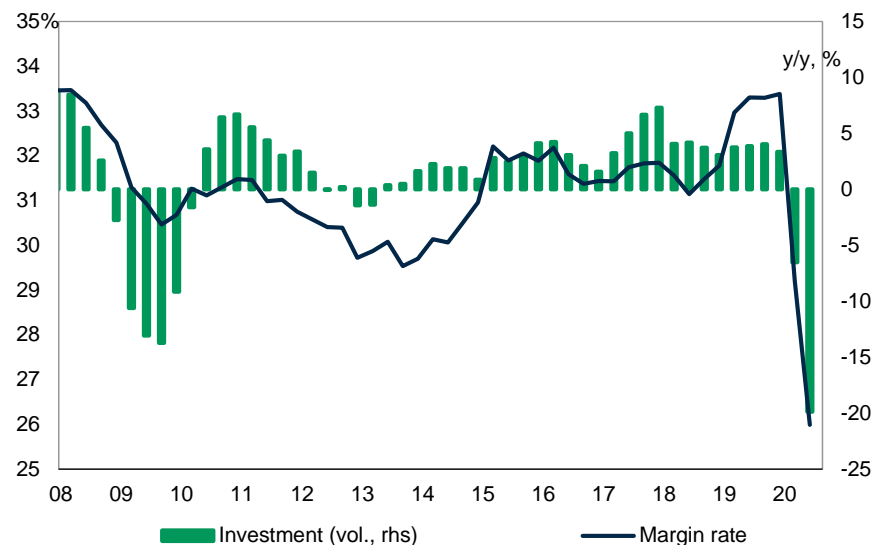
Profits and capacity utilisation rate



Sources: Insee, Crédit Agricole S.A. / ECO

Businesses will be the main beneficiaries of the government's stimulus plan. As discussed in the [focus](#) section, production taxes will come down by €10 billion from 2021. The goal of the tax cut is to make French industry more cost-competitive and give a boost to their profit margins as of next year. After a temporary drop to 29% in 2020 (from 33.2% in 2019), we expect a margin rate of around 32.5% in 2021. Lowering the tax burden is intended to encourage investment, but, in our opinion, next year, a substantial share of this €10 billion will go to rebuild companies' cash flow post-pandemic.

NFCs: margins and investment



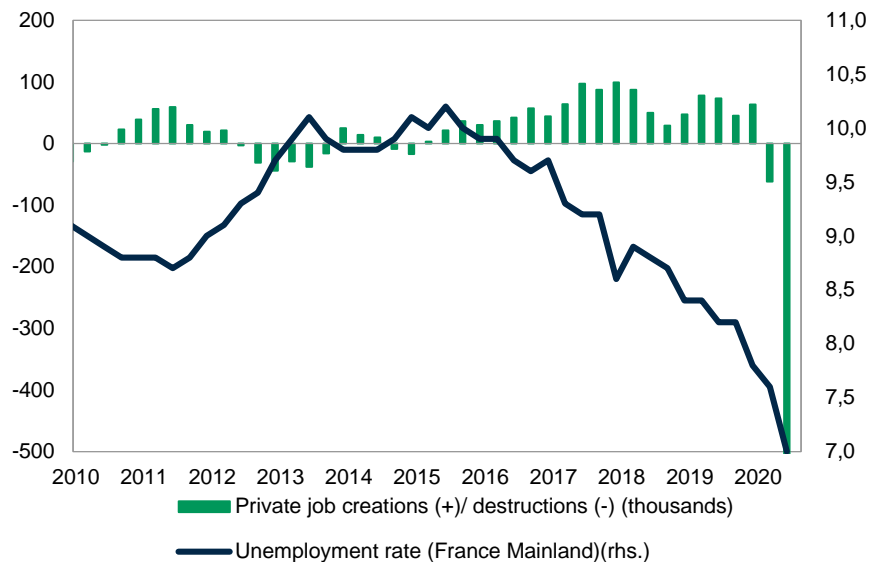
Sources: Insee, Crédit Agricole S.A. / ECO

However, we do expect investment to pick up markedly in 2021. The upturn in the economy and the measures in the stimulus plan to boost investment will reduce working capital requirements (which will nevertheless remain high) and help push up corporate investment by 9.5% in 2021, following a 10.5% contraction in 2020.

OUR 2020-2021 SCENARIO

HIGHER UNEMPLOYMENT PROBABLY INEVITABLE

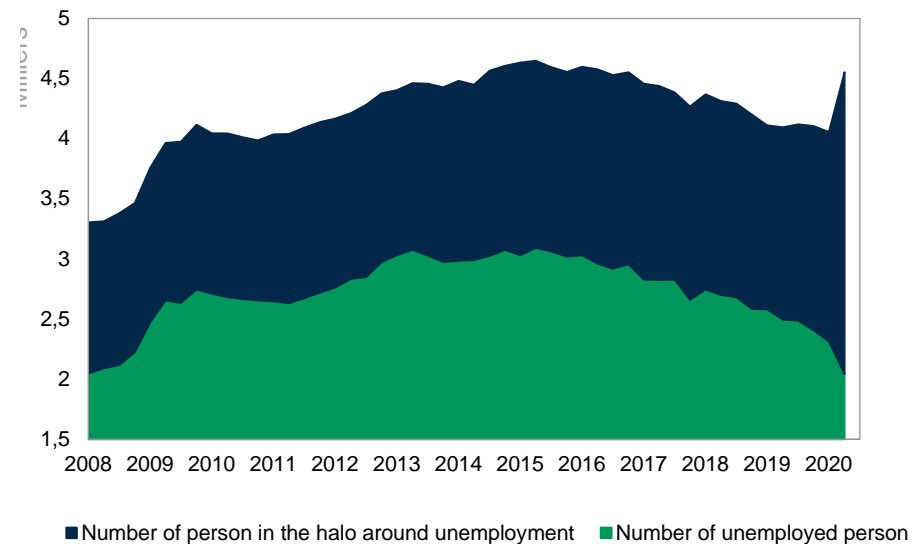
Illusory first-half improvement in jobs



Sources: Insee, Crédit Agricole S.A. / ECO

For technical reasons related to how unemployment is defined, the unemployment rate continued to decline in the first quarter. Indeed, some had to temporarily stop looking for work during lockdown as whole sectors came to a standstill. There was some job destruction with job losses concentrated mainly in temporary and short-term fixed-term contracts. The newly jobless people inflated the unemployment halo figures (defined by National Institute of Statistics and Economic Studies (INSEE) as "those who want to work but are classed as being inactive either because they are not immediately available to work or

Unemployed and individuals in the halo around unemployment (Mln)



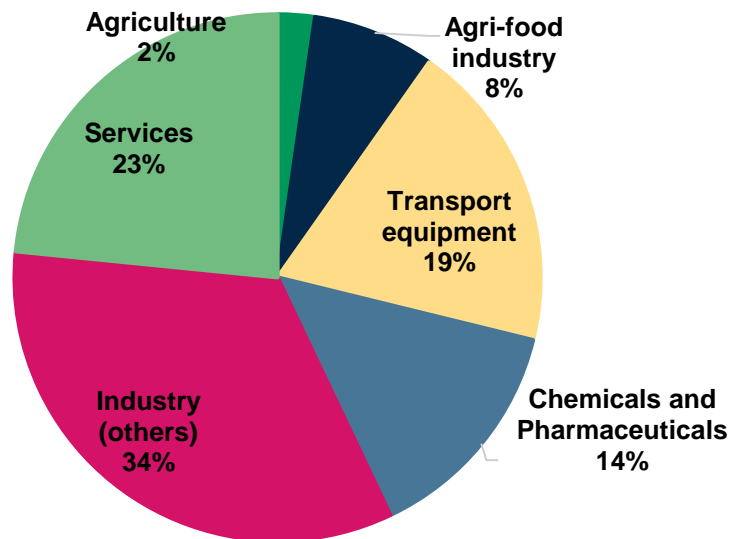
Sources: Insee, Crédit Agricole S.A. / ECO

because they are not actively seeking work"). All in all, our estimates put private sector job losses at around 830,000 in 2020. Workers on permanent contracts – who have been sheltered by the furlough scheme – are likely to become more vulnerable to losing their jobs in the coming months. 14 million private sector employees were covered by the scheme during the worst of the crisis, although not necessarily all were on short-time working. We could see unemployment rise to 9.9% in Q4 2020 in metropolitan France and peak in the second quarter of 2021 before gradually declining.

OUR SCENARIO FOR 2020-2021

INTERNATIONAL TRADE: UNEVEN PATH OF GLOBAL RECOVERY WILL WEIGH ON EXPORTS

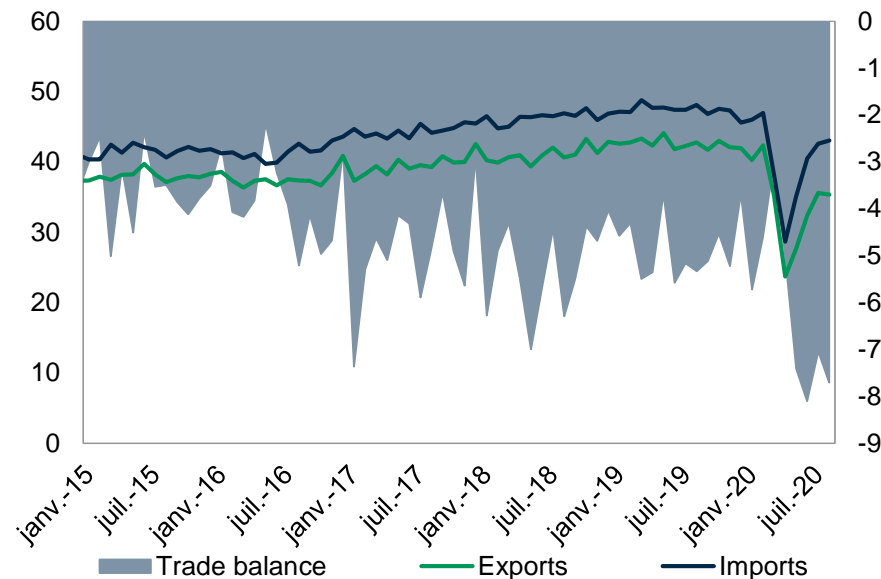
**Main export sectors
(% of 2017 exports)**



Sources: Insee IOT 2017, Crédit Agricole SA / ECO

The structure of French exports will militate against a quick turnaround. Accounting for 13% of our exports, the impact on the aeronautics industry could be a lasting one as airlines could cancel orders amid the slump in air travel. But the government has introduced a special stimulus package for the sector to safeguard competitiveness and protect the fabric of SMEs and suppliers to major manufacturers such as Airbus. The services sector – especially tourism – will also put a damper on the recovery in exports. The leading destination for foreign tourists, France's tourism trade surplus has been wiped out since the virus hit. The industry will struggle badly

**Trade of goods
(monthly data, €bn)**



Sources: Douanes, Crédit Agricole SA/ ECO

as long as international travel is crippled.

Turning to goods, the speed at which consumer spending in France bounced back and the divergence in the pace of recovery between countries (causing a softer turnaround in exports) has widened the trade deficit in recent months. International trade will pull down growth in 2020 (-2.2%) and make a 0.4% positive contribution in 2021.

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