



FRANCE 2022-2023 SCENARIO

THE ECONOMY & THE CHALLENGES OF INFLATION

October 2022

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WORKING EVERY DAY
IN YOUR INTEREST



GROUP ECONOMIC RESEARCH

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SUMMARY

INFLATION SHOCK WEIGHS ON DOMESTIC DEMAND

The 2021 rebound seems firmly in the rearview mirror and GDP growth is expected to slow sharply both this year and in 2023. GDP declined 0.2% in Q1 vs. Q4 2021 before picking up in Q2 2022 (+0.5%), fuelled by services and foreign trade, and is also expected to grow in the third quarter. Overall, **growth is expected to come out at a relatively high 2.6% in 2022**, lifted to a large extent by a very favourable growth overhang, which obscures the slowdown in activity we expect at the end of the year. Inflationary pressures are not only putting a damper on consumer spending, despite the considerable measures introduced by government to help cope with the higher cost of living, but also adding to uncertainty. At the same time, the sharp hike in interest rates and squeeze on margins is holding back investment.

We expect growth to slow overall at the end of 2022 and in the first half of 2023 and do not rule out a contraction in GDP, even though falling into recession (defined as two consecutive quarters of decline in GDP) is just about avoided in our central scenario. In the second half of 2023, domestic demand should pick up slightly as inflation comes down. **Our estimates put average annual growth limping along at 0.6% in 2023.**

This central scenario is based on significant energy supply and production assumptions. But there are considerable downside risks. If energy rationing becomes a reality or if

prices spike sharply again, recession will be impossible to avoid in 2023.

Main components of the scenario:

- **Household consumption** is set to slow, despite budget measures in 2022 to shore up purchasing power. The energy price cap limits the increase of consumer prices and the “Purchasing Power Act” will protect household budgets in the second half. Yet, uncertainty means consumers are wary. Growth in household spending is likely to be anaemic in 2023, although inflation should slow, especially in the second half of the year.
- We also expect **business investment** to decline in 2022 and 2023, after a particularly strong showing in 2021. The lower spending under the France Relance recovery plan, combined with the reduction in corporate taxes will not fully offset the combined impacts of higher interest rates and pressure on margins in almost all sectors of the economy. That said, company financials were in good health when the energy crisis first hit.
- **Inflation** will continue to eat away at purchasing power and company margins in 2023. However, we expect it to moderate, assuming that energy prices stabilise at high levels. As rising commodity prices add to inflationary

pressure, pushing up the cost of goods and services, energy will cease to be the main driver of consumer price rises. The price cap will be rolled over and cushion some of the increases in 2023, even though its impact on inflation will be lower than in 2022.

- At an estimated €48.6 billion in 2022 and slightly more in 2023, fiscal policy measures to protect consumers from rising inflation are costly for the public finances. Even though the emergency supports introduced during the pandemic have been withdrawn, **the deficit should remain above 5% in both 2022 and 2023.**
- Terms of trade continue to deteriorate with a knock-on effect on the trade deficit for goods. As the aviation sector gradually ramps back up in 2023, it should make a positive contribution to the trade balance. What is more, once adjusted for price effects, exports are growing faster than imports, lifted by the surge in international tourism.
- **The labour market** is expected to remain on a sound footing despite a slowdown in job creation after an exceptional 2021. A slight rise in the unemployment rate in 2023 cannot be ruled out in the event of a sharp slowdown in domestic demand.

SUMMARY

INFLATION AND UNCERTAINTY CLOUD THE OUTLOOK FOR GROWTH

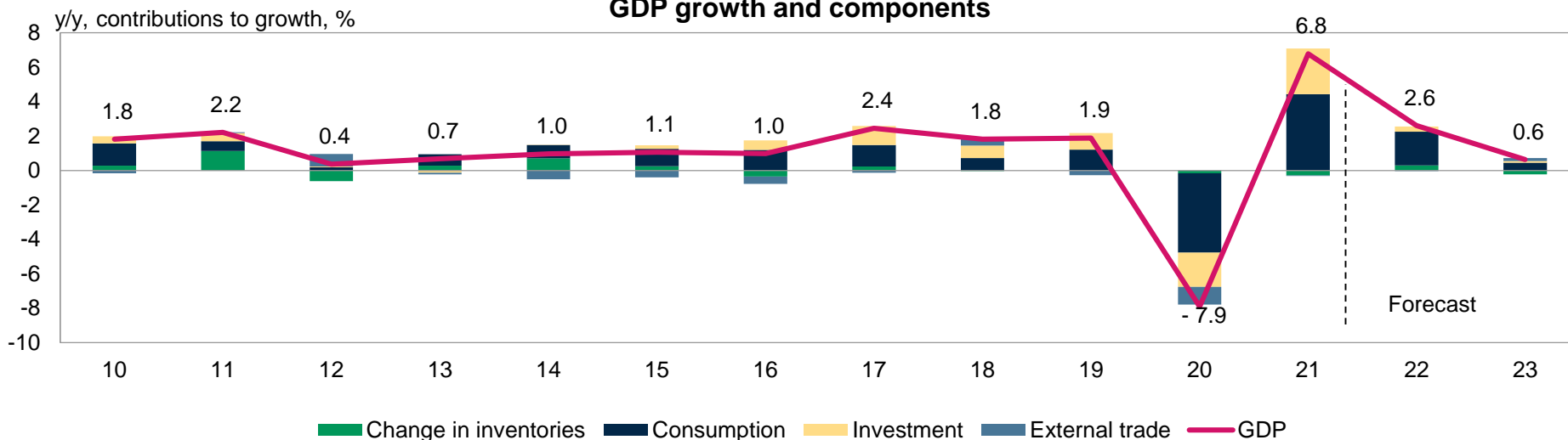
Main numbers of our outlook

France	Annual average (y/y, %)					Quarterly growth (q/q, %)															
	2019	2020	2021	2022	2023	2020				2021				2022				2023			
						T1	T2	T3	T4	T1	T2	T3	T4	T1	T2	T3	T4	T1	T2	T3	T4
GDP	1.9	-7.9	6.8	2.6	0.6	-5.6	-13.5	18.4	-0.9	0.0	1.0	3.4	0.5	-0.2	0.5	0.2	0.1	-0.1	0.2	0.4	0.3
Households consumption	1.8	-6.8	5.2	2.7	0.7	-5.4	-11.5	18.4	-5.5	0.3	1.1	5.8	0.4	-1.2	0.3	0.5	0.1	-0.1	0.2	0.3	0.4
Investment	4.2	-8.4	11.3	1.2	0.4	-9.4	-14.6	24.2	2.6	0.9	1.7	0.5	0.0	0.4	0.2	0.1	-0.2	0.0	0.2	0.3	0.3
Corporate investment	3.5	-8.0	11.8	1.5	0.6	-8.9	-14.5	24.6	1.9	1.7	1.5	0.6	0.1	0.4	0.4	0.3	-0.2	0.0	0.3	0.3	0.3
Change in inventories*	0.0	-0.2	-0.3	0.3	-0.2	0.7	0.4	-2.0	0.7	0.5	-0.3	-0.9	0.7	0.4	0.1	-0.2	0.0	-0.1	-0.1	0.1	0.0
Net exports*	-0.3	-1.0	0.0	0.0	0.2	-0.4	-1.4	0.5	0.8	-0.7	0.2	0.4	-0.6	-0.1	0.3	0.1	0.1	0.0	0.0	0.0	0.0
Unemployment (Insee)	8.2	7.8	7.7	7.2	7.5	7.6	7.1	8.8	7.8	8.0	7.7	7.8	7.2	7.1	7.2	7.2	7.2	7.4	7.5	7.5	7.5
CPI Insee (yoy)	1.1	0.5	1.6	5.1	4.5	1.2	0.3	0.3	0.1	0.7	1.4	1.7	2.7	3.7	5.3	5.9	5.4	5.5	4.4	4.1	4.1
Government deficit (% of GDP)	-3.1	-9.0	-6.5	-5.1	-5.3																

* Contributions to GDP growth

Source : Crédit Agricole SA/ECO, forecast

GDP growth and components



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

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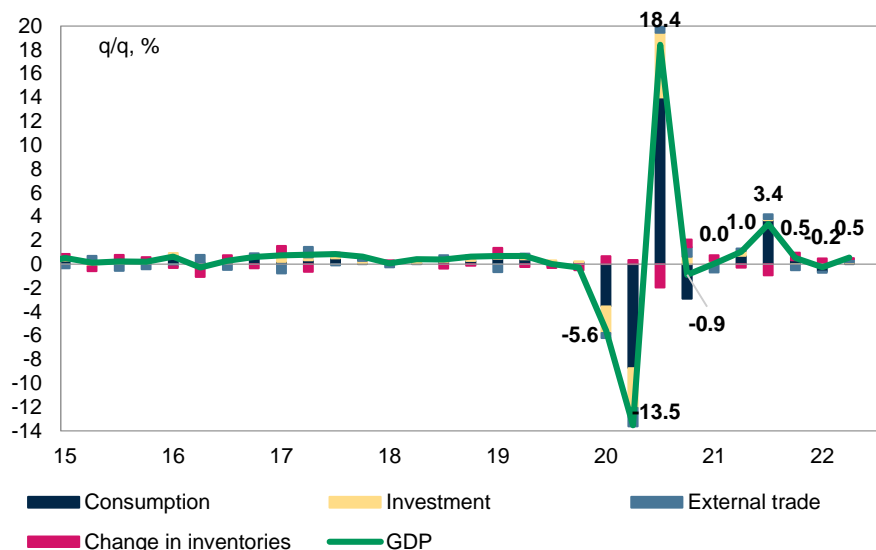
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RECENT TRENDS IN ACTIVITY

GDP REBOUNDS IN THE SECOND QUARTER

GDP growth and contributions



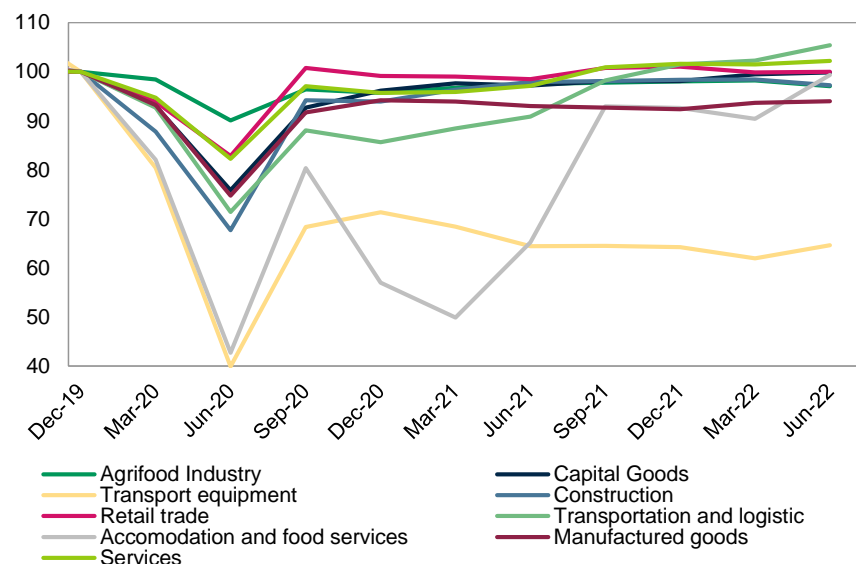
Sources: INSEE, Crédit Agricole S.A. /ECO

French GDP rebounded 0.5% qoq in the second quarter, following a contraction of 0.2% at the start of the year. The growth overhang for 2022 comes out at 2.5%.

Domestic demand remains lacklustre as inflation erodes the value of the euro in people's pockets and weighs on households' purchasing decisions. After contracting 1.2% in Q1, consumer spending made a feeble recovery (+0.3%) in the second quarter to just around its pre-pandemic level.

Investment by non-financial companies remained buoyant and was up 0.5% compared to the first quarter. Services fared particularly well, while investment in construction declined.

Trend in value added by sector



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

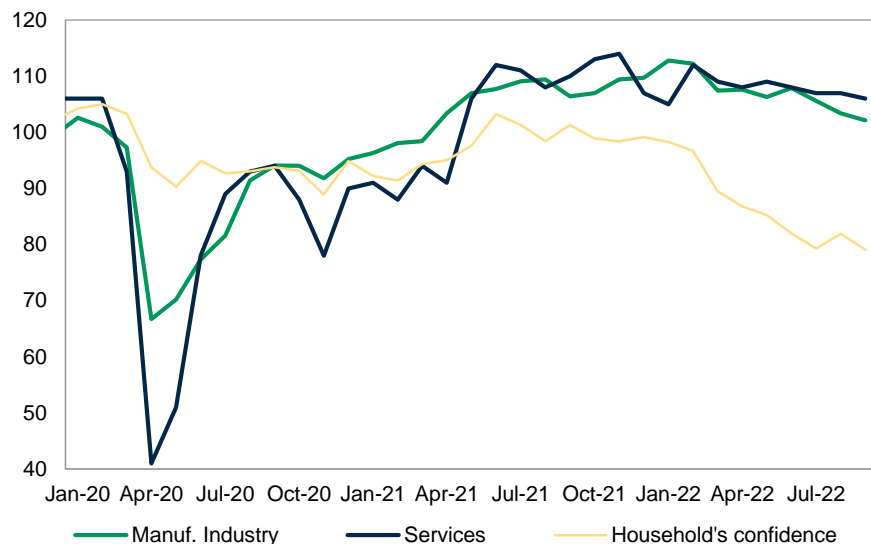
Domestic demand added 0.3 points to growth. With import costs rising and domestic demand slower, volumes imported stagnated while growth in exports accelerated 0.9%, fuelled by tourism (transport services and spending by foreign tourists in France, amongst others).

Looked at by sector, hotels and restaurants continued to recover in Q2 and throughout the summer. Automotive production on the other hand was still hobbled by disruptions to supplies of intermediate goods.

RECENT TRENDS IN ACTIVITY

BUSINESS CONFIDENCE FALLS. ARE WE LIKELY TO SEE DEMAND FALL?

Business climate and consumer confidence

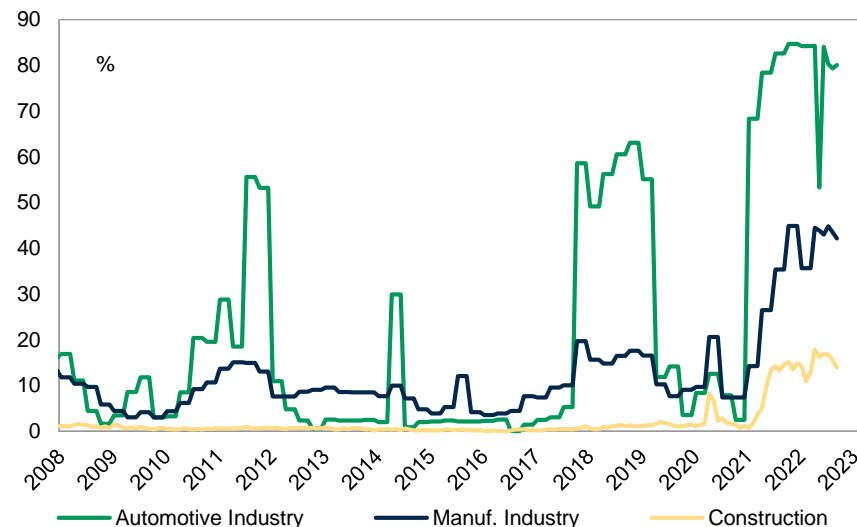


Sources: INSEE, Crédit Agricole S.A. /ECO

Consumer confidence fell sharply over recent months to 79 in September, well below its long-term average (100) and at its lowest level since 2013. Inflation and the cost of living are the main worries for households, while the labour market is running strong, despite a recent hike in unemployment fears (which remains relatively low).

In a sign that activity continues to grow, albeit at a slower pace, we are seeing a much more gradual slowdown in the business climate indicator. Nevertheless, it remains above its historical average. The fact that the indicator has held up – in services notably – seems to indicate that the economy has continued to improve over the past few

Companies whose activity is limited by supply shortages



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

months. We expect positive growth in the third quarter of some 0.2%, driven by household consumption and by brisk growth in services (hotels, restaurants and leisure) over the summer period.

On the supply side, supply constraints are still there, but the picture has improved slightly in recent months. Economic surveys also show that demand is set to dip in the near future, with sparser order books and lower production as a result. Although supply problems – which were responsible for choking off production – are set to gradually unwind, there is a risk that lower demand will in turn dent industrial production.

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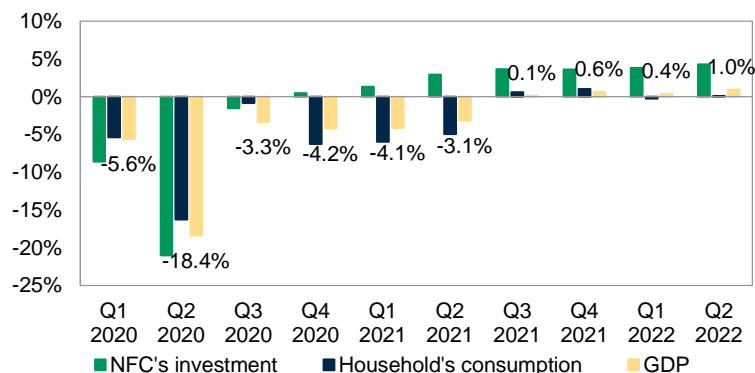
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OUR SCENARIO FOR 2022-2023

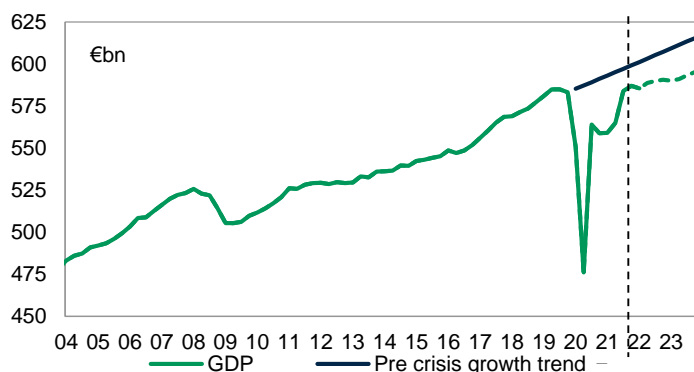
UNCERTAIN OUTLOOK BASED ON SIGNIFICANT ASSUMPTIONS

Level compared with Q4 2019



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

Quarterly GDP



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

Inflation sapped the vigorous rebound in growth in 2021, when activity had seemed firmly on track to close the gap with the pre-pandemic growth trend. Inflationary pressures, primarily fuelled by soaring energy prices, are holding back domestic demand, dampening both household spending and business investment through a negative impact on margins (except for some sectors). Supply chain difficulties and scarcity risks are also playing their part: some very energy-intensive industries, such as aluminium or glass production, have even been forced to suspend operations. They cannot increase selling prices in line with higher production costs, and therefore cannot make a profit.

To add to the mix, the European Central Bank is on a path of rapid monetary tightening. The resulting sharp hike in interest rates will further dent economic activity, but with only a limited impact on inflation in the near term. It is worth pointing out that inflation is largely imported, rather than made in France, as was the case a few months ago in the United States when both demand and wages were overheating.

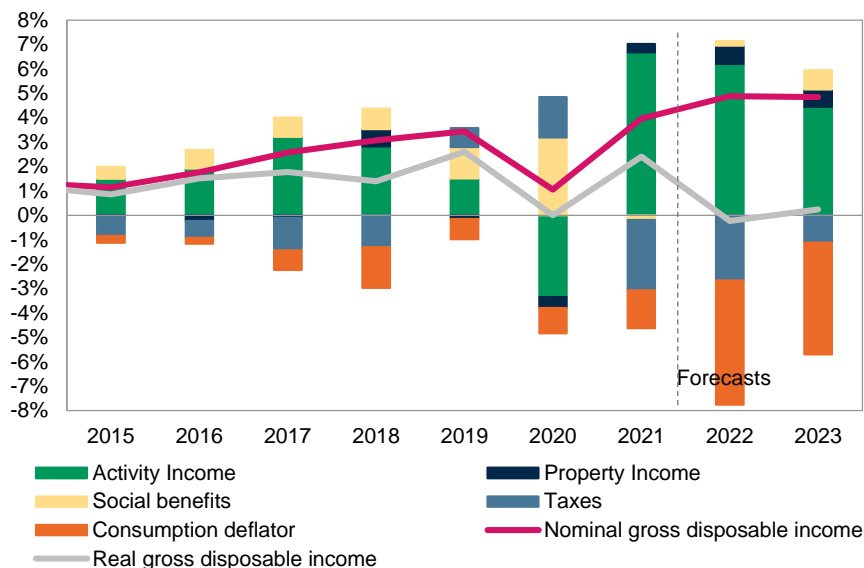
The rebound in the services sector should ensure growth stays in positive territory in the third quarter. Yet activity is expected to slow significantly at the end of the year and early in 2023, when a slight contraction in GDP cannot be ruled out, even in our central scenario.

It is important to note that our scenario is built around significant assumptions regarding supplies of natural gas and production of electricity in Europe. Notably, we expect gas supplies to be stable, but without the Nord Stream pipelines coming back on stream. Remember also that some of France's nuclear power stations will be back up and running between now and the winter, which will boost electricity production from current levels, according to EDF's schedule (almost half of the country's reactors are currently shut down). We also assume that France will consume around 10% less energy than in a "normal" year. These assumptions will not prevent a slowdown, but should help avoid a sharp contraction in the French economy. However, there are downside risks. If we have a hard winter or if we cannot produce enough electricity, energy rationing could be introduced in some sectors, which would plunge the country into recession.

OUR 2022-2023 SCENARIO

CONSUMPTION: WEAKER DEMAND, DESPITE GOVERNMENT COST-OF-LIVING SUPPORT PACKAGES

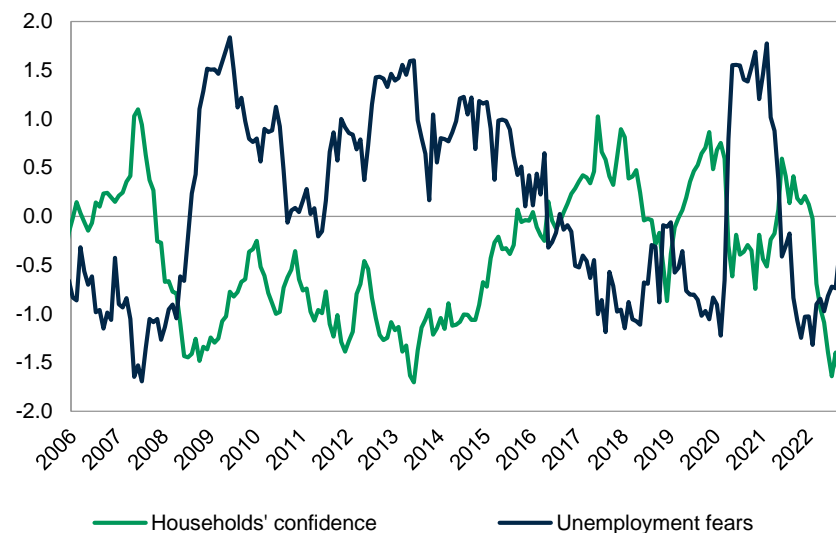
Growth in purchasing power and contributions



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

Real disposable income (purchasing power, in other words) contracted over the first half, by 1.6% in Q1 and 1.1% in Q2, (quarterly change) but is likely to rise in the second half. Uprating benefits and the upward adjustment in the civil service wage index are set to push up incomes in the third quarter. Axing the TV licence fee will also ease the cost of living crisis for households in Q4 while the energy price cap will continue to curb inflation. The job market in the private sector is buoyant. Salaries are rising but, on average, not enough to keep up with inflation. Ultimately, **over 2022 as a whole, the erosion in purchasing power should be contained at around 0.2%.** As the French government plans to keep the energy price cap in place in 2023 for the most part, disposable income will stagnate next year.

Consumer confidence (normalised balance of opinion)



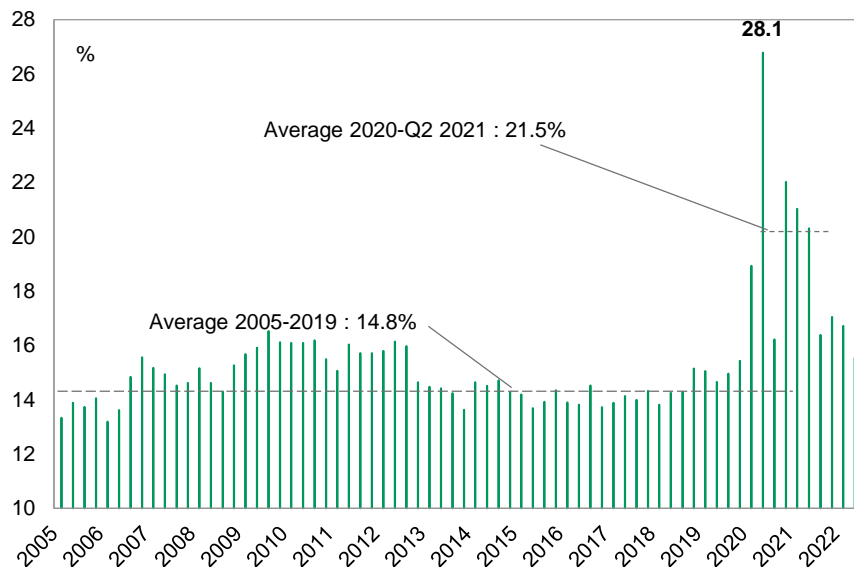
Sources: INSEE, Crédit Agricole S.A. /ECO

That said, we expect household spending to slow over the coming quarters, after services-driven growth in Q2 and Q3 2022. From a macro point of view, the small reduction in disposable income masks differences within the population as a whole. Consumer confidence has been in free fall since January. Households are worried about rising prices, which generates uncertainty about their future finances and discourages major purchases – all of which dampens consumer spending overall. **Consumer spending is expected to increase 2.7% on average in 2022**, a seemingly high target but one that should be achievable on the back of the strong performance at end-2021, which led to a growth overhang of 1.8% at the end of Q1. **In 2023**, inflationary pressures are expected to gradually decline throughout the year and **household spending to increase by 0.7%.**

OUR 2022-2023 SCENARIO

PRICE INCREASES MAKE A HOLE IN SURPLUS SAVINGS

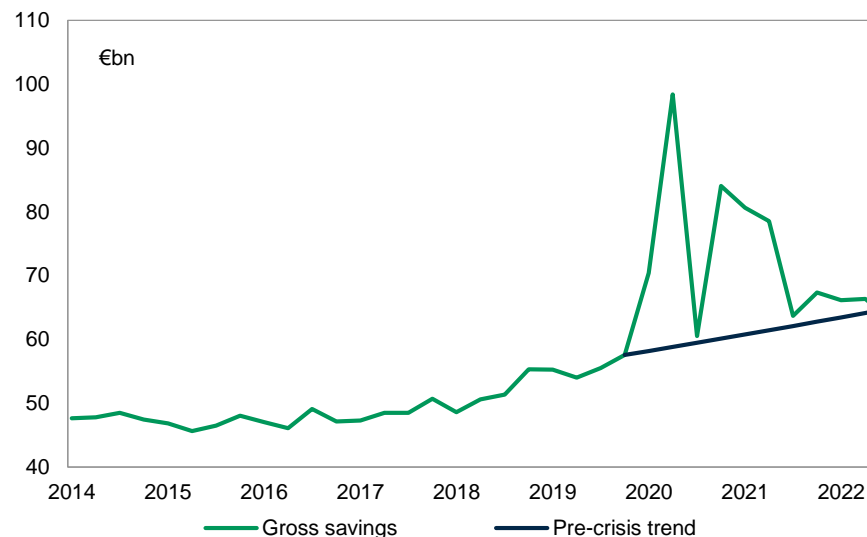
Household savings rate



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

The decline in the savings rate has accelerated as inflation bites. In Q2 2022, the savings rate stood at 15.5%, its lowest since Q4 2019, while consumer spending by volume (adjusted for price changes) has barely recovered to pre-crisis levels. Savings flows are returning to close to pre-pandemic trends after more than two years of Covid-19 induced excess saving, when incomes were protected but opportunities to spend were curtailed by the pandemic. According to the French independent economic analysis council, the Conseil d'analyse économique (CAE), some sectors of the population have already started to dip into their savings, while the richest continue to build up substantial amounts. Those on the lowest incomes have already spent all of their savings buffer.

Quarterly flows of gross household savings



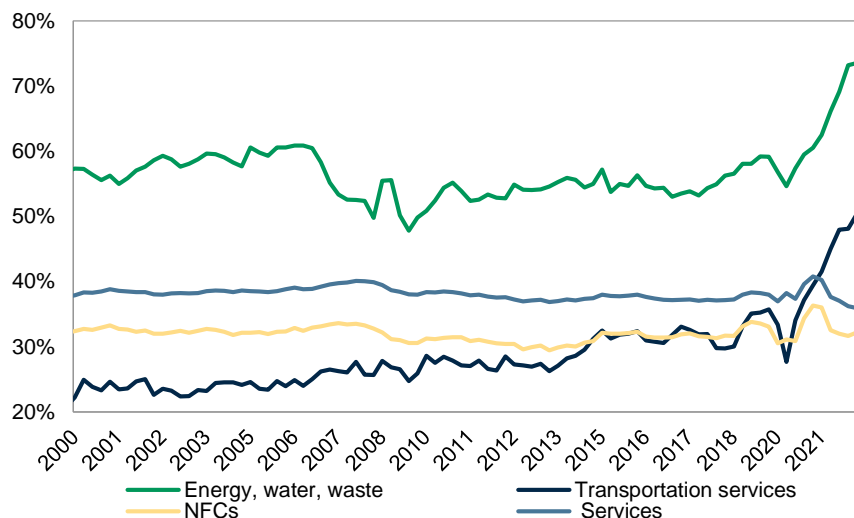
Sources: INSEE, Crédit Agricole S.A. /ECO

Yet, some households could want to be cautious and keep saving. During periods of high inflation and uncertainty, households tend to hold on to the purchasing value of their savings to meet future essential spending, rather than focus on a particular target amount. As inflation eats away at the value of savings, households are encouraged to put more aside, even if this means pulling back on current spending (especially on non-essential goods and services) to ensure they have enough aside for essential purchases in the future.

OUR 2022-2023 SCENARIO

HIGHER INTEREST RATES AND PRESSURE ON MARGINS MAKE POOR BEDFELLOWS

NFC profit margin rates



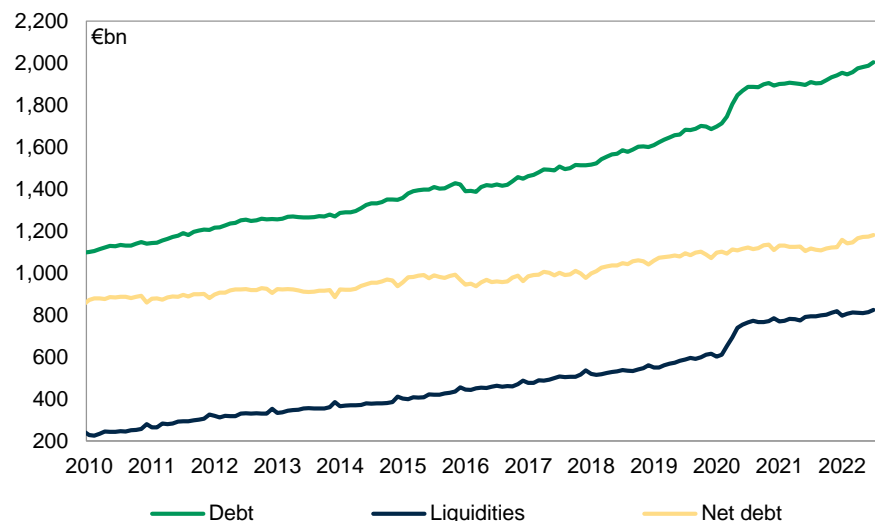
Sources: INSEE, Crédit Agricole S.A. /ECO

Profit margins of non-financial companies recovered in 2021 as companies benefited from the recovery in the economy and continued generous government support measures.

However, we have observed a contraction in NFCs' profit margins since the start of the year. This is down to three factors: the withdrawal of supports to pay workers, the end of furlough schemes and higher production costs. With demand still relatively lacklustre, companies cannot pass on all the production cost increases in higher sale prices, which means they are absorbing some of these higher costs.

And that's not all. As inflation takes hold, interest rates rise, financing conditions tighten and fiscal supports are reined in. The budget impact of the France Relance plan will be lower in 2023, with less than €10bn in loans.

NFC debt and cash:
cash reserves remain high



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

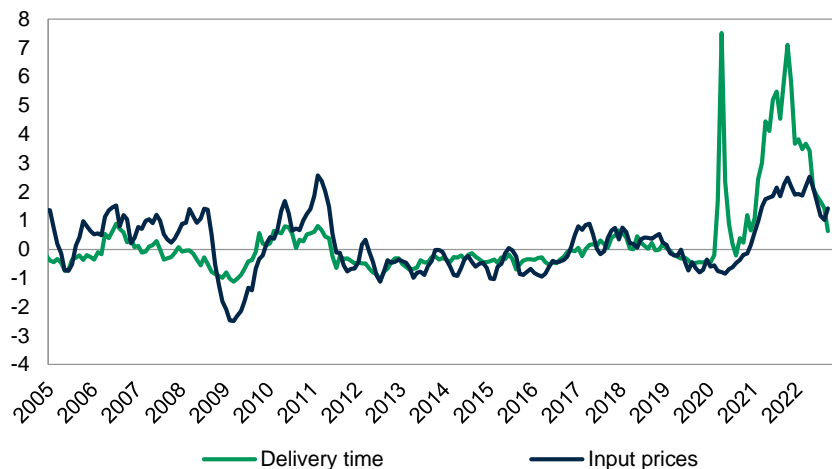
All of these factors will together act to slow investment by non-financial companies, which is expected to grow 1.4% in 2022 and 0.6% in 2023 after bouncing back strongly in 2021.

However, we do not expect investment to collapse. Despite the uptick in recourse to credit in recent months, the non-financial corporate sector still has significant liquidity reserves and policy support measures have not been withdrawn altogether. In line with the cut in production taxes as part of the recovery plan, the CVAE (a business tax assessed on companies' added value) is being phased out over two years. Companies – mainly industrial companies – will see a 50% reduction in the CVAE tax in 2023, amounting to a tax cut of €4.1 billion. The tax will be abolished in 2024.

OUR 2022-2023 SCENARIO

INFLATION TAKES HOLD ACROSS THE ECONOMY

Balances of opinion on supply times and prices of intermediate consumption



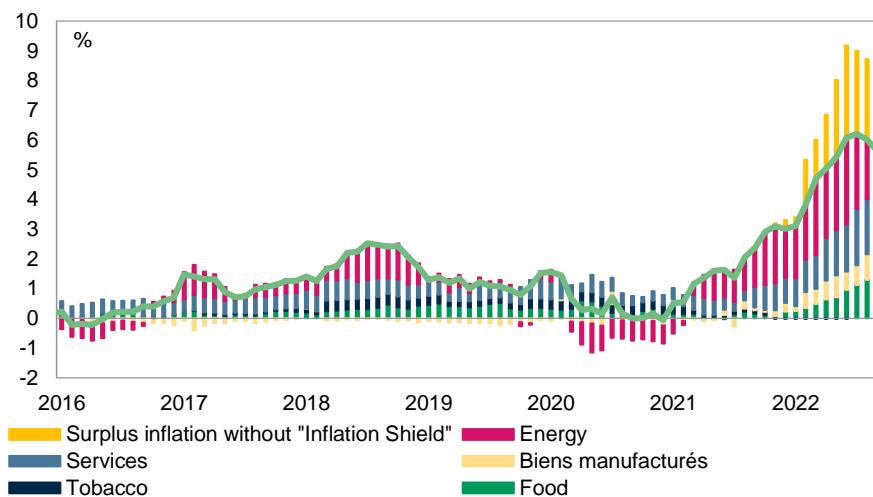
Sources: IHS Markit, Crédit Agricole SA/ECO

Inflationary pressures initially built up as global demand overheated in the second half of 2021, Inflation accelerated early in 2022, fuelled by Russia's invasion of Ukraine and the resulting surge in energy prices (especially gas prices and electricity). The war in Ukraine has also increased food prices.

Driven by the increase in energy prices, inflation peaked at 6.1% year-on-year in France in July and then came down in August and September. We expect the inflation rate to head up again by the end of the year, before gradually falling in 2023. **Overall, inflation in France is expected to average 5.1% in 2022 and 4.5% in 2023.**

In 2022, the energy price cap will take 2.2 points from French consumer price increases, which explains why inflation in France

Inflation and contributions



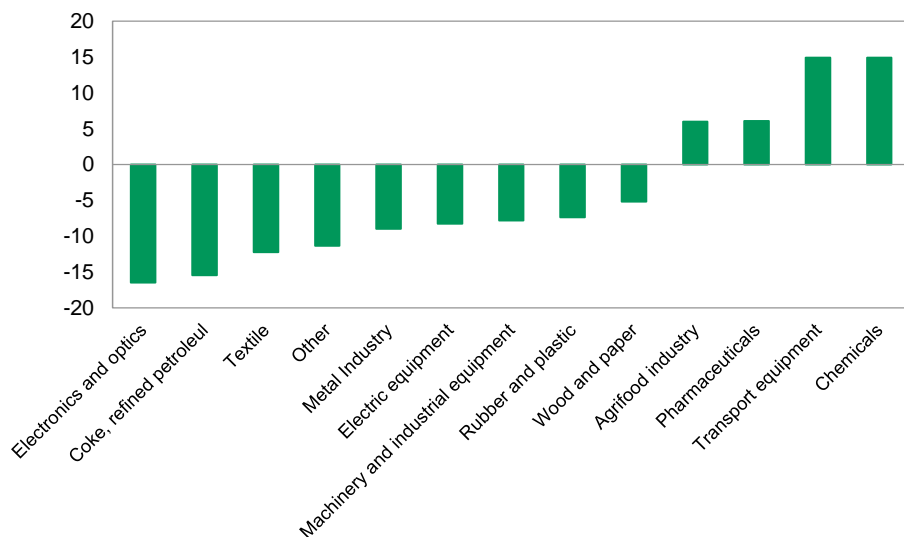
Sources: INSEE, Crédit Agricole SA/ECO

(annual Harmonised Index of Consumer Prices (HICP) inflation at 6.5% in August) is lower than in other European countries, which didn't freeze energy prices, (9.1% annually on average in the Eurozone as a whole). But the price cap **will not be as effective in containing inflation in 2023, with the average impact estimated at around 1.5% that year.** In our view, energy will not be the main driver of price rises going forward. Commodity price increases will gradually hit consumers' pockets in the form of higher prices for other goods and services – especially food. Rising food prices will be the main factor fuelling inflation. On the other hand, lower demand will help curb inflation, as we have seen in the balance of opinion on international value chains (shorter supply lead times and less pressure on the price of intermediate goods).

OUR SCENARIO FOR 2022-2023

INTERNATIONAL TRADE IN GOODS: UNFAVOURABLE TRADE TERMS

Trade balance by sub-sector
(value, €bn, 2019)

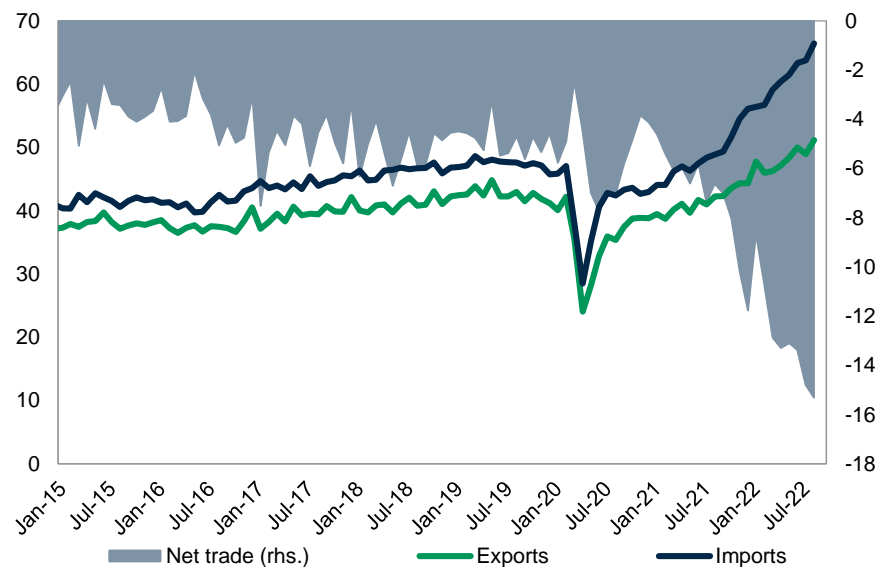


Sources: Customs, Crédit Agricole SA/ECO

The trade balance in goods has continued to deteriorate in recent months, due in particular to worsening terms of trade (the price of imported goods (especially energy) has risen faster than the price of exports). The dollar's rise against the euro intensifies this pattern as the majority of energy trades are transacted in dollars. On the other hand, the euro's relative depreciation could make European exporters more competitive.

In volume terms, however, exports grew faster than imports in the second quarter and foreign trade made a positive 0.3-point contribution to growth. Moreover, despite demand from other

Trade in goods
(monthly data, €bn)



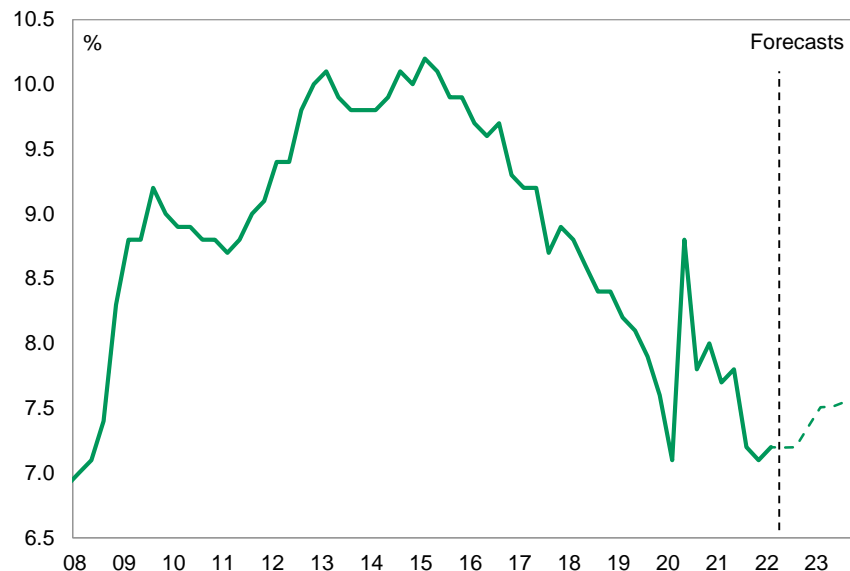
Sources: Customs, Crédit Agricole SA/ECO

European countries slowing and a downward revision in our growth forecasts, French exports could, by their nature, be in a slightly better position compared to those of our German and Italian neighbours in particular. When travel restrictions were lifted, tourists flocked back to France during the spring and summer months. We could also see Asian tourists come back to France if zero-Covid policies were rolled back. In addition, we expect production in the aviation sector is to pick up during 2023, and therefore to add to exports, following order cancellations at the height of the Covid-19 crisis. Aviation ranks as one of the leading trade surplus in France.

OUR SCENARIO FOR 2022-2023

MIGHT UNEMPLOYMENT EDGE UP?

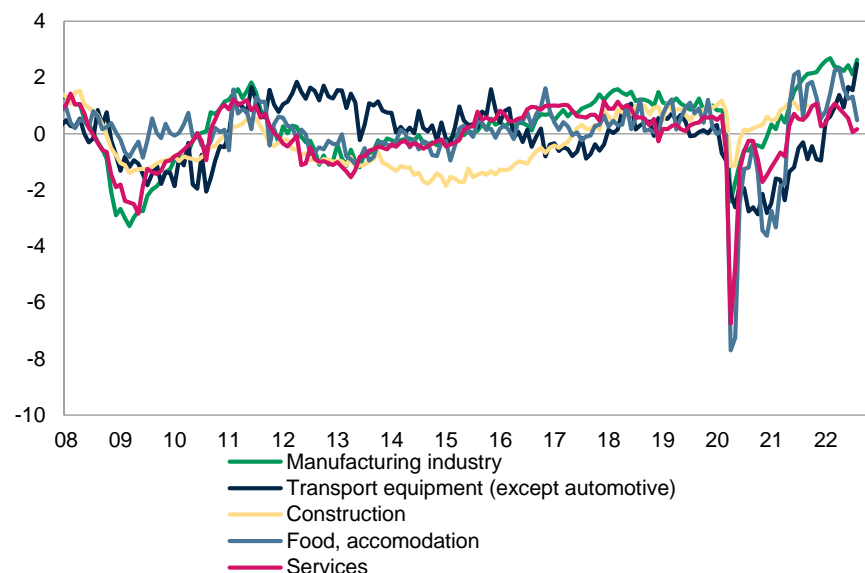
Unemployment rate
(mainland France)



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

The jobless rate rose slightly to 7.2% in mainland France in the second quarter. In our opinion, this uptick should not be seen as pointing to a sudden downturn in the labour market. We expect unemployment to stabilise at this level by the end of the year. It should remain well shy of the pre-pandemic rate (7.9% in Q4 2019). While the bottlenecks observed in some sectors (notably the hotel and restaurant industry) seem to have been ironed out, hiring intentions remain high overall in most industries. Hiring will stay strong to the end of the year, although it could slow, as employment has picked up faster than activity since lockdown ended. We cannot rule out a slight

Hiring intentions
(normalised indicators)



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

rise in the unemployment rate at the year-end and in 2023. Although low overall, company insolvencies have increased markedly and are likely to return to pre-pandemic levels. For now, they concern mostly very small and new companies. We do not expect a wave of business failures. However, job losses could be on the cards. Hiring could slow in line with the slowdown in the economy early in 2023.

The unemployment rate in mainland France is expected to average 7.2% in 2022 and rise to 7.5% in 2023.

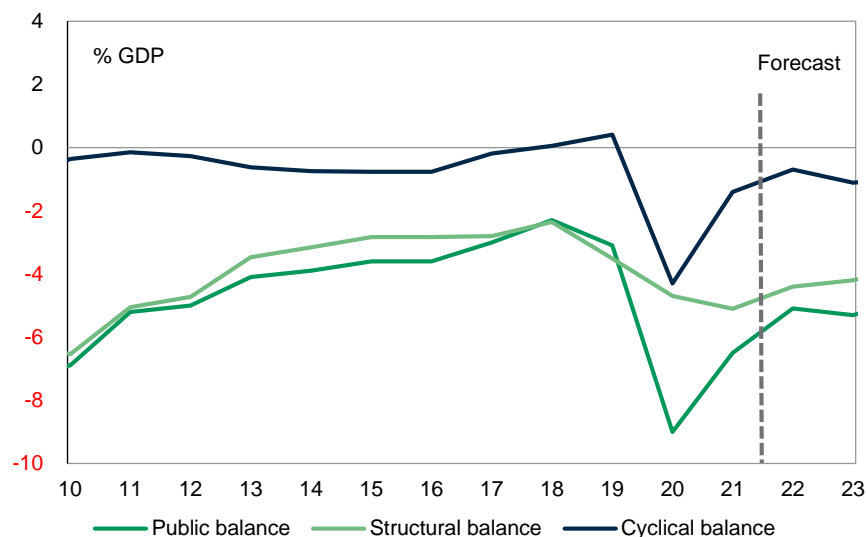
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FOCUS: PUBLIC FINANCES

THE PATH TO STABILISING THE (HIGH) DEFICIT

Public deficit

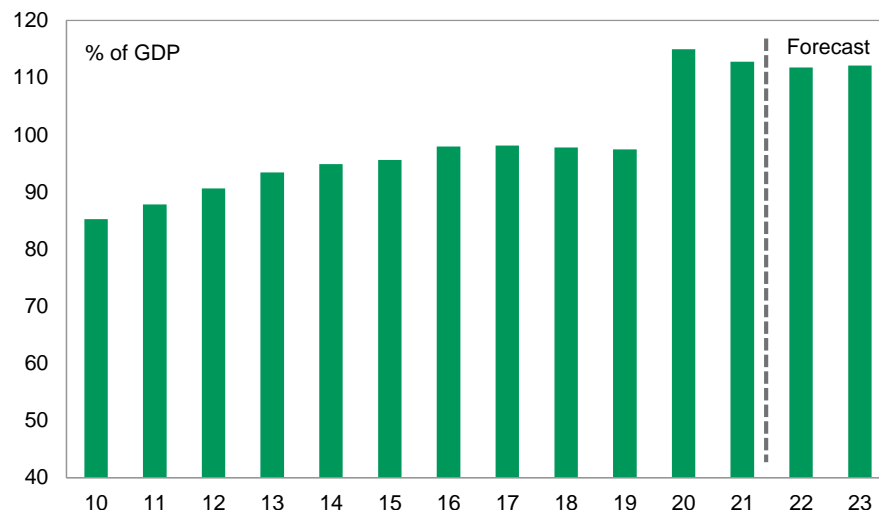


Sources: Minefi, Crédit Agricole S.A. /ECO

In 2021, France's public deficit was a lofty 6.5% of GDP, bloated by the impact of the recovery plan and continued emergency support measures.

The deficit narrowed somewhat in 2022 but is still high at 5.1% of GDP. On the one hand, emergency packages to cope with the pandemic have been pared back considerably and the improvement in GDP has helped to reduce the deficit. Conversely, the structural deficit is impacted by the ramp-up in the France Relance plan, including the start of the 2030 investment plan. Above all, the public accounts reflect the support measures introduced to cushion against inflationary shocks (mainly) as a result of the war in Ukraine, through the energy

Public debt



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

price cap and the cost of living plan (known as the purchasing power package). The total cost of these measures is estimated at €49 billion.

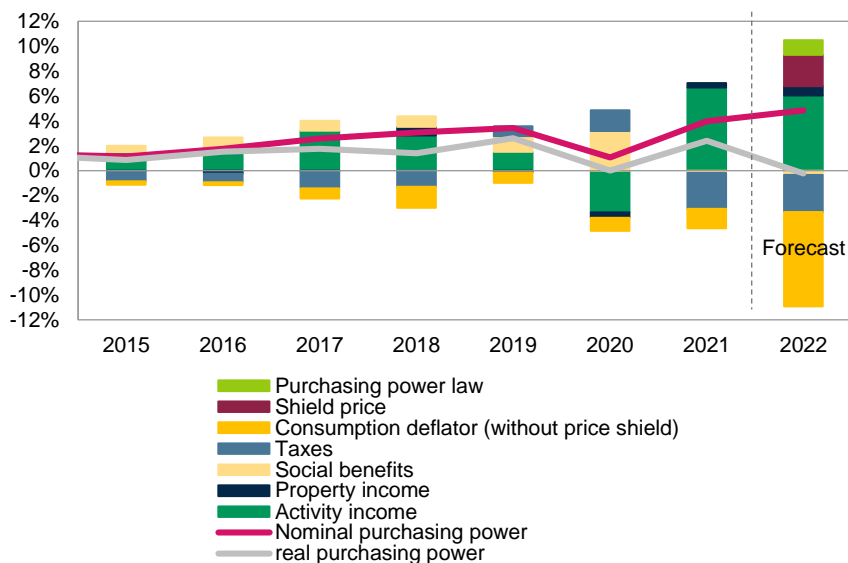
The public deficit ratio is expected to almost stabilise at 5.3% of GDP in 2023 (government projections put the deficit at 5%). But, although the set of emergency measures introduced to cushion the impact of the pandemic are ending, spending to help people cope with inflation will amount to a massive €49.5 billion, mainly due to prolonging existing caps on gas and electricity prices.

In 2022, the debt ratio should decline by 1.3 points of GDP, to 111.8%. In 2023, the public debt ratio looks set to rise again, to 112.1% of GDP.

FOCUS: PUBLIC FINANCES

LIMIT THE EROSION OF PURCHASING POWER

Growth in purchasing power and contributions



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

Although the government announced the end of “whatever it takes”, cost-of-living supports will be generous in 2022 and again in 2023 as the gas and electricity price caps are extended.

Over full-year 2022, the measures in the purchasing power act will prop up household incomes by 1.2%. The uprate in benefits and the upward adjustment in the civil service wage index will push up incomes in the third quarter. Axing the TV licence fee (valued at €3.2 billion) will also ease the cost of living for households in the fourth quarter. From a macroeconomic point of view, **the direct supports by government will help offset the decline in purchasing power by around 3.5 points in 2022** (bring inflation down by 2.2 points and increasing disposable income by 1.2 points) for a cost to the public purse of €49 billion, or 1.9% of GDP.

Support packages to help tackle inflation

(€ bn)	2021	2022	2023
Gas price tariff shield	0.4	8.1	11.1
Gas storage		1.4	-1.3
Electricity price tariff shield		18.7	33.8
Inflation and energy cheques	4.3	1.8	
Discount on fuel		7.6	
Increase in social benefits and pensions		6.7	1.6
Subsidies to energy-intensive sectors		1.5	1.5
Others		2.8	2.8
TOTAL	4.7	48.6	49.5

Sources: Minefi Budget Bill 2023, Crédit Agricole S.A. /ECO

The cost of the energy price cap will be even higher in 2023 than in 2022. The government has budgeted €44.9 billion for the cap on increases in electricity and gas, compared to €34.4 billion in 2022 and including the fuel discount. **But the price cap will not be as effective in containing inflation as the average impact in 2023 is estimated at around 1.5%.** In our view, energy will not be the main driver of price rises going forward. Commodity price increases will gradually hit consumers’ pockets in the form of higher prices for other goods and services – especially food. Rising food prices will be the main factor fuelling inflation.

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