

ECONOMIC ENVIRONMENT

Laurent Berrebi,
Chief Economist

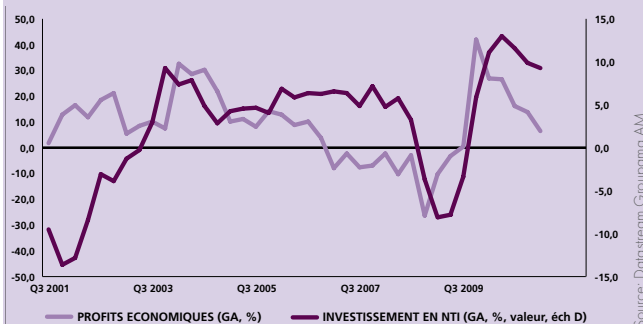


United States

DETERIORATION OF FIRMS' DOMESTIC PROFITABILITY

The ISM manufacturing index lost 7 points to 53.5, posting its biggest monthly drop since the early 1980's. Over the last two months, all leading indicators have sharply reversed course, confirming the sudden deceleration that we've been expecting in growth and which should persist until autumn. The recent deterioration in domestic profitability resulted in a tightening of credit conditions for SMEs, forcing them to significantly slow the pace of investments in new information technology and cut job creation, which fell overall from 180,000 to 80,000 in one month. The continued rise in inflation—to 3.6 % in May—should be accompanied by a decline in purchasing power, depressing consumer spending for several more months. The fresh acceleration in activity that we had been expecting for the summer has been pushed back, but should take place under the combined impact of lower long rates and oil prices. In the coming months, the environment should nevertheless remain highly uncertain for the markets, owing to the fragility of the banking system which continues to suffer from inadequate reserves vis-a-vis outstanding doubtful loans, and which could harden consumer credit terms following the new uptick in unemployment.

United States: The sharp slowdown in profits should lead to the same in capital investment

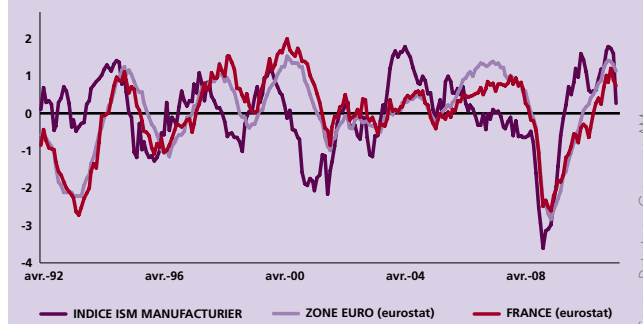


Eurozone

THE REVERSAL OF LEADING INDICATORS JUST BEGUN COULD BE BRUTAL

Growth was buoyant in the first quarter (+0.8 % quarter-on-quarter, after +0.3 %), led by Germany (1.5 %) and France (1 %), but penalised by Italy (+0.1 %) and the peripheral countries. Exports remained an engine of growth, but the strong increase in imports reduced their net contribution to nil. Capital investment rebounded, mainly owing to the normalisation of construction activity in Germany after the harsh weather conditions of late 2010. Consumption benefitted from the final phase of the car scrapping incentive in France and from the sharp rise in contractual salaries in Italy. After this peak in growth, activity is expected to slow sharply, hurt by domestic demand. With the remedial works now complete, construction expenditure should fall. Business investment in new information technology (NIT) will likely be affected by the deterioration in corporate profitability due to lower productivity gains. Consumption is expected to contract under the impact of the continued rise in inflation (expected to peak at 3% in August), the end of the car scrapping incentive in France and the austerity policies and structural reforms in the peripheral countries.

Eurozone: Industrial confidence has begun a sharp reversal (centred, normed, standard deviation)



Japan

GDP EXPECTED TO CONTRACT BY 1.5 % IN 2011

GDP contracted by 0.9 % in the first quarter, following an 0.8 % decline, penalised by consumption, external events and inventories. Despite the current rebound in industry, GDP is expected to further decline by almost 1 % in the second quarter. The industrial rebound will come from exports, which should take off sharply after falling by 9 % in March and 8 % in April due to the disruption of the supply chain following the Fukushima accident. However, consumer spending should continue its downward trend: a direct consequence of the decline in activity, salary purchasing power is deteriorating faster, as calculated by the number of hours worked and average pay. Job cuts are expected to accelerate. Households will also be penalised by the continued rise in inflation due to soaring energy prices, a consequence of the price of oil and the Fukushima accident. Companies seeing their profitability worsen are now cutting back heavily on capital expenditures, as shown by falling domestic orders for capital goods in April. Ultimately, the recovery will not take place before autumn.

Japan: consumer purchasing power is falling again.

