# DIVERSITY FINDS FAVOUR WITH FRENCH CONSUMERS

- *Household consumption continued to see healthy growth in 2005, albeit slightly down on the previous year (2,1% a year, versus 2.3 % in 2004), remaining the foundation for economic growth. Yet, consumption remained distinctly uncorrelated to consumer confidence, which was slipping until November.*
- *The household consumption structure is in the throes of dramatic change. The trends witnessed over the past few years have continued, with households turning away from staple commodities in favour of Information and Communication Technology (ICT), housing (and fittings) and financial services. Meanwhile, they are becoming increasingly price sensitive, taking advantage of low-cost products and services.*

Household consumption is by far the most important component of demand (55 % of GDP by value). The change in the composition of consumption witnessed since the mid-90s continued in 2005, with considerable differences apparent depending on whether consumption is quantified *by volume* (chained prices, base year 2000) or *by value*.

**STRUCTURE OF CONSUMER SPENDING**

| *(By volume, %)* | 1978 | 1985 | 1995 | Q3 2005 |
|---|---|---|---|---|
| Food industry | 21.3 | 21.3 | 20.3 | 16.4 |
| Manufactured goods | 27.6 | 26.6 | 26.2 | 28.2 |
| Energy | 9.5 | 9.1 | 8.4 | 7.3 |
| Housing services | 13.9 | 15.9 | 17.3 | 17.8 |
| Other services | 29.8 | 29.3 | 29.3 | 31.3 |
| *(Value, %)* | **1978** | **1985** | **1995** | **Q3 2005** |
| Food industry | 22.8 | 21.0 | 19.5 | 17.3 |
| Manufactured goods | 31.5 | 28.8 | 27.7 | 25.8 |
| Energy | 8.7 | 10.4 | 7.5 | 8.0 |
| Housing services | 11.4 | 12.6 | 16.8 | 18.8 |
| Other services | 25.9 | 28.0 | 29.6 | 30.9 |

*Source: Insee (without regional adjustment)*

On the one hand, one significant trend (which goes hand in hand with increases in the purchasing power) is the decrease in the relative importance of expenditure on food, which has been intensifying since 1995. Conversely, and in contrast to previous trends, since 1998 households have been devoting an increasing proportion of their spending *by volume* to manufactured goods (the component of consumption which is monitored monthly by the French National Institute for Statistics and Economic Studies, the INSEE), which now account for 28.2% of goods consumed. *By value,* however, this component is declining thanks to significant relative price falls. Lastly, since the second oil crisis, energy consumption has been declining *by volume,* reflecting households' energy-savings. Its share of consumer spending fell to 7.3% *by volume* in 2005, which was insufficient to offset the impact of higher oil and gas prices on *value* data.

On the other hand, there is a structural increase in the percentage of expenditure French consumers are allocating to housing services [1]. This item grew at an average annual rate of 2.5% *by volume* between 1990 and 1997, and has taken off since 1998 (+3% in 2005) following improvements in the quantity and quality of the housing stock, as a result of the sharp dynamism of the building industry, over the last few years. *By value*, the increase in rents is accentuating this trend. Moreover, other services have also grown in importance in households' expenses since 1996.

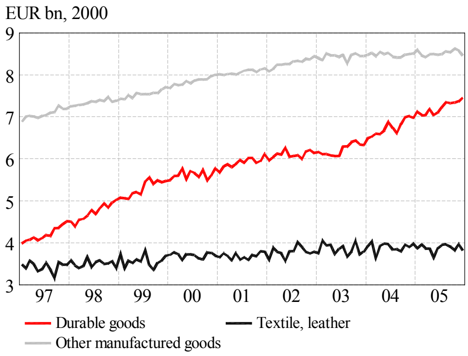
[1] *This is a major item given that it encompasses both rent paid by tenants as well as amounts paid by owner occupiers, valued by national accountants. These rents are not reflected in the monthly index of consumer prices.*

### *Households' infatuation with electronics*

*By volume,* the structure of consumer spending is more and more favouring increasingly sophisticated durable consumer goods.

- Clothing and leather goods (which had been declining in importance) have stabilised since 2001 at 4.5% of consumer spending *by volume.* However, the quest for reasonable prices has increasingly encouraged consumers to postpone their purchases until the sales or other promotions, whilst the growing importance of imports (particularly from China) is slowing price rises. The widening of the foreign deficit in the sector (+4.1 % in 2005) and serial bankruptcies confirm the decline in the competitiveness of the French textile industry.
- According to the French carmakers committee, the CCFA, new car registrations went up by 2.7% in 2005. The proportion of household income spent on the purchase of new vehicles and associated equipments has not changed since 2000 (6% both *by value* and *by volume*), whilst the share spent on car maintenance (included in the services' category 'commerce') is down slightly (1.6%, versus 1.8%).

**CONSOMMER GOODS STILL UNDERPINNING HOUSEHOLD SPENDING**




*Source : Datastream*

Noteworthy changes in the consumption of goods since 1998 have been centred on two types, namely electronics, and to a lesser degree, household appliances. Though their share of the household budget remains small (3.2% *by volume* in the third quarter of 2005), purchases of household equipment have made spectacular strides (up from just 0.8% in 1995) and are still rising. *By volume*, average annual growth has gone from +4.3% in 1991-98, to 15.9% subsequently, spurred by consumer electronics.

**BOOM IN CONSUMER ELECTRONIC**

| *(000 units)* | 2005 | 2005/2004 |
|---|---|---|
| MP3 players | 4,700 | **+ 200 %** |
| PCs | 4,400 | **+ 11 %** |
| Laptops | 2,700 | **+ 40 %** |
| Hard disks | 2,300 | **+ 126 %** |
| Flat screens | 1,400 | **+ 100 %** |
| DVD recorders | 1,200 | **+ 100 %** |
| Portable DVD players | 350 | **+ 250 %** |

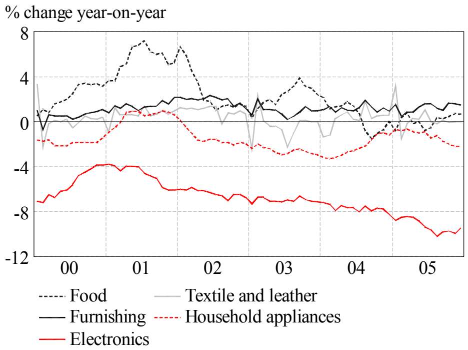
*Source: GfK*

This trend was confirmed over Christmas period. There was a rush on MP3 players, with over one million sold in the month of December.

The equipment rates speak for themselves: in 2005, half of all households owned a computer (39% of which are connected to the Internet, versus 35% in 2004), 41% a digital camera, 22% a mobile phone connected to the Internet, 21% an MP3 player and 30% a games console, percentage reflecting an intergenerational phenomenon.

The success of consumer electronics offsets the decline in traditional products such as argentic cameras, televisions with cathodic ray tube or even video recorders, and is fuelling growth, stimulated by the general decline in prices (the index of consumer electronics and IT equipment prices lost 9.4% and 14.8% respectively in 2005, and 16.9% and 26.7% respectively since 2004). Sales *by volume* of consumer electronics rose significantly faster than sales *by value* in 2005 (+17.5% a year, versus 6.5%).

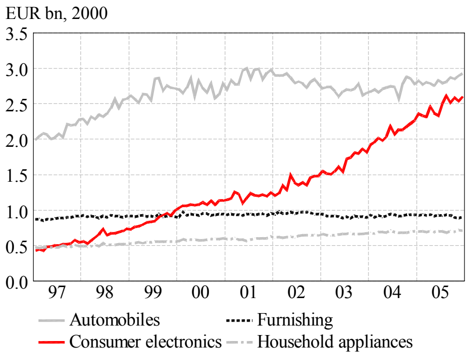
**SHARP CHANGES IN RELATIVE PRICES OF CONSUMER GOODS**




*Source : Insee*

The sharp fall in prices, product improvements, the increase in market players and an expansion in the product offering in the wake of technological breakthroughs favour a rapid replacement of equipment and a trend towards multi-equipment. For example, the growing popularity of WiFi networks is driving the trend to purchase a second home computer.

**CONSUMER GOODS SPENDING UNDERPINNED BY CONSUMER ELECTRONICS SINCE 2002**



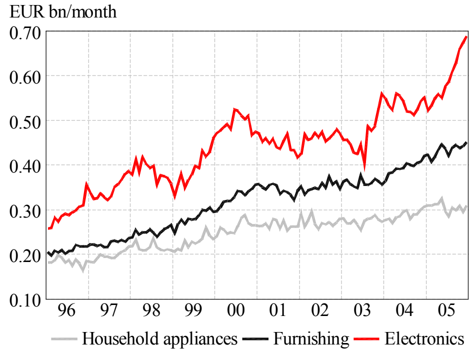

*Source : Datastream*

If major events such as sporting events can stimulate sales, the main factor prompting households to renew electronic equipment such as home cinema is the strong property market and the record level of property transactions underpinned by an exceptionally low interest rate environment. Households' appetite for electronics is benefiting not only specialist retailers but also super/hypermarkets (electronics account for 15% of their non-food sales, and 30% of total sales). Their respective positioning is very different however.

Generalist super-and hypermarkets, serving a large public in medium-sized towns with few specialist retailers, are in sharp contrast with more upmarket specialist stores that are encountering major changes in patterns of consumption (their record sales, for example, fell by 7.8% in 2005 and are down 25% since 2002).

This dynamism has accelerated the widening of the trade deficit, as the consumption of imported consumer electronics has held up well. This is also a reflection of a structural inadequacy (on products using the most advanced technologies that are likely to be manufactured in countries with high labour costs) and of a certain inertia on the part of domestic supply to respond to changes in domestic demand.

**IMPORTS CONTINUE TO RISE, PARTICULARLY ELECTRONICS**




*Source : MINEFI*

### *Buoyant demand for services*

The growth in services excluding housing has been around the 3% mark *by volume* since 1995 and accelerating since 2003, despite low consumer confidence and the as yet limited impact of the consumer services strand of the Social Cohesion Plan (the CESU, a simplified payment voucher which has just been implemented, while leading French companies are gradually structuring their offerings). INSEE's consumer services turnover index trend fell in 2005.

**BREAKDOWN OF SERVICES EXCLUDING HOUSING**

| *(By volume, % of total)* | 1978 | 1985 | 1995 | Q3 2005 |
|---|---|---|---|---|
| Commerce | 3.9 | 3.2 | 2.5 | 1.7 |
| Transports | 2.5 | 2.5 | 2.5 | 2.7 |
| Financial brokerage | 1.9 | 2.1 | 2.2 | 2.6 |
| Insurance and other financial services | 3.2 | 3.2 | 3.3 | 3.6 |
| Post and telecommunications | 0.6 | 1.0 | 1.2 | 3.0 |
| Other business services | 1.5 | 1.7 | 2.2 | 2.4 |
| Consumer services | 12.9 | 11.5 | 11.0 | 11.0 |
| *(Valeur en % du total)* | **1978** | **1985** | **1995** | **Q3 2005** |
| Commerce | 2.1 | 1.9 | 2.3 | 2.0 |
| Transports | 2.1 | 2.3 | 2.4 | 2.8 |
| Financial brokerage | 2.8 | 4.4 | 2.9 | 1.2 |
| Insurance and other financial services | 2.8 | 2.8 | 3.3 | 3.8 |
| Post and telecommunications | 1.3 | 1.7 | 1.7 | 2.7 |
| Other business services | 1.5 | 1.6 | 2.2 | 2.4 |
| Consumer services | 9.9 | 9.4 | 10.4 | 11.6 |

*Source: Insee (without regional correction)*

Services are being stimulated, above all, by the acceleration in telecoms spending (+11.6% a year *by volume* since 1995, although the growth rate has slightly slowed down over the last two years).

At the same time, changes in operators' strategic models and the multiplication of players have triggered a reversal of the trend towards higher prices for consumer telecoms services, which dropped by 5.9% between March and December, dragging down the increase *by value* since 1995 to +7.3% a year.

Another buoyant spending category is financial services, which have risen substantially, up 7% in 2005 and 45.5% over the last 10 years, *by volume*, on the back of brokerage services (+4.3% a year *by volume* since 2002 thanks to the rapid growth in lending and deposits as well as the expansion in the number of services offered to customers) and, above all, insurance (life and welfare), which gained 6.3% a year over the same period. The French save a considerable amount to protect themselves against future risks such as retirement. According to the French Insurance Federation, the *FFSA*, life and capitalisation insurance premiums rose by 14% in 2005 (to a total of EUR 120.2bn), increasing outstanding debt by 11% (EUR 951bn).

Spending on leisure and culture continues the increase seen over the past 40 years (over 5% in 2005 and 2004 *by volume*, compared to +4.4 % on average since 1990), despite growing competition from ICT products. There has been a slight dip (-1.1%) in the prices index for this category since June 2002. In contrast, household spending on hotels and catering has been slowing down since 2001; and declining since 2003.
Finally, healthcare expenditure continues to rise at an average annual growth rate of 2.3% since the mid-90s.

### More intelligent consumers?

In addition to these changes in the relative importance of different categories of spending, the other major change is an increase in consumer price sensitivity for two main reasons. Firstly, French consumers of all socio-professional groups are adopting new patterns of consumption due to the lack of any real improvement in their purchasing power. They are becoming experts in the art of "spending less" by reducing their consumption of branded goods in favour of own brands or bottom-of-the-range goods, increasing their shopping at hard discounters, and spending time more searching for the best value for money. And, as already mentioned, their priorities have changed, with a gradual shift away from staple goods (food and beauty/hygiene) towards an increasingly wide range of more durable goods.

Hard discount stores accounted for 12.7% of consumer goods sales *by value* in 2005, and, despite the more limited ranges they offer, they are frequented for their low prices and proximity. However, the scenario seen in Germany (where hard discounters account for almost 40% of total distribution) seems unlikely to happen in France. The sector is still growing through geographical expansion (over half of all supermarkets opened in 2005 are hard discounters; on a same-store basis, hard discount food sales dropped by 1% *by value* in 2005). This global phenomenon is triggering a race for size and increasing concentration within the sector.
The shift towards low-cost goods and services has spread to air travel, sparking an explosion in week-end air traffic within Europe, and in package holidays.

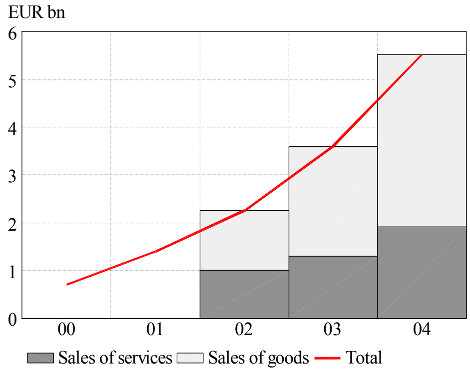
The quest for rock bottom prices has reached its paroxysm with the boom in free goods such as press and music (on-line music downloading is said to have doubled in France in 2005). Fixed telephony is another example. Following the opening of the market and the arrival of digital telephony, consumption patterns have shifted towards an unlimited or even free offering via the Internet, accelerating the setback of the fixed telephony which was already cannibalized by mobile phones.
*France Télécom* estimates that 15% of total consumer voice traffic in 2005 passed through the internet.

These new patterns of consumption are impacting the economy as a whole. Consumers are increasingly postponing their purchases until the sales or other promotions. Reduced visits to major retailers have led to a decline in their food sales as well as impacted textile sales.

### Changes in distribution channels

E-commerce continued its upward trajectory in 2005, as did the number of internet users: almost a quarter of households uses the internet for purchases estimated at EUR 5.5bn in 2004, up 53% a year (*FEVAD*). This market is still limited: there are few major players (5% of players account for 90% of sales) in key markets (in 2004, 25% of total sales were for travel, 19.1% IT equipment and 12.1% hotels and catering). In 2005, on-line sales of holidays outstripped travel agency sales for the first time.

**EXPLOSION IN ON-LINE SALES**




*Source : FEVAD*

The French research and study centre for the monitoring of living conditions, *CRÉDOC*, stresses that the Internet is revolutionising *information* rather than actual *purchasing*, offering new services such as price comparisons, last minute holidays or even a direct link with a wholesaler. Rather than replacing traditional distribution channels, the Internet is helping consumers to increase their knowledge and creating new markets (second-hand, foreign or rare products) thanks to new distribution channels (peer-to-peer, particularly via auctions). This market is not small. The addition of peer-to-peer sales is estimated to double total Internet sales (up to almost EUR 10bn in 2004).

In contrast, a return to small neighbourhood stores for certain categories, notably food, is evident in major cities. These stores offer an alternative to monotonous hard discounters and target a wealthier customer base than in the suburbs.

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