

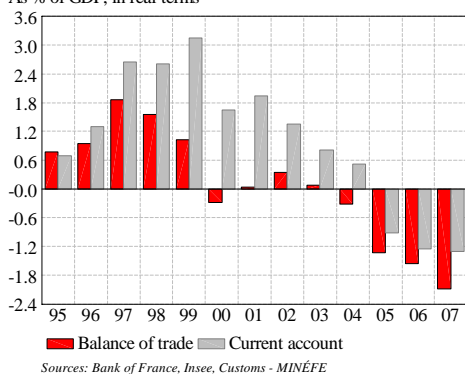
## BALANCE OF TRADE: IS THE WORST STILL TO COME?

⚡ After two years of strong growth, France's foreign trade activity ran out of steam in 2007. The trade deficit – which appeared for the first time in 2004 – reached a record level. The current account deficit widened to a lesser extent thanks to surpluses generated on foreign direct investment. As France is a euro-zone Member State, these developments heighten the necessity of adopting a supply-based approach.

⚡ The balance of trade widened in all industrial sectors. Conversely, in 2007, commodity price levels were propitious for the energy and food product sectors.

### Foreign deficits widen relentlessly

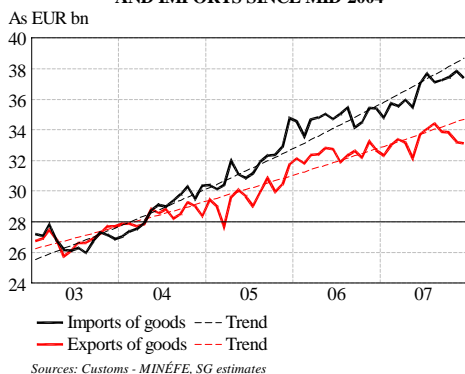
**EXTERNAL DEFICITS DETERIORATE FURTHER**  
As % of GDP, in real terms



The FOB/FOB trade deficit attained unscaled heights in 2007: EUR 39.2bn (i.e. 2.1% of GDP), which represents a 38.7% increase on 2006 (EUR 28.2bn).

The deterioration in the current account deficit was considerably less severe: EUR 24.4bn (1.3% of GDP) which represents an increase of EUR 1.9bn. Growth in the revenue surplus (EUR 7.5bn to EUR 28.5bn), largely due to net revenues related to foreign direct investment<sup>(1)</sup>, made a positive contribution. However, net exports of services suffered a minor setback: EUR 7.3bn vs. EUR 8.3bn in 2006. The current transfer deficit held virtually stable, at EUR 22bn in 2007.

**GROWING DIVERGENCE BETWEEN EXPORTS AND IMPORTS SINCE MID-2004**  
As EUR bn



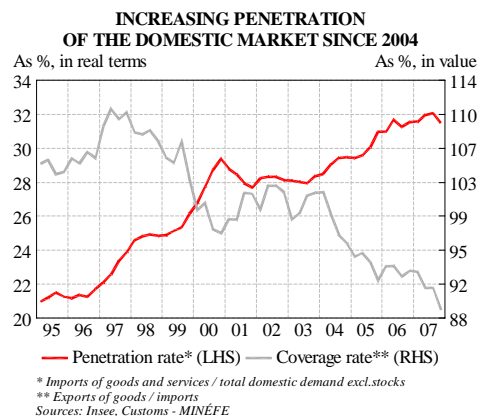
Given that the international business climate was favourable until last summer, export figures were disappointing once more, and France lost further market share.

The divergence between the trend in exports and the trend in imports underway since the middle of 2004 has widened. Growth in

<sup>(1)</sup> Outward FDI also increased sharply in 2007 (EUR160bn vs. EUR 91.7bn in 2006) and remained well in excess of net inward FDI attributable to non-residents in France. These attained record levels: EUR 107.9bn vs. EUR 64.6bn in 2006.

Although FDI inflows are substantial, they do not attest to the attractiveness of France. The increase witnessed last year was principally due to loan transactions and transfers of funds to French-based subsidiaries. The percentage of FDI dedicated to the extension or creation of production capacity are on a downward trend, averaging no more than 10% of the total since 2003. Furthermore, according to AFII (the French Agency for International Investment), FDI created (or preserved) fewer jobs in 2007 than it did in 2006 (down 13%).

exports (3% in value terms, vs. 9% in 2006) slowed more significantly than growth in imports (5.4%, vs. 9.9%). In value terms, the percentage of imports covered by exports consequently declined further more: 91.1% vs. 93.2% in 2006 (and even 89.5% in Q4 2007). As was only to be expected, the penetration rate of foreign goods rose in 2007, ending the year at 32% of domestic demand (in real terms).



### All industrial sectors went through a hard time in 2007

1- Problems plaguing the automobile sector proved persistent in 2007: exports were almost static in value terms (0.2%) following two years of decline (-2% in 2005 and 2006), whereas growth in imports was explosive (11%). The trade surplus was virtually wiped out – which makes this sector the worst performer in terms of net balance.

With the exception of Italy, sales to France's main trading partners (Spain, Germany, the United Kingdom and Belgium) continued falling, despite the range renewals that occurred during the course of the year. The European market share of French car manufacturers contracted further: 21.5% vs. 22.1% in 2006. At the same time, imports were underpinned by favourable range effects and by the introduction of the eco-label at the beginning of 2008 which artificially inflated demand for up-market foreign vehicles. Foreign car manufacturers consequently continued to make gains in market share: 48.2% vs. 45.7% in 2006 and 40.9% in 2000. The fact that national car manufacturers have outsourced part of their production to new EU Member States also contributes to boost imports.

**BALANDE OF TRADE BY SECTORS**

(Gross data, as EUR bn)	2002	2003	2004	2005	2006	2007	07/06
Fewer sectors boosting growth...							
Agribusiness	8.3	8.4	7.9	7.6	8.7	9.0	0.3
Energy	-21.4	-22.8	-28.6	-38.3	-46.5	-45.2	1.3
Sub-total CIF-FOB 1	-13.1	-14.4	-20.7	-30.6	-37.8	-36.2	1.6
... and balances are deteriorating for structural and cyclical reasons							
Capital goods	7.6	5.9	2.9	2.0	5.6	3.3	-2.3
Automobile	10.9	11.7	12.3	8.8	5.6	0.7	-4.9
Consumer goods	-6.3	-6.8	-7.8	-8.5	-8.4	-10.0	-1.6
Intermediate goods	-2.1	-3.0	-5.6	-7.8	-7.6	-12.4	-4.8
Sub-total CIF-FOB 2	10.0	7.8	1.8	-5.5	-4.8	-18.5	-13.7
<b>Balance of trade FOB-FOB</b>	<b>5.2</b>	<b>1.1</b>	<b>-4.8</b>	<b>-22.9</b>	<b>-28.2</b>	<b>-39.2</b>	<b>-10.9</b>
<b>As % of GDP</b>	<b>0.3%</b>	<b>0.1%</b>	<b>-0.3%</b>	<b>-1.3%</b>	<b>-1.6%</b>	<b>-2.1%</b>	<b>-</b>

Sources: Customs - MINÉFE, Insee, SG estimates

2- The **intermediate goods** sector staged a dynamic performance both in terms of exports (5.1%, notably sales of metals to Germany) and, to an even greater extent, of imports (8.6%, boosted by purchase of metals from Germany and by imports of chemical products and minerals, the prices of which escalated). Hence, the sector's deficit widened in 2007.

3- After a good year in 2006, the trade surplus of the **capital goods** sector was eroded by the scissors effect. On the one hand, exports stagnated (0.1%) as robust growth in sales of mechanical equipment (7.2%) and a respectable performance from the transport industry (1.9%) were offset by a severe setback in sales of electronic equipment (-10.3%) due to the backlash of the VAT carousel fraud in 2006<sup>(2)</sup>. On the other hand, imports grew (2.7%) owing to the mechanical equipment (12%) and transport equipment (8.5%) sectors. The globalisation of production processes is contributing to the resilience of imports and exports alike, notably at the European level.

As regards the "transport" segment (1/3 of capital goods), two contrasted trends have emerged: *i)* upward in the case of sales of trains (20% metros for China and Caracas, trams for Tunis) and boats (5.3%); and *ii)* downward in the case of satellites and aircraft (277 Airbus planes were exported for a amount of EUR 14.5bn, vs. 256 for EUR 15.2bn in 2006, due to the range effect – very few large planes were sold – and to the impact of currency fluctuations on the average price of small planes).

4- The structural downtrend in the balance of the **consumer goods** sector was palpable again in 2007, following a pause in 2006. Sales rose by 3% underpinned by exports of perfumes and cosmetics (7.5%), textiles and leather goods (6%) – notably to Italy and Spain – and pharmaceutical products (to Belgium and Germany). In the meantime, exports of household durables decreased by 3.4%. Growth in imports of consumer products (5.1%) – mainly from Germany and China – exceeded growth in exports. Household durables fully explain the increase in the consumer products deficit. This is indicative both of the vigour of household consumption – which is strongly focused on consumer electronics – and the fact that France's product offering is poorly adapted to demand. In 2007, household consumption of electronic goods surged by 29.1% in real terms, after another strong increase in 2006 (25.4%).

### **Overall, the escalation in raw material prices had a positive impact on the balance of trade**

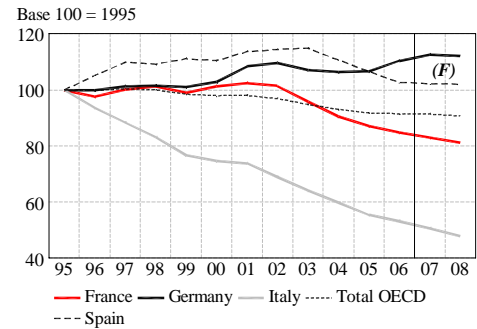
1- **Oil.** Although it remained at high levels, the energy bill decreased slightly last year thanks to the softer trend in oil prices in the first half (down 3.2% half-on-half). However, the price of the barrel of Brent has increased further since the mid-2007: 30.1% between June 2007 and January 2008.

2- **Agricultural commodities.** As France has been a net exporter of food products since 1984, it has fully taken advantage of the escalation in agricultural commodity prices last year. In value terms, sales of food products rose by 7.6%, driven by cereals, alcoholic drinks and dairy products. Imports (dairy products and cereals in particular) also increased sharply (8.6%). As a result, the surplus inched ahead, up by EUR 0.3bn.

<sup>(2)</sup> The professional telephone equipment sector was rocked by a large-scale European VAT fraud in the first half of 2006 (it is estimated that between 1.2% and 1.3% of French exports and imports were affected). The fraud resulted in the booking of exceptionally high virtual flows of goods transiting through France from the United Kingdom and Finland to Spain, Poland, the Czech Republic and Portugal. The impact on the balance of trade was virtually zero. Imports of electrical and electronic equipment also fell sharply in 2007 (7%).

## **A consequence of a combination of weaknesses**

### **WEAKER EXPORT PERFORMANCE**



Ratio in real terms of exports to "goods and services export markets" i.e. the weighted average volume of imports per market based on foreign trade figures of 2000, incl. intra-regional trade  
Sources: OECD 2007, SG estimates

France has been losing market share since 1998. In value terms, French exports accounted for only 4% of global exports in 2007 (vs. 5.7% in 1998), to be compared with Germany's 9.2%. Although the deterioration in France's external position is partly due to the rapid catching-up of emerging countries, it also reflects intrinsic weaknesses. For instance, France, unlike Germany, has been unable to meet foreign demand addressed to it. To give another example, the percentage of euro-zone exports accounted for by France has declined: 13.6% in Q3 2007 vs. 16.6% in 2000. Furthermore, French terms of trade have been deteriorating since 2003 due to higher oil and industrial commodity prices.

### **BALANCE OF TRADE BY EXPORT MARKET**

(Gross data, as EUR bn)	2002	2003	2004	2005	2006	2007	07/06
Asia	-15.3	-17.1	-19.6	-21.5	-23.6	-25.9	-2.3
European Union	7.9	7.0	3.0	-9.1	-9.0	-16.0	-7.0
Rest of Europe	-3.8	-3.8	-6.4	-7.9	-9.7	-11.6	-1.8
Others	-2.4	-3.0	-3.6	-3.2	-3.1	-3.8	-0.7
America	2.9	2.4	0.8	2.3	0.9	-0.5	-1.4
Africa	3.9	2.7	3.2	2.2	0.7	1.3	0.6
Near and Middle East	3.5	4.9	3.4	0.9	1.3	1.7	0.3

Source: Customs - MINEFE

France's deficit with the European Union widened more sharply than its deficits with other regions in 2007, which suggests that the impact of the appreciation of the euro should not be over-estimated. The French offering would appear ill adapted both to European (exports to the EU slowed from 8.5% in 2006 to 2.6% in 2007) and domestic demand (the deceleration in imports from the EU eased back from 8.2% to 5.2%).

In addition, France's industrial exports are disadvantaged by their high level of specialisation (in particular the aeronautical, automobile and food industries). France is heavily exposed to big cyclical contracts, notably in the transport sector. More than 2/3 of high technology exports are related to the aeronautical industry. By and large, the offering of high technology products – which have strong market power – leaves much to be desired.

Finally, export capacity is limited by the structure of French industry. Firstly, the number of exporting companies has been declining since 2002 (-0.6% to 98,329 in 2007 vs. 107,885 in 2002), in stark contrast to the strong increase in company creations (12.2% in 2007). Secondly, French companies lack critical mass: nearly 72% of exporting companies are very small businesses which generate only 18% of sales volume. Subsidiaries of major groups are in a position of strength: although 91% of exporting SMEs are independent, they account for only 72% of foreign sales.

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