

WHICH SECTORS ARE DRIVING FRENCH GROWTH?

⚡ The French economy has grown modestly over the past five years. Services and the building and public works sector have been the driving forces, constantly increasing their share in production, added value and employment, while industry and agriculture contributions have dwindled.

⚡ While the service sector is set to remain the chief sustained source of growth and job creation, the same is not true of the building and public works sector since increasing indicators back up a housing market soft landing.

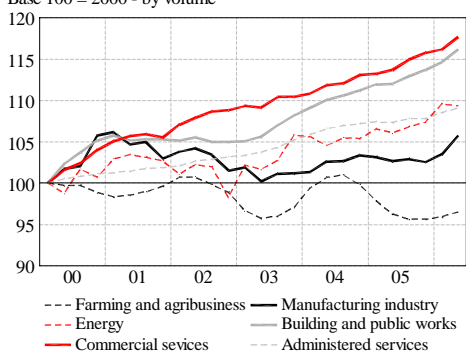
⚡ In terms of manufacturing, the car industry is lagging behind at the end of period. Conversely, all capital goods sector components have a clear road ahead.

Services and the public works sector have driven production

Goods and services output has been growing at a moderate rate since 2000 (2% per annum in volume terms on average) and rose by a mere 1.1% in 2005, versus 2.1% in 2004. However, the trend has been improving since the first half of 2006, reflecting robust consumer demand and an upturn both in exports and business investment (in the second quarter). By the way, the business outlooks for the various industries are stabilising at high levels.

SERVICES AND CONSTRUCTION DRIVE PRODUCTION

Base 100 = 2000 - by volume



Sources: Insee quarterly accounts, SG calculations

That said, sectoral discrepancies persist and are even strengthening. Services and construction have driven the economy growth since 2000, with commercial-sector services output rising by an average of 3.1% per annum, and the public works sector one by a yearly 3.2%.

Diverse factors explain these trends: *i)* a structural "tertiarisation" of the production system characteristic of developed countries; *ii)* the dynamism of consumer spending and productive investment in telecommunications in terms of mobile telephony, ADSL products and the widespread use of IP technologies which are translated into consumption of IT services and of associated telecommunications (software, household consumption and intermediate consumption by businesses and government departments); *iii)* in 2005, the privatisation of the directory services market sparked a consultancy revival (advertising and market research); *iv)* the long housing-investment cycle, thanks to historically favourable financing conditions, attractive buy-to-let tax incentives and favourable demographic effects, marked by the increase in single-person households, is underpinning both the public works sector and property services; *v)* the electoral cycle and the launch of major building projects also stimulated the public works sector.

Production is increasingly focused on high added value (AV) services: in 2005, financial and property services stood for 13.1% of production and 18.1% of AV (versus 12.7% and 17.1%

respectively in 1995) while business services accounted for 15.1% of production and 16.5% of AV (versus 12.5% and 14% in 1995). Administered services production is growing steadily but slightly less rapidly than the total production, as is energy production. Farming output has picked up slightly since late 2005, although the overall trend has been downwards since 2000, because domestic production is facing increasing competition from other countries.

Deviations within the industrial sector

FRENCH GROWTH BY INDUSTRY

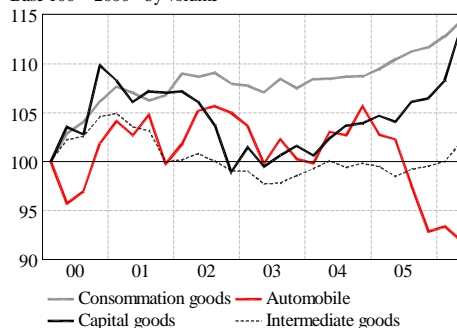
(As % of total - EUR bn 2000)	PRODUCTION			ADDED VALUE		
	1995	2000	2005	1995	2000	2005
Farming	3.2	2.9	2.5	2.9	2.8	2.5
Industry	30.5	31.4	29.7	17.0	17.7	17.9
O/w: Agribusiness	5.0	4.3	4.0	2.4	2.1	2.0
Consumer goods	4.6	4.4	4.4	2.9	2.8	2.9
Automobile	2.4	3.3	3.1	0.8	1.2	1.1
Capital goods	4.8	6.1	5.8	3.0	3.5	3.5
Intermediate goods	9.8	9.7	8.8	5.8	6.2	6.0
Energy	3.9	3.6	3.6	2.0	2.0	2.3
Building and construction works	6.8	6.0	6.2	6.3	5.2	5.0
Commercial-sector services	43.9	45.6	47.6	50.4	53.6	54.2
O/w: Trade	9.7	9.5	9.8	10.4	10.5	10.3
Transport	4.2	4.5	4.6	3.7	4.7	4.1
Financial and property services	12.7	12.5	13.1	17.1	17.4	18.1
Business services	12.5	14.1	15.1	14.0	15.7	16.5
Personal services	4.8	4.9	5.1	5.2	5.3	5.3
Administered services	15.8	14.0	14.0	23.6	21.3	20.4

Source: Insee annual accounts

Sector discrepancies are apparent within manufacturing, while aggregate production growth falls significantly behind services and construction, averaging 1.4% per annum since 2000 and only 0.3% in 2005. Nevertheless, production has rallied since early 2006, rising 3% yoy in the second quarter.⁽¹⁾

THE AUTOMOBILE SECTOR GOES AGAINST THE MANUFACTURING INDUSTRY TREND

Base 100 = 2000 - by volume



Sources: Insee quarterly accounts, SG calculations

⁽¹⁾ July 1.5% drop in the manufacturing production index poses no threat to the modest recovery observed since late 2005, as the tendency surveys continue to indicate. In fact, the index is volatile and rebounded sharply in May, opening the way to a likely downward correction. Moreover, the heat wave may also have had a negative impact along with the uncertainties linked to summer seasonal adjustments.

Despite strong global recovery, manufactured goods exports scarcely benefited from the increase in foreign demand before the 1st semestre 2006, while imports surged ahead thanks to consumers' fondness for imported goods (particularly mass-market electronics).

Sector divergences are also emerging.

Production is gathering pace in some industrial sectors...

Having previously hovered around its 2000 level, capital goods production (aerospace and machine-tools) has been accelerating since 2005, particularly since mid-2005 (+3.4% then 9.3% in the 1st and 2nd quarters YoY). Production is being simultaneously spurred on by strong exports (including record Airbus deliveries to emerging countries) thanks to a global recovery and by a rebound in productive investment in France. However, this rise in production is having little knock-on effect on added value due to the large presence of imported intermediate goods (the same goes for consumer goods).

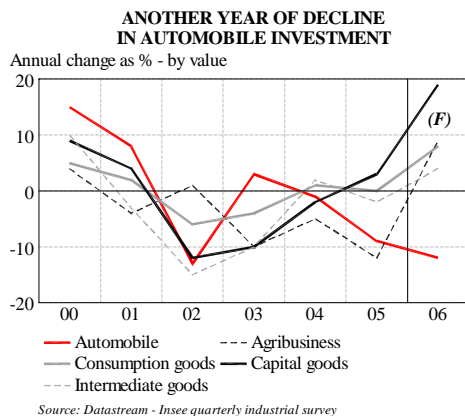
Consumer goods production is being boosted by purchases of pharmaceutical goods (and the development of generic drugs), perfumes/cosmetics and luxury textiles, both in France and abroad. At the same time, a growing share of household budgets is being devoted to audio/televisual goods and household appliances, which are heavily imported in the absence of a significant French alternative offering.

Finally, the production of intermediate goods, such as chemicals and metallurgy, has picked up since mid-2005, despite being hit by rising commodity prices (particularly energy).

... while the automobile industry lags behind

The decline in car production since late 2004 has been spectacular (-3.9% YoY in 2005) and explains the virtual stagnation of manufacturing output in 2005. Various factors come into play: a slack national market, the loss of market share in Europe by French carmakers and the relocation of some production into Eastern Europe. Thus, after 11 consecutive years of growth, car exports dipped by 1.3% in 2005, while imports rose, resulting into a sharp drop in the automotive trade surplus. This trend keeps ongoing in 2006. Furthermore, the soaring cost of intermediate goods (metals and oil derivatives) weakens carmakers' as well as car parts manufacturers' margins.

A rebound in productive investment to come



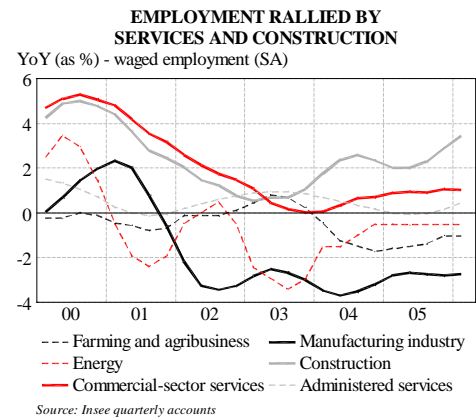
Manufacturing investment has fallen in value terms over the last four years, reflecting a slow growth in both production and AV. Projections for 2006 are more encouraging in line with a brighter overall business outlook: the July Insee quarterly survey forecasted a 4% rise in investments by value.

Investment trends reflect the same industry dynamics as production trends. First, investment is rebounding substantially within capital goods and, to a lesser extent, consumer goods (in particularly pharmaceuticals). The trend within intermediate goods remains subdued.

Conversely, the auto industry is following its own downward course: in 2006, the value of investments on French soil is expected to fall for a 3rd year on.

Finally, a study by the French Industry Studies and Statistics Service (SESSI) [MINEFI 2006] showed that the most *innovative* industrial sectors are R&D (business services) followed by pharmaceuticals, electrical and electronic components and the automotive industry.

Sector trends are shaping the employment recovery



Labour intensive and sustained by solid activity, construction and services are the two sectors that have sustained waged employment over the past five years. Judging by the latest surveys and declining business projections, job creation is likely to slightly slow down in the construction sector in 2007, but should continue to grow at a relatively steady rate in the tertiary sector. Job losses in the industrial sector, reflecting considerable productivity gains and a late production recovery, should ease off somewhat in the future. Finally, public-sector employment has rallied since late 2005 thanks to the impact of the Social Cohesion Plan and to job creations in the non-commercial non-subsidised sector (health, social work, etc).

WAGED EMPLOYMENT BY SECTOR

(As % of total)	1995	2000	2005
Farming	1.7	1.7	1.6
Industry	18.5	16.7	14.8
O/w: Agribusiness	2.3	2.2	2.2
Consumer goods	3.4	2.8	2.2
Automobile	1.1	1.0	1.0
Capital goods	3.8	3.5	3.1
Intermediate goods	6.8	6.2	5.4
Energy	1.1	0.9	0.9
Building and public works	6.1	5.6	6.0
Commercial-sector services	42.1	45.1	47.1
O/w: Trade	12.6	12.7	13.4
Transport	4.4	4.5	4.6
Financial and property activities	4.6	4.2	4.2
Business services	13.6	16.1	16.6
Personal services	7.0	7.6	8.3
Administered services	31.6	30.8	30.5

Source: Insee annual accounts

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