

THE RESIDENTIAL PROPERTY MARKET CYCLE HAS ALREADY PEAKED

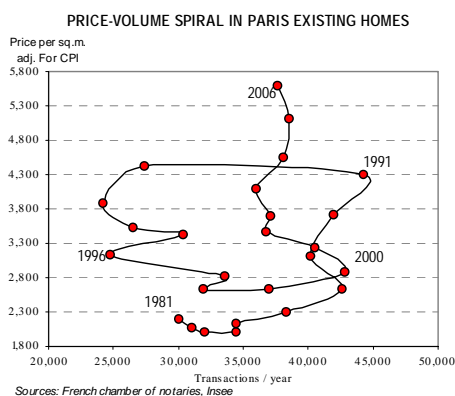
At a time when the risk to the business climate is distinctly on the downside (property market crisis in the United States, slowdown in European growth, rising risk premiums, explosive increase in commodity prices – notably in the energy and agricultural sectors, etc.), the question is whether France is on course for a severe downturn in residential investment or merely a continuation of the soft lending already underway?

Despite the fact that its weight in the GDP remains relatively low compared with private sector consumption (5% and 56% of real GDP respectively), residential investment has significantly contributed to the economic growth since 2004 (from 0.2 pp to 0.3pp of GDP per annum) and has helped to boost other sectors of demand, such as property services and housing equipment.

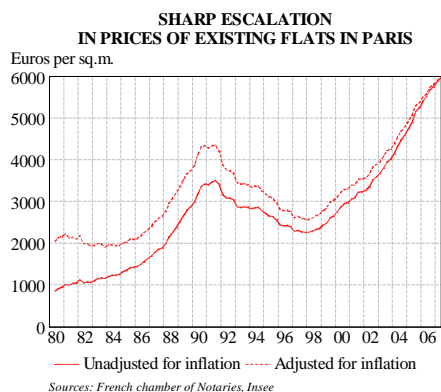
Given recent data, an American-style scenario would appear improbable, especially as tax exonerations will give demand a shot in the arm. That said, after two years of strong growth (+6.2% in 2005 and +4.5% in 2006, in volume terms), household residential investment is set to slow down sharply: +1% in 2007, followed by a virtually static showing in 2008.

A – Long-term factors underpinning demand

Over the last few years, property has been the preferred investment of French households thanks to a number of factors that have fuelled price appreciation in this sector.



Prices of both existing and new homes have increased substantially since 1998. Adjusted for inflation, euro-denominated prices of existing homes in Paris – the sole market for which long-term statistics are available – are standing well in excess of the previous high points reached in 1990/91.



In contrast to the localized property market bubble of the late 1980s (Ile-de-France and Côte d'Azur regions), price increases have affected France as a whole, despite major discrepancies from one region to another. Moreover, the table below underlines that price increases of existing homes have outpaced those of new homes. This phenomenon has created anomalies in some segments of the market: prices of existing homes are higher than prices of new homes. The existing home market is consequently particularly vulnerable.

SUBSTANTIAL APPRECIATION OF HOME PRICES IN FRANCE

	Price (per sq.m.)	2004	2005	2006	2007	07 / 98
New flats in France (SESP)	3,314	8.6%	11.3%	7.8%	6.6% (Q2)	70.2%
Existing homes in France (FNAIM)	-	15.4%	10.4%	7.1%	4.7% (Q3)	132.6%
Existing homes in France (Insee)	-	15.2%	15.3%	12.1%	6.8% (Q2)	138.8%
Existing flats in Paris (Notaires)	5,970	13.6%	14.3%	11.4%	8.3% (Q2)	158.3%

Sources: FNAIM, French chamber of notaries, SESP, Insee

1- Demographic factors

The profile of French households is evolving: the increase in the divorce rate and the ageing of the population, combined with the fact that an increased number of senior citizens continue to live at home, are fuelling the demand for housing, the size of which is declining. Furthermore, due to the ageing of the population and the decrease in the replacement rate of retired persons, households tend to consider property as a safe long-term investment.

HOME OWNERSHIP RISES IN FRANCE

In 2005, 56.7% of French households owned their main residence, compared with 55.7% in 2000 and 52.1% in 1984. The home ownership rate in France is nonetheless still below that of most OECD countries:

Spain (2005)	86.3%
Japan	71.9%
Italy (2001)	71.4%
United Kingdom (2006)	70.1%
United States of America (2005)	69.0%
France (2005)	56.7%
Germany (2002)	42.2%

National statistics

Over the last few decades, the percentage of debt-free households that own their main residence has increased: 36.8% of total households in 2005, versus 32.4% in 1995 and 28.1% in 1984. Conversely, the number of indebted home owners has held virtually stable over the last ten years and decreasing down to 20% of total households.

Between 1984 and 2005, the annual average growth rate in the number of main residences (84% of existing homes in 2005) emerged at 1.2% (the pace picked up slightly to 1.4% in 2004/2005). Secondary residences account for almost 10% of homes while vacant housing fell from 7.6% in 1984 down to 6.1% in 2005.

2- Growth in prices and short-sightedness of households

Home prices in Paris have been escalating steadily since 1998. The same trend is affecting the rest of France which did not go through the period of price decreases sparked by the bursting of the late-1980s property bubble. Price increases have only fed through to rents to a limited basis. The long-term nature of this trend, together with a short-sightedness of French households, has fuelled a widespread belief that prices will keep on increasing. Hence, property is considered as the best long-term investment and price escalation has become a self-fulfilling prophecy.

3- Lending conditions are still attractive

THE DURATION OF LOANS IS INCREASING

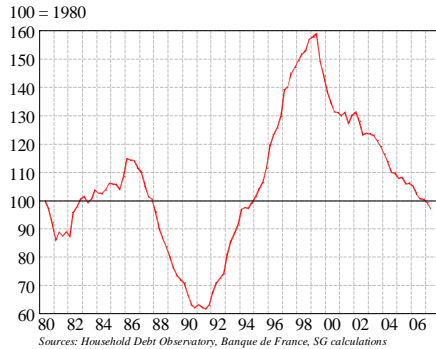
	2003 Q3	2004 Q3	2005 Q3	2006 Q3	2007 Q3
Average duration of loans (year)	14.8	15.5	16.5	17.8	18.7
Average interest rate (banking sector)	4.05%	3.92%	3.40%	3.84%	4.40%

Source: French residential property market financing observatory

Private sector lending rates fell until 2005, but subsequently surged by 115 bp due to ECB monetary policy tightening. Lending rates hit a low point of 3.36% on average (excluding insurance and deposits), but increased ever since up to 4.40% in Q3 2007 and to 4.55% last October. In 2005, 45% of home loans were on a rate of less than 3.50%, compared with 2.7% in the third quarter of 2007.

In addition, the duration of mortgages has increased significantly since the early 1990s: 18.7 years in Q3 2007, versus 13.8 years in 2001. Last September, 64.4% of home loans were granted for a period of more than 20 years, compared with 16.4% at the beginning of 2001. Moreover, the personal capital contribution has decreased. This higher flexibility reflects the fact that home buyers are younger than before and that life expectancy is increasing. In 2001, 20.9% of the under 35s and 0.9% of the over 65s had home loans of a duration of more than 20 years. In 2007, the respective percentages were 73.8% and 6.3%.

HOUSEHOLD SOLVENCY INDICATOR
PARIS EXISTING HOMES



Despite this easier access to lending, which is responsible for the increase in household mortgage indebtedness (in excess of 50% of GDI in Q2 2007, versus 32% in 2000), the explosive increase in prices has resulted in a relentless decline in household's solvency¹ since 1999. That said, solvency rates are still sustainable.

4- Tax incentives to encourage investment

SALES OF NEW DWELLINGS BY PROPERTY REALTORS

(000)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Home Ownership	36.9	37.0	37.5	38.7	48.5	51.2	50.2	50.4	49.2	50.2	52.8	59.6
As % of total	59%	51%	47%	41%	48%	68%	63%	59%	48%	45%	43%	47%
Rental	26.0	35.6	43.1	55.0	53.0	24.0	30.0	35.0	54.0	62.0	68.7	66.7
As % of total	41%	49%	53%	59%	52%	32%	37%	41%	52%	55%	57%	53%
Total sales	62.9	72.6	80.6	93.7	101.5	75.2	80.2	85.4	103.2	112.2	121.5	126.3

Source: French Federation of property developers. Buy-to-let laws in 2006: classical and recentred Robien, Popular Borloo

Over recent years, a number of incentives to encourage residential investment have been introduced. Tax credits have been granted to boost buy-to-let investments. This resulted in an increasing percentage of property developers' sales accounted for by rental property - notably just before the expiry of the Périssol (in 1999) and Robien (in 2005) incentives. However, the latest incentives (the new Robien and the popular Borloo) have not met with the same success. Zero interest-rate loan conditions have been relaxed: the income ceiling has been raised and existing property has qualified for this category of loan since 2005. Following a decline in the number of beneficiaries between 1996 and 2004, zero interest-rate loans later proved highly successful: 236,421 contracts were signed in 2006 versus 195,724 in 2005 and 79,311 in 2004. The decision to maintain the 5.5% reduced rate VAT on maintenance-improvement work and the National Home Improvement Agency subsidies were also favourable factors.

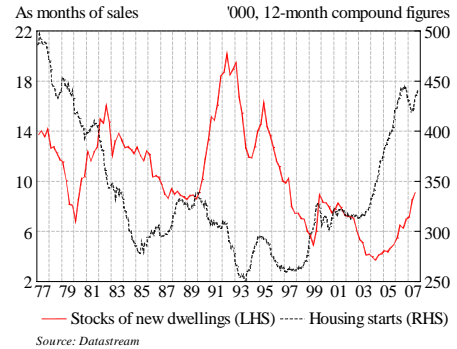
B – A gradual reversal is underway

Supply of housing is rising rapidly and is currently in excess of demand. Growth in new construction has reached a ceiling since late 2006 at its highest levels on record since the late 1970s: on an

¹ The solvency indicator measures the borrowing capacity of the average waged worker with respect to the surface area of an existing property in Paris. It is calculated on the basis of the following variables: the price index for existing homes in Paris issued by the French Chamber of Notaries; fixed-rate mortgage interest rates; the average household's income; the average duration of home loans (12 years in 1992 and 18.7 years in Q3 2007, according to the French residential property market financing observatory).

annualised basis, 572,691 construction permits were granted in October 2007 (-0.2% YoY) while housing starts emerged at 440,932 (-0.5% on an annualised basis). Moreover the stocks of unsold property/sales ratio has been on the increase since the all-time low hit in 2004 up to 9.8 months in Q3 2007, which is in line with levels recorded in 2000/01. Stocks of unsold new homes are running at high levels (94,631), while sales were penalized by the households' wait and see attitude following elections (-7.8% YoY).

HOUSING STARTS ARE STATIC
WHILE STOCKS ARE ON THE INCREASE

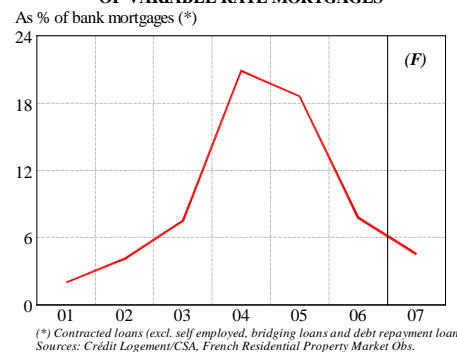


An American-style scenario in France still looks improbable:

1- Measures of the TEPA law: demand will be underpinned by capped income tax deductions of the interest rates of loans contracted for the acquisition of a main residence and by capital transfer tax exonerations, which will encourage intergenerational transfers. These tax credits should boost household's solvency from Q3 of this year onwards and its impact will be heightened in cases where the amount of interest due is lower than the ceiling (which depends on the structure of the family).

2- The softer trend in prices, or even according to the FNAIM a slight downturn in the prices of existing flats, will underpin household's solvency. On the flip side, the erosion of the wealth effect will depress consumption. The easier trend in prices can be expected to gain momentum, given that stocks of unsold property are rising and that property developers' price expectations have been falling since mid-2005. Moreover, households might adopt herd-like behaviour – due to uncertainty over price movements and the risk that the US property market downturn could spill over to the rest of the world. This would make the price decrease a self-fulfilling prophecy in France.

DECLINE IN THE PRODUCTION
OF VARIABLE RATE MORTGAGES



3- The nature of mortgage lending in France. As France has no equivalent to the sub-prime mortgage market, its only potential source of spill-over is the direct or indirect financial institution ownership of securities linked to sub-prime loans. This risk still appears limited. Moreover, the percentage of bank home loans accounted for by variable-rate loans (capped in the vast majority) has fallen, maybe down to 4.5% in 2007. The Bank of France's October banking industry survey indicates that mortgage lending conditions have not been tightened up drastically since the beginning of this year.

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