

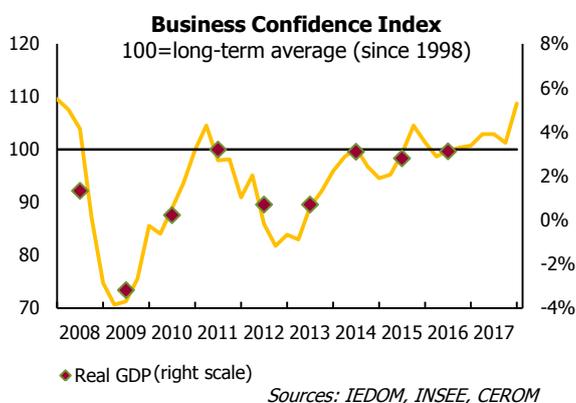
Réunion's economy in 2017 A strong year and positive signals for 2018

2017 confirmed that Réunion's economy was established in a well-oriented economic environment for the fourth year in a row. Positive knock-on effects are generated by the strengthening of investment, which has finally become more robust, and are shored up by a rise in cash flow and financial assets. Household consumption was buoyant, in a context of an increase in the payroll, low inflation and an acceleration in credit. Private paid employment rose (although more modestly than in 2016), while there was a marked development in jobs with short-term contracts and the labour market is faced with a decline in assisted jobs. The business climate ended the year on a high point, giving signs of a positive trend for the short-term outlook. With these favourable levels there are, however, risks of a slowdown.

This upturn benefits most sectors. Agriculture maintained its activity, with an increase in the sugarcane crop year and a recovery in the poultry industry. Trade and agribusiness industries benefited from the positive trend in consumption. The construction activity was bolstered by works on roads, airports and hospitals. Conversely, the construction and refurbishment of social housing were not as strong as expected. The situation of market services is deemed favourable, particularly in the tourism industry. Banking activity was strong and supported this upturn, in a context of organisational restructurings and a change in the retail banking model (regulations, digitalisation, etc.).

BUSINESS CLIMATE AT A 10-YEAR HIGH

Upturn in business climate gathers pace

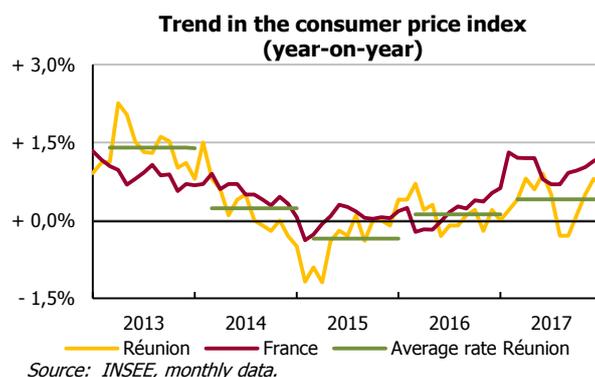


Signs of a continued improvement in the Business Confidence Index (BCI, which measures the opinion of business leaders on the economic context) seen at the end of 2016 were confirmed in 2017. The BCI stood at an average of 104 points, against 100 points in 2016, a year of strong growth (GDP increased by 3.1% in volume). It reached a 10-year high in 2017 and is therefore close to its long-term average (corresponding to growth in the region of 3.0%) for the third year in a row. Furthermore, the BCI ended 2017 with a sharp rise (index at 108.7 points in the fourth quarter), showing signs of a positive outlook for 2018. The possibility of this favourable context being maintained is shored up by the fact that there are no signs of a slowdown, with improvements simultaneously in the

current and anticipated situation, particularly in terms of activity and the workforce. The high level of business leaders' investment intentions is also reassuring for the future.

Inflation held in check

Household consumer prices rose by an average of 0.4% in 2017, after +0.1% in 2016. This trend is due to the rise in the energy component (+5.5% on average, in a context of a 21% increase in the price of oil) and, to a lesser extent, that of food products (+0.9%) and tobacco (+4.7%). However, service prices, which account for almost half of the household consumption expenditure of the population of Réunion, fell by an average of 0.3% in 2017, against +1.1% in 2016. This decline is in particular due to the arrival of new competitors on the airline and telecommunications markets. This trend consequently leads to an inflation excluding energy (+0.1%) which is lower than in 2016 (+0.5%). The rise in prices on Réunion in 2017 was more moderate than in mainland France (+1.0%, against +0.2% the previous year).



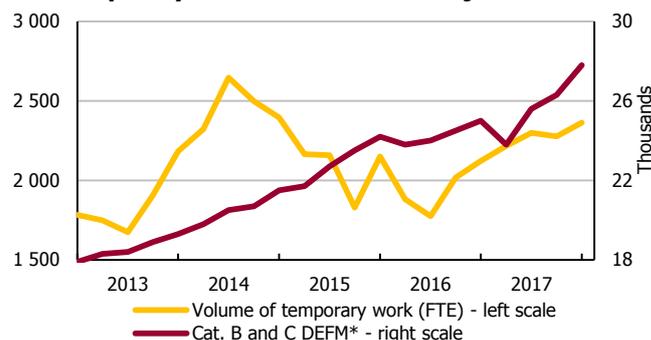
Good performance on the private employment market and development of short-term contracts

Private paid employment continued to increase in 2017, but at a more moderate pace. It rose by an average of 1.7%, following two years of strong growth (+2.9% in 2016 and +2.6% in 2015). At the same time, the volume of full-time equivalent temporary work saw a sharp rise in 2017 (+17.5% on average). This increase was combined with an 11.2% rise in demand for employment from the categories B and C (who have been in reduced employment).

However, the reduction in the number of assisted contracts (which became "skills-employment pathways" in January 2018) is expected to have a negative impact on non-market jobs and therefore on total employment in 2017.

Yet the labour market is continuing to improve. At the end of December 2017, 135,780 (seasonally-adjusted data) Category A jobseekers were registered at the Pôle Emploi employment agency, *i.e.* a reduction of 0.3% year-on-year, after a stabilisation in 2016. This decline has mainly benefited men, the number of which fell by 0.7%. Demand for employment by the under 50s is declining, especially by the under 25s (-4.7%). Only the number of jobseekers aged over 50 is continuing to rise (+5.5%, after +6.2% in 2016).

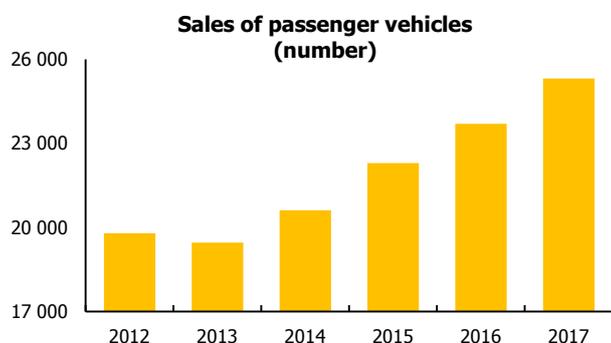
Temporary work and cat. B and C jobseekers*



* number of jobseekers who had a reduced working activity during the month.

Sources: Dares; Pôle Emploi, quarterly data.

Dynamic household consumption



Source: SOeS-RSVERO.

Household consumption remains strong, bolstered by low inflation and a positive trend for the payroll (+3.8% on average for the private sector in 2017, after +4.1% in 2016). Trade sector professionals also have a positive opinion of their activity.

With over 25,300 sales, the market for new passenger cars reached a record level in 2017 and rose by 6.8%, after already +6.3% in 2016. Generally speaking, imports for households remained at high levels, particularly for agribusiness industry products, which rose by 4.1% in 2017 (+2.9% in the previous year). Imports of everyday products and of capital goods rose by 0.6% and 2.7%, respectively. This dynamic consumption is bolstered by growth in outstanding consumer credit, which is gathering pace: +11.4% over the year, after +7.4% in 2016 and +2.0% in 2015.

Investment finally gathers strength

After a slow start to the year, following on from 2016, in 2017 there was a marked rise in the investment intentions of business leaders interviewed in the context of the economic survey, particularly in the agribusiness and market service sectors. At the same time, the increase in outstanding investment loans gathered pace: +8.5% year-on-year at the end of December 2017, against +4.0% in the previous year.

Given the high levels already reached, there was a slowdown in the growth of imports of professional capital goods (+1.2%, against +10.7% in 2016), after a 2016 boosted by the construction site for the New Coastal Road and the arrival of a new longliner for toothfish fishing in the French Southern and Antarctic Territories. The rise in imports of intermediate goods levelled off (+1.7%, after +1.8% in 2016) and there was a 4.6% rise in sales of commercial vehicles (to over 6,100 units).

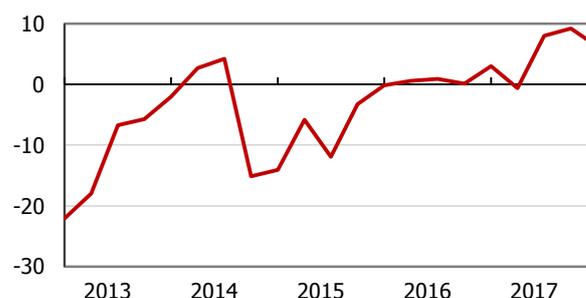
There was a rise in outstanding housing loans to households (+7.5% in a year, after +4.9% in 2016), which is also to be seen with the sustained increase in property transactions (+15.3% in value, against +3.7% in 2016). This trend benefits both the sale of existing housing (+13.5%) and new housing (+19.2%).

Decline in trade

Following two consecutive years of growth, there was a decline in foreign trade in 2017. Exports fell by 7.3%, to EUR 292.1m. This trend is mainly due to exports of agribusiness products, which fell by 15.2% compared to 2016, particularly for toothfish exports, part of which were placed under customs-warehousing.

Total imports fell by 11.3%, after the delivery of four planes in 2016. Excluding planes, imports rose by 3.3%, after +3.9% in 2016, in connection with the strong performance of consumption and investment. They are in particular supported by demand for agribusiness products and are affected by the rise in oil prices.

Investment forecasts



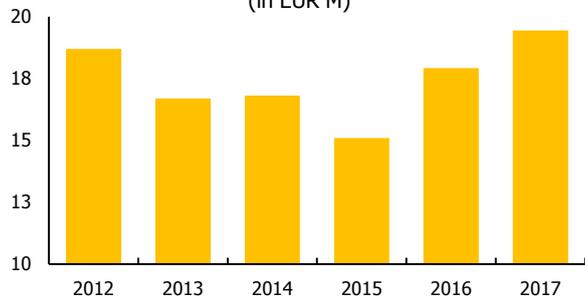
Source: IEDOM economic survey

STRENGTHENING OF ACTIVITY AND INVESTMENT INTENTIONS

Mixed results in the primary sector and agribusiness industries

According to business leaders in the **agriculture** sector, activity remained at a level close to its long-term average, but slowed at the end of the year. Exports of agricultural and fisheries products fell by 11.5% in 2017, due to a poor season for fruit growing (lychees, mangos, etc.). There were mixed trends in the livestock sector. Beef production rose by 2.4% in 2017, while pork production fell by 3.4% and poultry production levelled off (+0.8%). The sugarcane crop year for 2017 rose by 4.8%, but was combined with a decline in sugar content. It should be noted that the remuneration conditions for sugarcane planters were revalued in August 2017 to allow the industry to adapt to the new environment marked by the end of quotas and reference prices since 1 October 2017.¹

Rum exports
(in EUR M)



Source: Customs.

Business leaders in the **agribusiness** sector had a positive opinion of their activity, particularly at the end of the year. This trend is to be found in the rum industry, where exports rose by 8.5% in value (+18.7% in 2016), supported by the increase in the quota for traditional rum. Sugar exports rose by 1.7% in value. However, exports of fisheries products halved in volume, after -10.9% in 2016. Sector professionals forecast a stabilisation in their activity and an increase in the headcount for early 2018. Their investment intentions are at a record high.

Road and airport works support the construction activity

The construction and public works activity held up thanks to the public procurement of the main contracting authorities, which rose by 6.6%, after -5.2% in 2016. The amounts assigned to roadworks rose by 6.7%, in connection with the sites of the New Coastal Road (+9.1%) and the bridge over the Rivière des Galets. At the same time, the continued upgrading of Roland Garros Airport, as well as the creation of irrigated areas on the west coast, have contributed to this increase.

In the building sector, the activity remains mixed, particularly for social housing: there has been an increase in refurbishments, but new deliveries fell by -9.6% over the year. Under 2,500 housing units were delivered, a number which is still within the average of recent years, but lower than the record level in 2013-2014 (some 3,400). Furthermore, the upturn in sales of new housing (+19.2%, after five years of decline) is positive, but needs to continue: in 2017, the total number of housing units authorised for construction fell by 6.8% (after an exceptional 27% rise in 2016), while those for which construction was launched fell by a quarter.

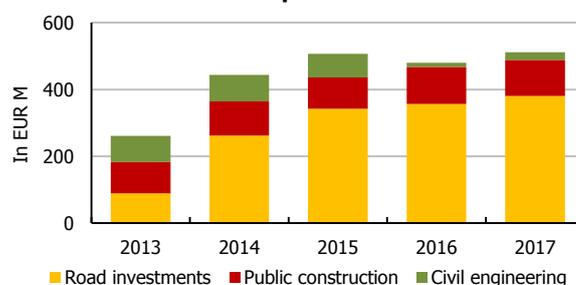
In this context, the number of employees registered at the Construction Industry Paid Leave Fund fell by 1.6%, after +2.8% in 2016.

Throughout the year, professionals in the **manufacturing industries** sector report stable activity and staff levels based on their own long-term average. However, their cash flow and investment forecasts are less positive than at the end of 2016. For the next quarter, business leaders in the industrial sector do, however, forecast an upturn in their business volume.

Positive activity for services

The activity of **market services** is deemed positive by business leaders in the sector in 2017, particularly in the first half of the year. The improvement in client payment periods in the second half of the year had a positive impact on their cash flow, thereby supporting their investment intentions. There is an upward trend for forecasts for activity in early 2018. The upturn continued for the **tourism** industry, with over 500,000 foreign tourists received in 2017 and EUR 356.2m of revenues, *i.e.* increases of 10.8% and 9.5%, respectively. With 1,210,000 overnight stays, there was a further increase in hotel occupancy (+4.9%, after +12.7% in 2016) and the occupancy rate stood at an average of 64%, up by four points compared to 2016. Furthermore, air traffic reached a record level, with over 2.3 million passengers (excluding transit) and rose by 8.3% compared to 2016. This dynamism has particularly had an effect on the mainland France-Réunion route, with the arrival of a new company in June 2017. It also benefits additional capacities and the opening of lines for regional destinations.

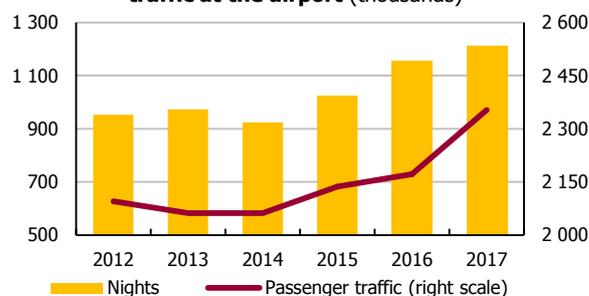
Public procurement*



Source: CERBTP.

* of the main contracting authorities: Region, Department, State and airport.

Number of overnight stays and passenger traffic at the airport (thousands)



Sources: INSEE, Gillot and Pierrefonds airports.

¹ Since 1 October 2017, the European sugar market has been liberalised and opened to competition. It is no longer regulated. This has led to the end of quotas and reference prices. Cf. Express Note 421 "The sugarcane industry faced with the liberalisation of the European sugar market in 2017", IEDOM, November 2016.

DYNAMIC BANKING ACTIVITY

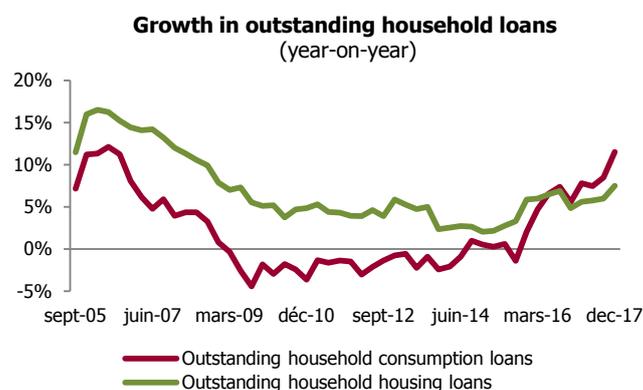
Banking activity was dynamic in 2017. There was strong growth in the financial assets held by residents of Réunion and the growth in loans gathered momentum. The rates applied on Réunion continued to drop in 2017, in a context of exceptionally accommodative financial conditions (ECB policy of historically low interest rates and quantitative easing, decline in usury rates). At the same time, the banking landscape on Réunion and retail banking activities are changing. New actors are emerging (Nickel account, Orange Bank, insurers, crowdfunding, etc.), while the merger between Banque de La Réunion and Caisse d'Épargne (CEPAC) has reduced the number of traditional actors, and other institutions are conducting organisational restructurings aiming to adapt to digitalisation and to the changes in the retail banking model (Basle 3, IFRS 9, compliance...).

Marked rise in financial assets and returns sought

The outstanding amount of financial assets held by economic agents on Réunion topped the EUR 14bn mark at the end of 2017. They are mainly made up of assets held by households (over EUR 9.8bn), with their growth gathering pace in 2017 (+6.1%, against half this amount over the three previous years), but do remain lower than pre-crisis levels (average growth of about 8% in the years 2000-2007). Households still have a marked preference for liquidity, in connection with the low level of interest on savings products: overnight deposits rose by over 12% in 2017. However, 2017 marked an upturn in certain long-term liquid investments, particularly for life insurance (+7.0%, against +4.0% on average for the period 2014-2016) and special savings accounts (+3.8%, against half this amount on average over the three previous years). There was also strong growth in the assets held by non-financial corporations (NFCs), particularly for overnight deposits, which rose by over 10% for the fifth year in a row. In addition to the favourable economic context and the tax credit for employment and competitiveness (CICE), the latter benefited from transfers related to the withdrawal of liquid investments (-17.6%).

Strong growth in loans, driven by consumption and investment

In 2017, the outstanding amount of performing loans to the economy of Réunion saw the strongest growth (+6.8%) since the crisis (average of 2.8% for the period 2009-2016) and now tops the EUR 21bn mark. Contrary to previous years, institutional lenders (mainly AFD and CDC) have not in particular driven the upward trend, even though they have contributed to it. Loans to non-financial corporations (NFCs) rose by 4.1%, driven by an 8.5% increase in investment loans (against +3.7% on average for the period 2014-2016). Property loans to companies rose by 3.2%. However, this growth remains well below the rates seen in previous years, in connection with the more moderate investments of social housing landlords. There was a marked decline in cash loans to NFCs for the second year in a row (-8.2%, after -3.4% in 2016). This decline goes hand in hand with the marked increase in their overnight deposits and probably reflects an improvement in their situation in terms of cash flow. There was also a decline in the outstanding factoring amount, whereas it had seen a sharp rise in previous years. In terms of households, the growth in outstanding housing loans gathered pace, at +7.5% (against +4.0% on average for the period 2014-2016), *i.e.* the highest increase since the crisis in 2009. This increase reflects the upturn in activity in the property sector. The dynamics for consumer loans gathered momentum (+11.4%, against +2.1% on average for the period 2014-2016), and they financed car and capital goods purchases by households. Finally, outstanding loans to local authorities rose by 8.2% over the year, following a slight decline in 2016.



Source: IEDOM, Surfi.

Portfolios of lending institutions continue to improve

For the fifth year in a row, the amount of gross outstanding non-performing loans held by locally established lending institutions fell in 2017 (-5.5%). The outstanding amount has fallen by EUR 300m since the end of 2012, also in connection with the assignment of impaired loans to specialised collection companies. The rate of non-performing loans stood at 3.9% of total gross outstanding loans at the end of 2017, against 6.6% at its highest level in 2012 (including the outstanding amounts of institutional lenders which do not declare non-performing loans).

POSITIVE SIGNALS NEED TO MATERIALISE

2017 confirms that the economy of Réunion is still on a sustained and strong growth path. Most sectors contribute to this performance, with self-sustained dynamics signalling a promising outlook for 2018. Indeed, the past financial year ended with positive momentum, showing no signs of a risk of a sudden slowdown in the short term, even if certain growth drivers are likely to run out of steam (interest rates, low inflation). The challenge for 2018 will lie in managing to maintain this pace of growth. To achieve this, the confidence and visibility of economic agents will once again be crucial, as well as the capacity of the economy to develop new structural and sustainable growth drivers. Certain sectors (blue economy, green economy, digital technologies...) are getting organised and emerging in this respect, leading to needs for training and appropriate skills, and are offering potential for the creation of wealth and jobs, which needs to materialise and will be decisive for the future. The challenge in the longer term, raised by the French Overseas Congress, will involve giving visibility and a plan for the future which are realistic and adapted to the territory.

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Edited and published by: IEDOM

Printed: April 2018 – Legal deposit: April 2018 – ISSN 1952-9619